<u>आयकर अपीलीय अधिकरण "एल" न्यायपीठ मुंबई में।</u>
IN THE INCOME TAX APPELLATE TRIBUNAL "L" BENCH, MUMBAI

श्री संजय अरोड़ा, लेखा सदस्य **एवं** श्री अमित शुक्ला, न्यायिक सदस्य के समक्ष ।
BEFORE SHRI SANJAY ARORA, AM AND SHRI AMIT SHUKLA, JM

आयकर अपील सं./I.T.A. No. 4323/Mum/2011

(**निर्धारण वर्ष /** Assessment Year: 1999-2000)

Renoir Consulting Ltd. C/o. Haribhakti & Co., Chartered Accountants, 42, Free Press House, 215, Nariman Point, Mumbai-400 021	**<u>बनाम</u>**/ Vs.	Dy. DIT (International-Taxation) 2(1), 1st Floor, Room No. 120, Scindia House, N. M. Road, Ballard Estate, Mumbai-400 038
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAACR 4920 K		
(निर्धारिती /**Assessee**)	:	(राजस्व / **Revenue**)

आयकर अपील सं./I.T.A. No. 4125/Mum/2011

(**निर्धारण वर्ष /** Assessment Year: 1999-2000)

Dy. DIT (International-Taxation) 2(1), 1st Floor, Room No. 120, Scindia House, N. M. Road, Ballard Estate, Mumbai-400 038	**<u>बनाम</u>**/ Vs.	Renoir Consulting Ltd. C/o. Haribhakti & Co., Chartered Accountants, 42, Free Press House, 215, Nariman Point, Mumbai-400 021
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAACR 4920 K		
(राजस्व / **Revenue**)	:	(निर्धारिती /**Assessee**)

आयकर अपील सं./I.T.A. No. 5298/Mum/2009

(**निर्धारण वर्ष /** Assessment Year: 1997-1998)

Renoir Consulting Ltd. C/o. Haribhakti & Co., Chartered Accountants, 42, Free Press House, 215, Nariman Point, Mumbai-400 021	**<u>बनाम</u>**/ Vs.	Dy. DIT (International-Taxation) 2(1), 1st Floor, Room No. 120, Scindia House, N. M. Road, Ballard Estate, Mumbai-400 038
स्थायी लेखा सं./जीआइआर सं./PAN/GIR No. AAACR 4920 K		
(निर्धारिती /**Assessee**)	:	(राजस्व / **Revenue**)

अपीलार्थी की ओर से / **Assessee by**	:	Shri R. Murlidhar, Shri Sunil Mandlai & Shri Vinay Deshmane
प्रत्यर्थी की ओर से/**Revenue by**	:	Ms. Neeraja Pradhan

सुनवाई की तारीख / **Date of Hearing**	:	15.01.2014
घोषणा की तारीख / **Date of Pronouncement**	:	11.04.2014

आदेश / O R D E R

Per Sanjay Arora, A. M.:

This is a set of three Appeals, i.e., the appeal by the Assessee for the assessment year (A.Y.) 1997-98 and cross appeals for A.Y. 1999-2000, arising out of the separate orders by the first appellate authority for the relevant years, disposing the assessee's appeals contesting its assessments u/s. 143(3) of the Income Tax Act, 1961 ('the Act' hereinafter) for the relevant years. The appeals raising common issues, were posted for and, accordingly, heard together, and are being disposed of vide a common, consolidated order for the sake of convenience.

2. The principal issue arising in the instant appeals is whether the assessee, a non-resident company registered in Mauritius, had a permanent establishments (PE) in India in terms of Article 5 of the India-Mauritius tax treaty during the relevant years.

3.1 It would be relevant to recount the background facts of the case, and toward which we shall, for the sake of context, advert to the facts and figures for A.Y. 1997-98, i.e., the first year under reference. The assessment for the year was initially made on 29.03.2000 at an income of Rs.514.27 lacs, including income of Rs.208.21 lacs (GBP 3,58,875) received from M/s. Godfrey Philips India Ltd. (GPI), a Indian company, on contract/s executed in India, as business income. The taxability of this income was contested by the assessee; the matter travelling upto the Appellate Tribunal. The bone of contention

between the parties was the existence or otherwise of a PE in India; the assessee claiming its absence, so that the income *qua* the said business with GPI, though admittedly carried on by it, could not be brought to tax in India. The tribunal vide its order dated 18.10.2002 (in ITA No. 4679/Mum/2001) discussed the issue, and finding it as indeterminate, restored the matter along with the ancillary issue of the expenditure allowable in relation thereto, back to the file of the Assessing Officer (A.O.), also dilating on the aspects deemed relevant by it, and on which, therefore, in its view enquiry would be required to be made; the relevant part of its order reading as under:

