`IN THE INCOME TAX APPELLATE TRIBUNAL,
KOLKATA 'B' BENCH, KOLKATA

[Coram: Pramod Kumar AM and George Mathan JM]

I.T.A. No.: 1336/ Kol. / 2011
Assessment year: 2005-06

Income Tax Officer,
Ward 12 (2), Kolkata ***……..Appellant***

Vs.

Right Florists Pvt Ltd ***……Respondent***
P 76, Lake Road
Kolkata 700 069 [PAN AACCR4578F]

Appearances by:
D K Rakshit, *for the appellant*
Subhash Agarwal, *for the respondent*

Date of concluding the hearing : March 19, 2013
Date of pronouncing the order : April 12, 2013

ORDER

Per Pramod Kumar:

1. By way of this appeal, the appellant Assessing Officer has called into question correctness of learned Commissioner (Appeals)'s order dated 15th July 2011, in the matter of assessment under section 143(3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act') for the assessment year 2005-06, on the following grounds:

> **That, on the facts and in the circumstances of the case, learned CIT(A) erred in satisfying himself in deleting the addition of Rs 30,44,166 on the basis that the assessee is not under an obligation to deduct tax at source under section 195 of the Income Tax Act, 1961, as well as holding the view that according to the provisions of the DTAA, no portion of payments made to the non resident companies is taxable in India.**

2. To adjudicate on this appeal, a few material facts, as culled out from orders of the authorities below, are required to be taken note of. The assessee is a florist and he uses advertising on search engines, i.e. by Google

and Yahoo, to generate business. The way it works, in broad terms, is like this. Whenever anyone does a web search on the respective search engines, in looking for a particular website, and uses certain keywords, the advertisement of the assessee is shown alongwith the search results. The assessee had made payments aggregating to Rs 30,44,166 in respect of online advertising to US based entities, namely Google Ireland Limited (**Google Ireland**, in short) and Overture Services Inc USA (**Yahoo USA**, in short) . However, no taxes were withheld from these payments. It was in this backdrop that, during the course of scrutiny assessment proceedings of the income tax return filed by the assessee, the Assessing Officer required the assessee to show cause as to why these payments not be disallowed, as a deduction in computation of its income, under section 40(a)(i). Section 40(a)(i) provides that when an assessee fails to discharge his tax withholding obligations, in respect of amounts paid to non residents, no deduction is allowed in respect of the expenditure so incurred. The stand of the assessee that these payments are made to foreign entities, who did not have any permanent establishment in India, was brushed aside on the ground that this claim was unsubstantiated and that there was no material to establish that these entities are of the treaty partner countries. As regards assessee's contention that even under section 9(1) of the Indian Income Tax Act, 1961, only so much of the income of the non resident can be brought to tax as is reasonable attributable to the operations carried out in India, the Assessing Officer rejected the same and also observed that irrespective of whether or not, in assessee's opinion, the income was taxable in India, the assessee ought to have approached the Assessing Officer under section 195 prior to making the foreign remittance. The assessee's failure to do so, according to the Assessing Officer, was contrary to the law laid down by Hon'ble Supreme Court in the case of Transmission Corporation of India Vs CIT (239 ITR 387). With these observations, the Assessing Officer disallowed Rs 30,44,166 under section 40(a)(i) of the Act. Aggrieved, assessee carried the matter in appeal before the Commissioner (Appeals). Learned CIT (A), after extensively reproducing from the submissions filed by the assessee but in a brief order, deleted the impugned disallowance by observing as follows:

After careful consideration, it is noticed that the assessee is engaged in the business of online florist and these advertisement expenses have been paid to M/s Google Limited, which is resident of Ireland, and M/s Overture Services, which is based in USA, and that double taxation avoidance agreements exist between India and USA and India and Ireland. The assessee, being a florist, was making advertisements through these two companies and had made payments to these companies for online advertisements. These two companies did not have any permanent establishment in India in the financial year under consideration. Because of overriding provision of the DTAA, no portion of payments made to these non resident companies was taxable in India, and, therefore, assessee was not under an obligation to deduct TDS u/s 195 of the Income Tax Act, 1961. Hence, addition made by the AO to the extent of Rs 30,44,166 is deleted.

3. Aggrieved by the relief so granted by the CIT(A), the Assessing Officer is in appeal before us.

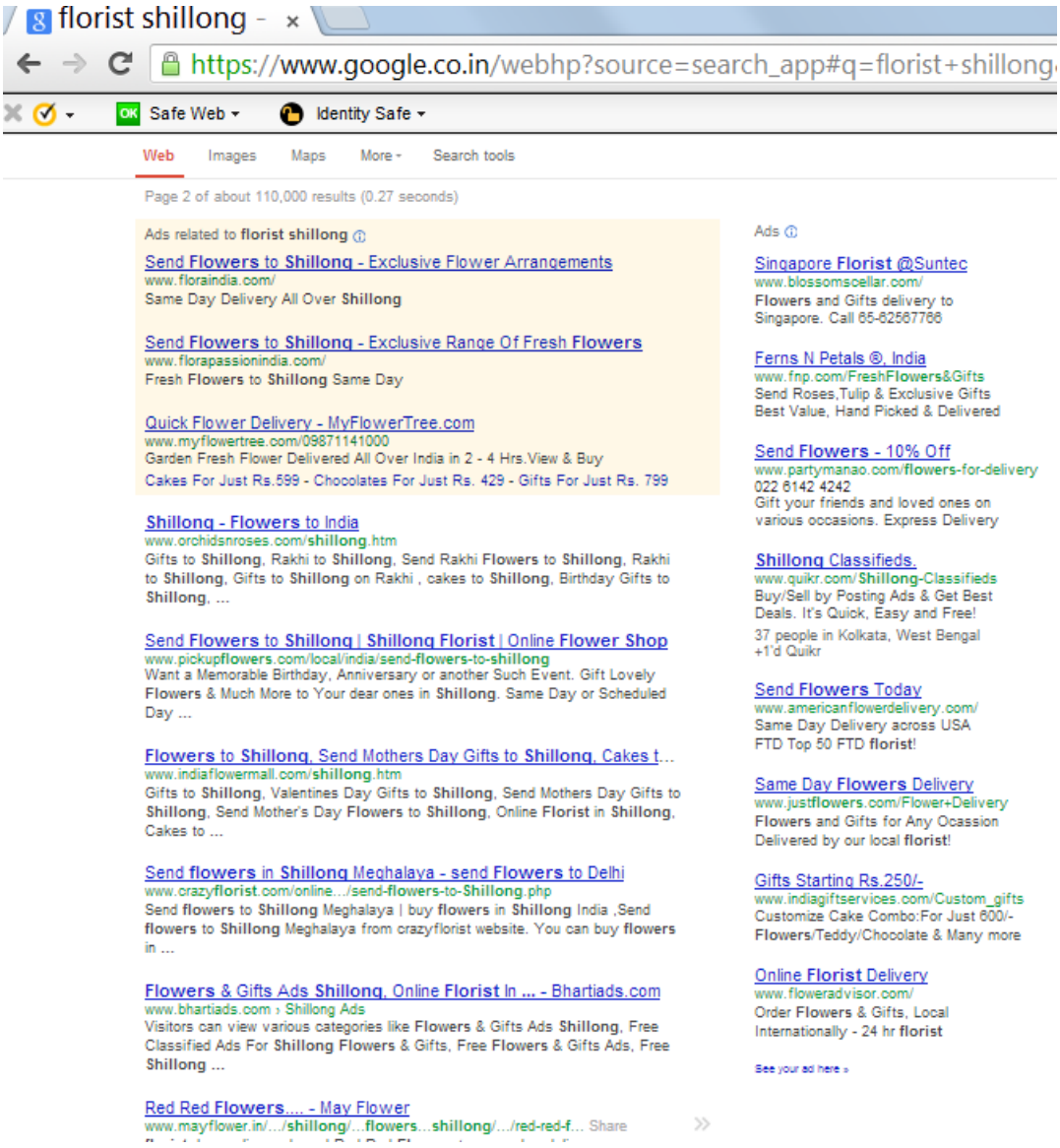
4. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