> '7. The term "Permanent Establishment" is defined under Article 5 of the Convention between the Government of the Republic of India and the Government of Mauritius for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains. It is stipulated that – "1. For the purpose of this Convention, the term "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on. 2. The term "permanent establishment" shall include: (a) a place of management; ……"
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> 8. In order to ascertain the fact that whether the assessee had permanent establishment in India or not, it is necessary to see the *modus operandi* of the assessee's business. How the assessee conducted business in India? Admittedly, for 30 weeks the staff of the assessee remained in India. Where they stayed? How the place of stay was acquired? How they communicated with the Mauritius office? What was their Indian address? Depending on the circumstances, hotel room could also be termed as fixed place of business. There was no enquiry on that aspect. Besides, it is also to be seen how the managerial services were rendered and what was the place of management. Whether the staff posted in India was getting all the commands from Mauritius or they were taking their decisions in India? How the assessee was inter-acting with its clients in the context of rendering managerial services qua the sales promotion etc.? How the meetings were organized? How the seminars were planned? Normally this all requires proper co-ordination and team efforts. De hors a fixed place of business, it is difficult to implement the task. The matter was not viewed from that angle.
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> 9. The assessee incurred some expenditure in India. The contextual enquiry may throw some light on the business operations of the assessee. Both the parties agreed that the matter needs to be examined afresh. We, therefore, in the interest of justice, set aside the impugned order on this

count and restore the matter to the file of A.O., with direction to decide it afresh, in accordance with law, after providing adequate opportunity to the assessee of being heard.'

3.2 In the set aside proceedings, the A.O. as well as the first appellate authority were of the view that there was a PE in existence in India within the meaning of India-Mauritius Double Tax Avoidance Agreement (DTAA) and, accordingly, the business income of GBP 2,08,20,596 was taxable in India. With regard to the expenditure, the assessee had claimed both direct as well as indirect expenditure, aggregating to GBP 2,87,055, including *qua* direct expenditure at GBP 1,02,335. The same, other than on salary (GBP 51,302) being not fully vouched, 15% thereof (GBP 51,033), i.e., GBP 7654.95 was disallowed. The first appellate authority found that the A.O. had not verified the assessee's claim of indirect expenditure, claimed at GBP 1,84,720, at all, merely accepting the certificate issued from the Auditors (KPMG) filed in its respect. The assessee was accordingly asked to prove the genuineness of its claim *qua* both direct and indirect expenditure. The assessee was unable to produce evidences, claiming that the matter being old, it was not possible to produce the vouchers. It however sought to emphasize the reasonableness of its claim with reference to the profit disclosed by it vis-à-vis the operating margin of other firms in the same business, i.e., disclosing consultancy income. On the basis of the vouchers as supplied as well as the case found comparable by him – DCM International Ltd., the first appellate authority enhanced the disallowance to 50% of the claim for direct expenditure other than on salaries (i.e., GBP 51,033), i.e., as against 15% thereof by the A.O. Similarly, 50% of the assessee's claim for indirect expenditure, save on salaries (GBP 1,13,942), i.e., GBP 70777.38, was also disallowed by him to the extent of 15%, thereby enhancing the total disallowance to GBP 60905.19.

3.3 For A.Y. 1999-2000, the assessee claimed total expenditure at Rs.95,22,523/- (GBP 139852) on a total business receipt of Rs.1,31,75,235/-. The same included direct expenditure at GBP 66,701, of which that on salaries was at GBP 38307. The expenditure

on salary could not be allowed in view of the non-deduction of tax at source and, consequently, applicability of section 40(a)(iii) of the Act. Further, of the indirect expenditure of GBP 73,151, the same being only in the nature of Head Office (HO) expenses, were to be, in terms of section 44C of the Act, restricted to 5% of the adjusted profit or the actual expenditure, whichever is less. The same was accordingly restricted to Rs.5,62,094/-, i.e., as against the claim for Rs.49,80,852/-. In appeal, the first appellate authority held that the restriction of sections 40(a)(iii) and 44C would not apply and the beneficial provision of DTA shall hold in determining the assessee's income. In fact, this aspect had already been considered by the tribunal in the assessee's own case for A.Y. 1997-98, whereat vide its order dated 18.10.2002 it had been held by the tribunal that if the assessee is found to have a permanent establishment in India, i.e., on the basis of the enquiry suggested by it, the assessee shall be entitled to deduction in respect of the business expenditure in terms of the DTA which would, where beneficial, prevail over the statute. Aggrieved, both the assessee and the Revenue are in appeal.

4. We have heard the parties, and perused the material on record.

4.1 We shall begin by delineating the respective cases of both the sides *qua* the principal issue arising in appeal, as follows:

The assessee's case

a) The appellant's employees deputed for the GPI project were mainly involved in planning the improved work methods for the sale force of the GPI and supervising /reviewing the results obtained by adopting the suggested improved work methods;

b) The appellant company was managed by the Board of Directors located at Mauritius, which gave directions to the 'Principal Consultants', and who in turn looked after the assignments in India, further directing the consultants deputed on the project. The communication between the directors and the principal consultants was mainly over phone or through electronic media. The marketing and the client contacts takes stand initiated through telemarketing from overseas followed by personal meetings with potential clients by the appellant's representatives, and who in turn report to the principal consultants. Based on these discussions and directions from the Board, the contracts/agreements with the clients are finalized. The place of the management of the assessee appellant was thus situated in Mauritius whereat the entire decision making

powers were located. The contracts though executed in India, did not entail rendering of any managerial services, so that there was no place of management in India. In this regard, it is clarified that the hotel rooms/accommodations used by the employees in India were only for the stay, i.e., for residence, and not used as an office.