5. To adjudicate on the issue in appeal, we will have to first understand the nature of services rendered by the Google and Yahoo. Both these companies own popular search engine websites, namely Google and Yahoo, and the advertising is done in the results generated by the search results against agreed keywords or by placing the advertising banners on websites. Yahoo and Google, as internet search engines, have brought about an information revolution and the entire conventional business model of businesses reaching out to the potential customers has undergone paradigm shift. Nicholas Negroponte, in his classic book 'Being Digital' published in January 1995, had said that "Information about information is more important than information" and illustrated this with an example, which looks too simplistic today, that "the fact that TV Guide makes more money than all the four major networks combined". It was around this time that the search engines "Jerry and David's Guide to the World Wide Web" and "backrub", former avatars of Yahoo and Google respectively, made the

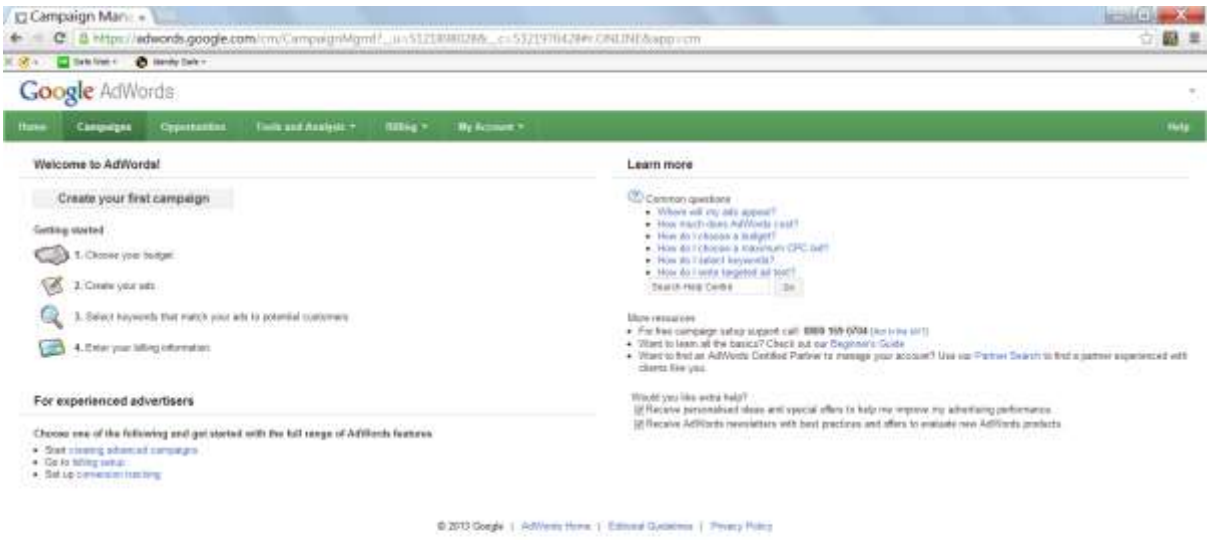
business of information about information, which is what these search engines are really involved in- with sophisticated technology and process of great value proposition, a reality. The services offered by Yahoo and Google are of the same nature, but, for the sake of convenience, we will take up Google's case as an illustration for the nature of services. Google is a web search engine. The way it works is this. A web search engine is basically software code that is designed to search for information on the World Wide Web. When an internet user needs information about, *inter alia,* a product or service, he visits the website of the search engine and keys in the search words. The software and database embedded in the search engine than produces a large number of results, such as addresses of the related websites so that internet user can then visit those website for further information on that product or service. This query need not be about a service or product only, it may relate to virtually anything under the sun. These search engine results are sometimes in thousands, are generally presented in a web pages, images, information and other types of files. While producing these results, there are sponsored search results also, which is *de facto* advertising, and these sponsored search results help those advertisers visibility of their respective websites. Unlike web directories, which are maintained only by human editors, search engines also maintain real-time information by running an algorithm on a web crawler, and, therefore, the advertising services offered by these search engines are practically without any human touch and entirely automated. When we use these search engines, the search results are produced which are termed as 'search engine result pages', and, as we have seen a little while ago, these SERPs also include sponsored search results or online advertising. The online advertising on SERPs is a part of the business of search engines like Google. To an advertiser, it is generally a three step process – advertiser creates advertisement and chooses keywords, which are words or phrases relating to his business. When people search on Google using one of the assigned keywords, the advertisement may appear next to the search results. The advertisements are then before an audience which is already interested in the related product or service. People can simply click on these

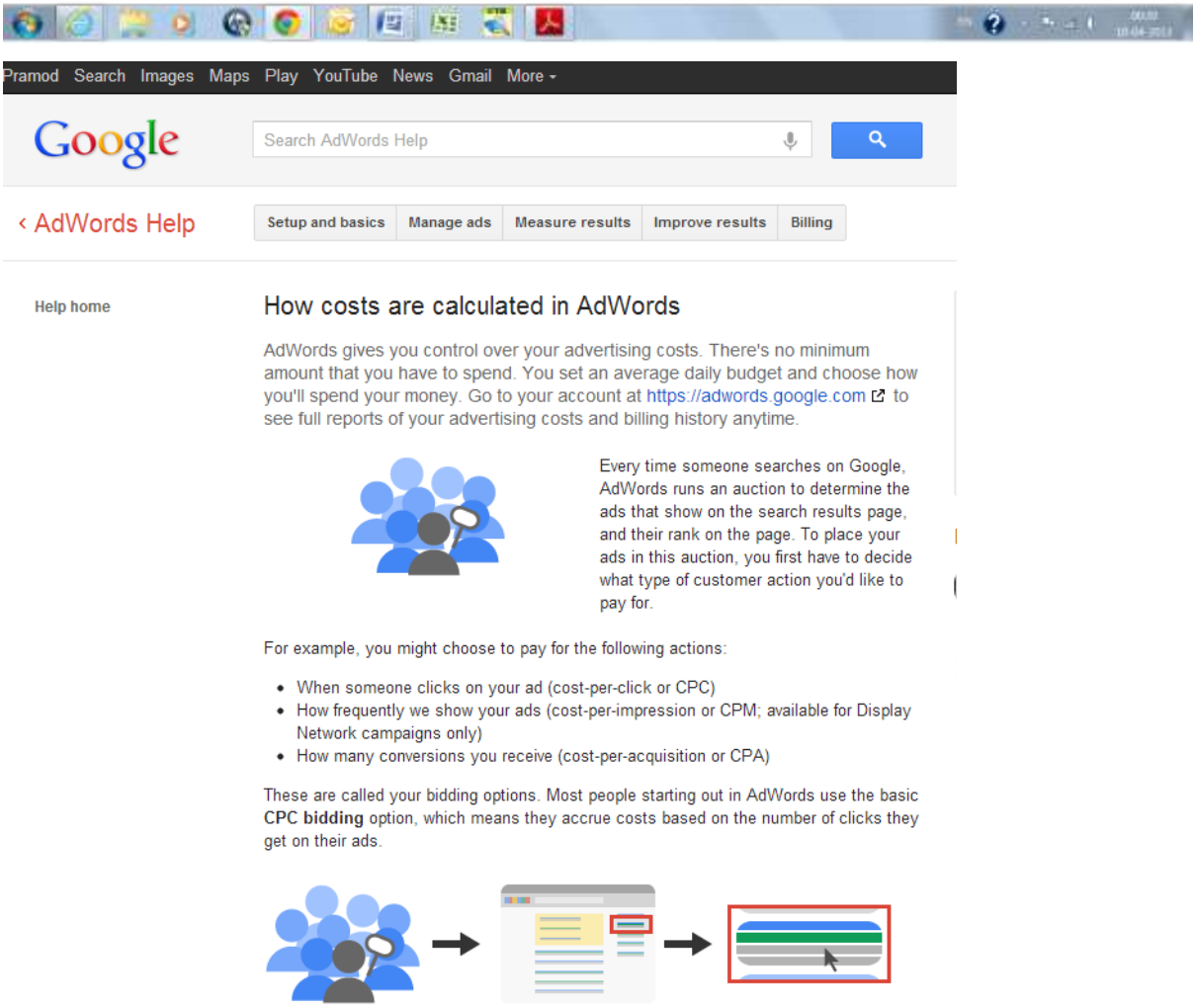
advertisements and they will reach the related website so as to make a purchase or learn more about the product or service. The functioning of this form of online advertising can indeed be explained in such simple terms, but actual rendering of this service is a highly technical process. To search engines, providing this online advertising service, is a complex technical activity and rendering of a highly technical service which works with the use of software code that is designed to search for information on the World Wide Web, and generate, alongwith the search results, sponsored search results – the service which is paid for by the sponsors of those results, like this assessee before us. On one hand, a web search engine like Google, as we have noted earlier also, maintains real-time information by running an algorithm on a web crawler, and, on the other hand, produces, in the search results to the internet users, advertisement sponsored. It is primarily for this service that the Google is paid for. An online advertising could also be by way of a web banner or banner advertisement is a form of advertising on the World Wide Web delivered by an adserver, an expression which refers to technology and service that places advertisements on web sites. The content of the adserver is constantly updated so that the website or webpage on which the ads are displayed contains new advertisements, when the site or page is visited or refreshed by a user. The purpose of ad serving is to deliver targeted ads that match the website visitor's interest. This form of online advertising entails embedding an advertisement into a web page. It is intended to attract traffic to a website by linking to the website of the advertiser. An ad server, which is at the core of this form of online advertising, is a computer server, specifically a web server, that stores advertisements used in online