c) The employees deputed on the different projects are rotated both for different projects in India as well as that abroad, from time to time, i.e., depending on the requirement of each project, so that the employees at GPI did not remain constant. Further, as a matter of business strategy, the appellant ensure that there was no discontinuance of the people on the project;

d) As regards the meetings organized by the task force (comprising of the employees of the appellant and GPI) for the purpose of discussing the progress/performance/implementation of the project, the same were normally conducted at the premises of the GPI, i.e., where the management/staff of the GPI was located. These meetings were held mainly for reviving the project. The seminars were also organized by the task force, which were for the purpose of disseminating information and to discuss the field experience with the sales personnel of GPI. As the project work was primarily for improvement of sales, meetings were held at different venues. The discussion/training sessions for the wholesale and retail dealers of GPI were conducted by the task force at the depot premises and while on field rounds. As such, there was no fixed place of business at its disposal in India.

e) The communication between the consultants *inter se*; the consultants and Principal Consultants, as well as between the Principal Consultants and the Board (top management), was not from any fixed place but variously through different mediums such as telephone, fax, email, etc. using the facilities normally available in close proximity of the place of stay. There was under the circumstances no common or fixed establishment in India.

Reliance was placed on the decision in the case of *CIT vs. Visakhapatnam Port Trust* [1983] 144 ITR 146 (AP); and *Airlines Rotables Ltd. vs. Jt. DIT(IT)* [2011] 44 SOT 368 (Mum), besides the tax treaty itself, even though a number of decisions find place in the compilation of case law filed by the assessee.

The Revenue's case

a) As apparent from the contracts dated 17.05.1996 and 26.08.1997, the same is for the application of its Performance Index Programme (PIP) for enhancing the market. Teams were deputed for the purpose, which were required to render services in relation to the implementation of PIP, which required continuous inputs from the clients for its

effective implementation. The inputs are generated from the continuous interaction between the employees of the GPI and the appellant and, further, subject to - review and analysis for further course of action. The rendering of the managerial services to GPI is thus manifest in the very execution of the contract/s, shares of the GPR's product/s. There was thus a place of management, power of which vested in the teams deputed for the purpose;

b) The implementation programme was to be carried over three phases, aggregating to 80 weeks. A place of business, as defined in the Model Convention of Klaus Vogel (3rd edition) would cover any premises, facilities, installations used for carrying on the business of the enterprises whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprises, and it may simply amount to space at its disposal. All it thus means is some tangible assets used for carrying on the business and in marginal cases even one tangible asset may be sufficient. In other words, there are no quantitative restrictions thereto, and a living accommodation of a travelling salesman, for instance, may well constitute a PE. Further, it is immaterial whether the premises is owned or rented or made available to the enterprise in any other manner. As apparent, all the activities relating to the work of the appellant in relation to the contract work were carried out in India. This can also be inferred from the huge claim of Rs.1.69 cr. in respect of expenses incurred in India. The assessee's claim that there was no contradictory in-as-much as it itself claims the staff to be staying in hotel. If, as claimed, they had not used any of the facilities or the office premises of GPI for the purpose of work or as a place of their work, as the case may be, where they had worked from? The hotel rooms where the consultants/principal consultants stayed in India must in that case necessarily be regarded as their place of work and for carrying out their activity in India. The same must thus be construed as a fixed place, i.e., a permanent establishment by definition.

Reliance was placed on the decision in the case of *DIT(IT) vs. Morgan Stanley & Co.* [2007] 292 ITR 416 (SC). The decision in the case of *Airlines Rotables Ltd.* (supra) was distinguished on the basis that the same was in respect of agency PE, which is not applicable in the instant case as there is no provision for the same in the India-Mauritius tax treaty.

4.2 Without doubt, the sole issue arising in the instant appeal – the other being alternate, is the determination as to whether a permanent establishment of the assessee-company, within the meaning of the term as defined under the India-Mauritius DTAA,

can be said to exist in relation to its GPI project. The matter is, therefore, principally factual, though would require an exposition and a clear understanding of the concept of PE, and toward which the parties before us have relied on the standard texts as well as the decisions by the higher courts of law. This is even otherwise incumbent as the said clear understanding must necessarily precede the application of the concept and, further, for the reason that the order by the tribunal, a judicial body, must reflect and bear out the same (understanding). The PE is an important issue in the treaty based international fiscal law, and all the three model conventions, namely, the UN, the OECD Model and the US Model, use it as an instrument to establish tax jurisdiction over a business income of a foreign entity. The basis of the concept of PE is that profit of an enterprise of one contracting state is taxable in the other state only if the enterprise maintains a PE in the latter state and, further, to the extent that profit attributable thereto (PE) (Art. 7). The PE thus seeks to compromise and harmonize the taxing jurisdiction between the source state and residence state for the purposes of taxation of business profits. The same must be understood with a view to arrive at the degree of economic penetration as per the applicable treaty that justifies a nation in treating a foreign person in the same manner as a domestic person. The profits attributable to a PE being taxable in the state of source are either exempt in the state of residence or it allows credit for the taxes paid in the source state by the PE on such profits. There is thus a transfer of the taxing jurisdiction by the state of residence to the state of source, and which shall explain our stating of the PE being a concept devised to harmonize and compromise the opposing fiscal interests of the contracting states. This understanding corresponds with the view as explained in the landmark decision of *Visakhapatnam Port Trust* (supra) on which heavy reliance was placed before us, as would be apparent from the following observation by the hon'ble court (at pg. 162):

> "…….the words "permanent establishment" postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another, which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual

> projection of the foreign enterprise of one country onto the soil of another country."

It is generally defined in Article 5 of the tax treaty and though the instant case shall be governed strictly by Article 5 of the India-Mauritius DTAA, it would be relevant to delineate the structure of a standard article 5; ***Article 5(1)*** defines a permanent establishment and lays down the basic rule that a business activity carried on through a fixed place of business would constitute the PE of the tax payer. ***Article 5(2)*** mentions several examples of fixed place of business. These examples could also be said to form the 'positive list'. ***Article 5(3)*** includes certain construction related activities and service related activities within the scope of PE if such activities continue for certain period. ***Article 5(4)*** mentions that a PE shall be deemed not to include certain activities. These could be said to form the 'negative list'. ***Article 5(5)*** stipulates rules for determining when an enterprise represented by an agent would have a PE. ***Article 5(6)*** deals with the case of an enterprise carrying on insurance business. ***Article 5(7)*** and ***Article 5(8)*** set out rules in respect of an enterprises represented by an agent or an enterprises related to it.

4.3 We may proceed further by reproducing Article 5 of the DTAA, which reads as under:

'**CHAPTER II – DEFINITIONS**

> ARTICLE 5 - *Permanent establishment - 1.* For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on.
>
> *2.* The term "permanent establishment" shall include—
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> (*a*) a place of management ;
>
> (*b*) a branch ;
>
> (*c*) an office ;
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> (*d*) a factory ;
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> (*e*) a workshop ;
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> (*f*) a warehouse, in relation to a person providing storage facilities for others ;

(*g*) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources ;

(*h*) a firm, plantation or other place where agricultural, forestry, plantation or related activities are carried on ;

(*i*) a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine months.

3. Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include:

(*a*) the use of facilities solely for the purpose of storage or display of merchandise belonging to the enterprise ;

(*b*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display ;

(*c*) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise ;

(*d*) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or for collecting information for the enterprise ;

(*e*) the maintenance of a fixed place of business solely—

(*i*) for the purpose of advertising,

(*ii*) for the supply of information,

(*iii*) for scientific research, or

(*iv*) for similar activities,

which have a preparatory or auxiliary character for the enterprise.

4. Notwithstanding the provisions of paragraphs (*1*) and (*2*) of this article, a person acting in a Contracting State for or on behalf of an enterprise of the other Contracting State [other than an agent of an independent status to whom the provisions of paragraph (*5*) apply] shall be deemed to be a permanent establishment of that enterprise in the first-mentioned State if :

(*i*) he has and habitually exercises in that first-mentioned State, an authority to conclude contracts in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise ; or

(*ii*) he habitually maintains in that first-mentioned State a stock of goods or merchandise belonging to the enterprise from which he regularly fulfils orders on behalf of the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission

> agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted exclusively or almost exclusively on behalf of that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.
> *6.* The fact that a company, which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other Contracting State (whether through a permanent establishment or otherwise) shall not, of itself, constitute either company a permanent establishment of the other.'

Article 5 of the DTA is thus in sync with a standard Article 5 except that there is no clause specifically for service PE, so that the understanding arrived at with reference to the other tax treaties would thus also become applicable and relevant for the purpose of the instant case. PE is also defined u/s. 92F(iiia) of the Act to mean a fixed place of business through which the business of the enterprises is wholly or partly carried out. The same, it would be seen, is *pari materia* with the definition of the term under the treaty, which though is not of much consequence in-as-much as only the definition per the treaty shall hold; section 92F being applicable only with reference to sections defined there-under and which does not include section 90. The same, however, stands referred to so as to bring forth the unanimity of the concept both under the domestic law as well as the tax treaty. The fixed place concept has thus following the elements built therein:

- There must be a fixed place of business (*situs test)*;
- The fixed place of business must be located [in a] certain territorial area (*locus test*);
- The use of the fixed place of business must last for a certain period of time (*tempus test*);
- The taxpayer must have a certain right of use [over] the fixed place of business (*ius test*);
- The activities performed through the fixed place of business must be of a business character (*business activity test*)

4.4 In order to, therefore, decide whether a PE stood constituted, one has to undertake a factual and functional analysis of the activities undertaken by the establishment. The decision by the tribunal in the first round (for A.Y. 1997-98), which is even otherwise

binding on and incumbent for the parties to follow in-as-much as the same stands not contested, so that it has assumed finality, becomes relevant in this regard, points as it does to the areas along which enquiry would have to be focused as well as of the matter, as afore-stated, being primarily factual. Secondly, it needs to be clarified as well as emphasized that the word 'permanent' in the term 'permanent establishment' does not in any manner signify or denote a permanent character, or that the right to use the place should be perpetual, but that there must be a certain degree of permanence. Not only, therefore, the existence of physical presence a must, it must have a certain degree of endurance associated therewith, excluding one which is temporarily in nature. A fixed place would though not exclude a movable place of business, viz. a petroleum drilling rig may constitute a PE if it is moved frequently from one location to another. How the fixed place or the right to use the same is however secured is though of little consequence, so that the same may be owned, rented or otherwise acquired in any other manner. Even a right which is not legal in its nature may, therefore, be of no adverse consequence. In fact, in the instant case as well, whether the hotel rooms could be legally or contractually used for business purposes is not ascertained, though, where so, it could be considered as PE despite such user being proscribed. Further on, the same, however, i.e., the establishment, must have a commercial coherence or purpose. *De hors* the same, the enduring quality would, of itself, be of no moment. On this aspect of the matter though there is little or no doubt in the present case in-as-much as the user of the client's premises or the hotel, if and to the extent so, is only for business purposes.

4.5 It is clear that the rule to be invoked in the present case shall be the base rule of Art. 5(1), which is also commonly referred as 'the basic rule PE'. The 'service' rule, or any other sub-rule for that matter, is only derived from this basic rule and not in derogation thereof. Its principal ingredients stand already delineated hereinbefore. The same find expression in the decision in the case of *Airlines Rotables Ltd.* (supra), relied upon by the assessee, signifying its parameters, again with reference to judicial

precedents and standard text in terms of the OECD commentary. The same being relevant, we may reproduce it as under:

> '10. In terms of the provisions of article 5(1), *i.e.,* the basic rule a PE is said to exist in the other Contracting State when an enterprise of one of the Contracting States has a fixed place of business in that other Contracting State, through which business is carried out—wholly or partly. There are three criteria embedded in this definition—physical criterion, *i.e.,* existence of physical location, subjective criterion, *i.e.,* right to use that place, and functionality criterion *i.e.,* carrying out of business through that place. It is only when these three conditions are satisfied, a PE under the basic rule can be said to have come into existence.
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> 11. As observed by a Co-ordinate Bench in the case of *Western Union Financial Services Inc.* v. *Asstt. DIT* [2007] 104 ITD 34 (Delhi), "a PE should project in the foreign enterprises in India (the other Contracting State)". In the case of *CIT* v. *Visakhapatnam Port Trust* [1983] 144 ITR 146 [1], Hon'ble Andhra Pradesh High Court, after an elaborate survey of worldwide judicial precedents and technical literature on this issue, has observed that, "in our opinion, the words 'PE' postulate the existence of substantial element of enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country". Their Lordships further added that "it should be of such a nature that it would amount to a virtual projection of foreign enterprise of one country into the soil of another country". Incidentally, the treaty definition of 'PE' basic clause, which came up for consideration of Their Lordships, was exactly the same as in the case before us.
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> 12. The physical test, *i.e.,* place of business test, requires that there should be a physical location at which the business is carried out. However, mere existence of a physical location is not enough. This location should also be at the disposal of the foreign enterprise and it must be used for the business of foreign enterprise as well. A place of business should be at the disposal of the foreign enterprise for the purpose of its own business activities. This place has to be owned, rented or otherwise at the disposal of the assessee, and a mere occasional factual use of place does not suffice. As observed by a Special Bench of Tribunal in the case of *Motorola Inc.* v. *Dy. CIT* [2005] 95 ITD 269 (Delhi) it has upheld this school of thought, and, *inter alia,* observed as follows :
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> > ". . . The OECD Commentary on Double Taxation Conventions refers to a fixed place as a link between the place of business and a specific geographical point. It has to have certain degree of permanence. It is

emphasized that to constitute a 'fixed place of business', the foreign enterprise must have at its disposal certain premises or part thereof. Philip Baker, in his commentary on*Double Taxation Conventions* (Third Edition), states that the fixed place is very much that of a physical location, *i.e.,* one must be able to pinpoint to a physical location *at the disposal of the enterprise* through which the business is carried on. On the other hand, possession of a mailing address in a State without an office, telephone listing or bank account has been held not to constitute a PE. Further, the fixed place of business need not be owned or leased by the enterprise provided *it is at the disposal of the enterprise in the sense of having some right to use the premises for the purposes of its business and not solely for the purpose of project undertaken on behalf of the owner of the premises*." [Emphasis supplied].

13. It is thus necessary that, in order to give a positive finding about existence of the PE, not only that there should be a physical location through which the business of the foreign enterprise is carried out, but also such a place should be at the disposal of the foreign enterprise in the sense that foreign enterprise should have some sort of a right to use the said physical location for its own business.

14. The third and final test for existence of PE under the basic rule is the functionality test, *i.e.,* the fixed place of business should be used for the purposes of business of the foreign enterprise. As observed by the Special Bench of this Tribunal in the case of *Motorola Inc.* (*supra*), such a use should not be confined to mere doing the work for owner of the enterprise owning that physical location and must extend to carrying on of the business of the foreign enterprise. The business carried out at that place should be such as to amount to, as was observed by Hon'ble Andhra Pradesh High Court in the case of *Visakhapatnam Port Trust* (*supra*), "virtual projection of enterprise of one country into soil of another country". The PE must project the foreign enterprise of which it is claimed to be PE. It is in this sense that the business must be carried on at the physical location in the other country. It is also important to bear in mind that when such a physical location has come into play as an end result of business having been carried out, such as a barge in territorial waters of the other country upon having given such barges on hire to a resident of the other country—in the case of a person who is engaged in the business of giving barges on hire, the business cannot be said to have been carried out on such place *qua* that business activity. It was so held by a Co-ordinate Bench in the case of *Addl. DIT (International Taxation)* v. *Valentine Maritime (Mauritius) Ltd.* [IT Appeal No. 1532 (Mum.) of 2005, dated 5-4-

> 2010]/[2010] 3 Taxmann.com 92 (Mum. - ITAT) wherein it was held that that "by no stretch of logic, when an assessee is in the business of hiring out the barges, a barge so hired out cannot be viewed as a place of carrying on its business, which, as we understand, is limited to, *qua* that barge, the barge having been so hired out".'

4.6 We may proceed with our analysis of the facts of the case. Our first observation, even as emphasized by the first appellate authority, is that the assessee's case is *sans* any material, despite the fact of the matter having been restored back at the instance of the tribunal (for one year) so as to enable a factual determination of the issue, and the observations wherein (reproduced hereinbefore), would apply equally for the other year as well. The assessee has sought to build its' case on, among others, the basis that what was being carried in India were essentially preparatory or auxiliary services, excluded under Article 5(3); the employees only gathering and collating the data for being transmitted to the Head Office, and then acting on the instructions received there-from. The same, apart from the fact that, where so, could only be easily exhibited, proving the assessee's claim, is completely inconsistent with the *modus operandi* followed, as explained by the assessee itself, entailing rendering of extensive, if not the entire services in India, and which constitutes the assessee's business in India, i.e., to apply Renoir Performance Improvement Programme (RPIP) designed by it for improving the management performance quotient of an enterprise by enhancing the operating parameters, as reducing costs, improving the work methods/services, providing efficient management control, as delineated by the assessee's letters dated 17.05.1996 and 26.08.1997 (PB 2, pgs.1-5), which provide the framework for both, the services to be rendered and the manner in which they shall be, also specifying the objective of the exercise or its output in terms of deliverables, thereby serving as base documents, regulating the business relationship between the enterprises. The total consideration would be for:

a) Development and improvement programme;

b) Providing information and scientific knowledge.

The project was to be completely in three phases, each beginning upon satisfactory completion of the preceding one, *so that time, though of significance, was not of essence*, with an expected time schedule thereto, as:

Phase I : Model phase – 30 weeks

Phase II: for Delhi region – 20 weeks

Phase III: other regions – 30 weeks

As stated, Phase III was abandoned, so that it continued only upto the completion of Phase II.

The project was aimed at improved market share and as also improved financial results. Defined management indices, such as better customer services; increased management and supervision effectiveness; improved moral, etc. are among the stated deliverables. The same, it would be noted, are in complete harmony and sync with the stated objectives of the RPIP. And the assessee wants us to believe, and that too without substantiation, that all that was being done in India were merely preparatory and auxiliary services by way of collection of data, its transmission, and carrying out the instructions of the Board of Directors through the principal consultants. *Why should, then, even the principal consultants be required to come to India, and that too frequently, the meetings of the stearing committee being scheduled fortnightly*? In our view, on the other hand, in complete contradistinction, even the securing of the relevant contract, valued at over Rs.7.5 crores (GBP 12.76 lacs), would require extensive execution and, thus, presence in India. Though bagging a contract does not by itself generate income, it definitely requires undertaking of concerted work, which is only toward and in carrying on its business. The same requires extensive preparation as well as communication skills – which may assume, both variously as well as in combination, the form of letters/mails, interviews, meetings, presentations, etc., exhibiting both personal as well as professional competencies. The project, thus, as a prerequisite, requires a deep conviction on the part of the customer/client of the continued presence over the period of the contract, which is itself indefinite in-as-much as each subsequent phase would ensue only on the

satisfactory completion of the preceding one. In fact, the base document clearly outlines that the application of RPIP would require that GPI share ideas which would be combined with that of the assessee. The clients, as the GPI, would only be unaware or only vaguely aware of RPIP, whose theory, mechanics, methodologies, etc. would be required to be explained to their personnel, and who in fact would be required to participate actively in its implementation and thus responsible for its success. Constant interaction at all levels, or at least upto the senior management level, between the personnel of the contracting parties is, thus, contemplated. The initial exchanges and interactions are to form the basis of the preliminary analysis and proposals, followed by a detailed study. The study is to be followed by its actual implementation, i.e., of the contents of the study, entailing what is required to be done and how. Constant feedback, which again has two variants thereto - formal and informal, on a regular and defined basis, and review, is contemplated, so that correctives and changes, validating or revising the assumptions made, are applied and the implementation stays on course, i.e., toward the desired objective, and provided for. It is, thus, as apparent, essentially an interactive exercise, and which is to assume various forms, viz. interviews, interactions, exchanges, meetings, training sessions, seminars, etc., as suitable for the specific objective at hand. Understandably, therefore, the assessee-company operates at all the three management levels. At Tier I or the base level, consultants (5 to 8) are to work full time as a team during the course of the project. This is subject to supply of additional resources, if so considered by Renoir management, though at no extra cost to GPI, who is also required to dedicate 10 to 15 of its employees full time on the project, and which is designated as the task force. The next level is of the stearing committee, consisting of senior management positions from both the companies, which is to, meeting fortnightly, manage the project. While this was the initial understanding, the second letter, i.e., dated 26.08.1997, is somewhat more specific, restricting the team of the consultants to be deputed by the assessee at between 3 to 4 and the task force to 12 employees. Clearly, the initial understanding had crystallized into a definite program of implementation, and only

on the basis of regular interactions between the parties, itself requiring the assessee's presence in India. Further, the letters are silent on the role of the top management, which has been projected as the sole repository of the decision-making and, thus, the sole driver and arbiter of the implementation process by the assessee before the Revenue. The said silence is, in fact, only understandable in-as-much as the execution of the project is only a regular business function, carried out in the ordinary course thereof, requiring little, if at all, intervention by the top management, i.e., once an understanding between the two parties is arrived at. Without doubt, the top management's sanction or overall control and management cannot be excluded, so that in the absence of any evidence we would confine its role to just that, i.e., providing strategic guidance and policy framework, i.e., the normal role of the top management, if and to the extent required for the project at hand.

The assessee's claims and contentions raised, both before us and the Revenue authorities, besides being un-evidenced, are at polar opposite to what would one would normally expect as well as the material on record in the form of the base documents and the communications exchanged between the parties in the regular course of business (PB-2, pgs.7-14). The plea of the employees being subject to change is without material. Rather, the assessee commits itself to the continuity of the same personnel for the sake of better and smooth implementation of the project. Further, it is the continued presence of the assessee-company, and not of its' particular person that is relevant. The contention of the personnel operating from different places, so that there is no fixed place of business, is again without merit, ignore as it does the fact that the location in case of a field job, as of a salesman, has necessarily to be a shifting one; it being fixed in terms of its' operating parameter/s, and the continued physical presence in India at the different locations being as warranted by the exigencies of the contract, which is undisputed. The claim of the personnel only executing planning and supervising work, is again without substance and contradictory of the contract work as profiled by the documents, and as stated here-in-before. Here we also clarify that a fixed place of business, as contemplated in the

definition of PE under Art. 5, does not at all imply or is confined to a place where the top management of the company is located. Thus, apart from the import of the said argument in the context of the present case being not clear, it is even devoid of any merit. A branch of an enterprises may well be its' PE; only the profit attributable to the same being liable to be taxed in the source State. The assessee's next argument is that no place of business, apart from meetings with its personnel, has been assigned or made available by the GPI to the assessee's team. The argument is devoid of any substance whatsoever. Firstly, it is to be appreciated that it is for the assessee, in the intimate know of its affairs, to specify as to how and from where it has performed its' work. If the team of its personnel deputed on the contract have not functioned from the GPI's premises, the same has, of itself, no bearing on the assessee's case in-as-much as it is for it to in that case specify the place/s from where they have functioned over their continued stay in India, which is stated to be at 874 man-days for the consultants and 81 days for the principal consultants, and how. *Surely, they could not only be meeting the assessee's employees or customers or retail outlets, etc., all the time, and neither without doubt could they perform their work in vacuum*. It is in this context that the ld. CIT(A) has inferred of the hotel/s, where the assessee's employees stayed, as also serving as their work place. The communications between them and the head office, *which is again a part of their work*, has again admittedly been carried out in India and, as stated, from a place in the vicinity of the place of the stay. Two, though to no effect, so that whether the communication has taken place from the hotel room through the medium of internet using laptops – a tangible asset/s, by the personnel, or similar facilities provided by the hotel or by a retail outlet providing such services is of little moment. Rather, as we discern, the assessee's personnel are only working together in conjunction with the GPI task force, assigned whole time on the project in-as-much as the working of the task force in isolation or removed from the assessee's employees, except perhaps sparingly, makes little sense in the fitness and the scheme of things. This is as the two have to work in tandem, complimenting each other. In fact, even working separately (as it in practice well be a

combination of the two forms of work organization or guided by work imperatives), again only implies availability of a separate place/s at its disposal to the assessee's team. Secondly, as is apparent from the *modus operandi* to be adopted, the regular interviews, interactions, meetings, training sessions and seminars, etc., both by the consultants and the principal consultants, forming Tier I and Tier II of the assessee's teams deputed on the project, and which are admittedly and principally at the GPI's premises, is as much a part of the work undertaken by the assessee-company as is the independent collection, collation, analysis and review, etc. of the data/information being sought from the organization during any phase of the project management. That thus some place is at the disposal of the assessee or its employees during the entire period of the stay in India is, thus, manifest and eminent and follows unmistakably from the work nature/profile and the *modus operandi* followed. The argument thus is of no moment.

4.7 We may next consider the assessee's reliance on case law. In fact, the same, based on the standard texts, as the OECD commentary or that by Professor Klaus Vogel, has been made by both the parties before us. We have in fact reproduced from the decisions in the case of *Visakhapatnam Port Trust* (supra) and *Airlines Rotables Ltd.* (supra), relied upon by the assessee, capsuling their ratios. The issue, as we discern, and, as clarified, is principally and primarily factual, and our decision follows a factual examination of the matter. As such, reliance on the case law, apart from the thrust on the legal concept of PE, which has been followed/adopted, is of little moment. We, accordingly, do not consider it necessary to dwell on the facts of each case, none of which though are similar to that of the present case.

4.8 In our clear view, therefore, the assessee clearly has a PE in India during the relevant years. This decides ground no. 1 of the assessee's appeals for A.Ys. 1997-98 and 1999-2000. We decide accordingly.

5. The next issue that arises for our consideration is the profit attributable to the PE, i.e., for the relevant years. The same, though not raised by the assessee per its memorandum of appeal, was agitated by the ld. AR during hearing, and being germane to the issue at hand, admitted by us. As explained by the apex court in *Morgan Stanley & Co.* (supra), economic nexus is an important aspect of the principle of attribution of profits. The matter being not subject to examination by the authorities below, we only consider it fit and proper to restore this aspect of the matter back to the file of the A.O., to decide the same in accordance with the law and in consistence with the facts of the case, the onus to lead which is on the assessee. We decide accordingly.

6. The only other ground for A.Y. 1997-98 by the assessee is with regard to the restriction of its claim for business expenditure. The claim has been restricted by the Revenue on the ground of it being not subject to verification; the assessee failing to produce the relevant vouchers. No improvement in its case stood made before us. The plea of the records being old, so that the same are not traceable, is not admissible; the assessee being in appeal right from the passing of the assessment order in the first instance. In fact, this position has obtained even before the A.O., before whom the proceedings in the second round have been on since October, 2002, i.e., after the disposal by the tribunal in the first round, wherein the tribunal has itself (vide para 13 of its order) clarified that the A.O. shall call for the relevant records and examine the veracity of the expenditure claimed. Further, even so, the ld. CIT(A) has sought to refurbish the disallowance, arising on the principal ground of non-verification of the claim, by the disclosed operating results of a comparable case – DCM International Ltd. No interference, in our view, is under the given facts and circumstances of the case called for. We decide accordingly, and the assessee fails on its ground no. 2.

7. The next and the only surviving issue in these appeals is the part allowance of the business expenditure as confirmed by the first appellate authority for A.Y. 1999-2000 *qua* which both the parties are in appeal.

8. As regards the Revenue's appeal, it agitates the deletion of the disallowance made with reference to sections 40(a)(iii) (wrongly written as '40(a)(ia)' by the A.O.) and 44C. The same is covered by the decision by the tribunal in the assessee's own case for A.Y. 1997-98, even as clarified by the first appellate authority. The limitation as regards the actual expenses, made particularly with reference to section 44C, has also been clarified by him as not applicable in view of Circular No.333 dated 02.04.1982 by CBDT, so that Art. 7(3) of Indio-Mauritius DTA would prevail.

No argument, much less material, has been led by the Revenue before us. The assessee in fact also argues that no tax is deductible in view of Art. 15 of the DTAA. We, accordingly, have little hesitation in following the decision by the tribunal in the assessee's own case for the preceding year, as well as the CBDT circular, to confirm the impugned orders on these grounds. The Revenue, accordingly, fails.

9. The only other issue raised by the assessee per its appeal for A.Y. 1999-2000 is the disallowance of the assessee's claim for indirect expenditure, made at GBP 73151, vide ground no. 2 thereof. Though the same stood restricted by the A.O. to 5% of the adjusted profits or the actual expenditure, which ever is less, i.e., in terms of section 44C, the said restriction was set aside by the ld. CIT(A) in-as-much as section 44C is not applicable, and which we have upheld (refer para 8). So, however, some reasonable basis for the allocation of the indirect expenditure is to be made. Accordingly, he, following his predecessor, allowed the assessee's claim for indirect expenditure in the ratio of the domestic turnover to the total (global) turnover. The A.O.'s report, after due verification *qua* global indirect expenditure, was called for by him for the purpose. Only the expenditure for which the vouchers could be produced, i.e., for GBP 9,71,335 (as against the total global expenditure at GBP 14,63,024), were admitted, and the disallowance worked out proportionately. Aggrieved, the assessee is in appeal.

10. We have heard the parties, and perused the material on record. In our view, the Revenue's stand is not maintainable. The assessee's claim for indirect expenditure is not

being disallowed on the basis of it being incurred specifically for the purpose of its business in India, but on the basis that a part of the expenditure incurred can be reasonably attributed to the Indian operations, taking the turnover as a surrogate measure of the quantum of the operations. In our view, therefore, the 'indirect expenditure' as reflected in the assessee-company's global audited accounts can be, without demur, taken as a legally firm basis for applying the same to the Indian operations in terms of Art. 7(3) of the treaty. The Revenue may, to satisfy itself, further seek a certificate from the auditors of the company after arriving at an agreement as to what constitutes and comprises 'indirect expenditure'. Insistence on the production of vouchers, in the given facts and circumstances of the case, is, in our view, exaggerated. Subject to the verification/satisfaction, as stated above, we accept the assessee's claim in principle. We decide accordingly.

11. In the result, the assessee's appeals for both the years are partly allowed on the afore-said terms, and the Revenue's appeal is dismissed.

Order pronounced in the open court on April 11, 2014

Sd/-	Sd/-
(Amit Shukla)	(Sanjay Arora)
न्यायिक सदस्य / Judicial Member	लेखा सदस्य / Accountant Member

मुंबई Mumbai; दिनांक Dated : 11.04.2014

व.नि.स./Roshani, Sr. PS

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent
3. आयकर आयुक्त(अपील) / The CIT(A)
4. आयकर आयुक्त / CIT - concerned
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt. Registrar)
आयकर अपीलीय अधिकरण, मुंबई **/ ITAT, Mumbai**