marketing and delivers them to website visitors. Whichever be the form of advertising service, whether by sponsored results or by web banner or by any other similar mode, there can hardly be any dispute on the proposition that these search engines or ad servers, which are patented and provide valuable services, which are essentially technical in nature. It is this kind of advertising service for which the payments were made by the assessee. Let us, for example, take the case of a florist in Shillong who intends to use these

services. His potential customer is a person looking for a florist in Shillong. When such a person actually uses the search words 'florist' and 'Shillong' in Google, the search engine result page could be like this:



6. The above search engine result page shows several sponsored results, termed and marked as "ads" and it is for these sponsored results being shown on the search engine result page that the Google charges a fees. The mechanism for this online advertising could be further appreciated by the following screenshots:





7. The question that we have to really adjudicate in this appeal is whether the payment made for the above services to Google Ireland and Yahoo USA is taxable in the hands of these entities, because admittedly, if

these amounts were to be held taxable in India, non deduction of tax at source from these remittances will result in disallowance of related payment in computation of business income of the assessee.

8. Our attention is invited by the learned counsel to a decision of the coordinate bench in the case of Pinstorm Technologies Pvt Ltd Vs ITO [TS 536 ITAT (2012)Mum] wherein, on materially identical set of facts and dealing with question of correctness of similar disallowance made by the Assessing Officer, a coordinate bench has observed as follows:

> *3. The assessee in the present case is a company which is engaged in the business digital advertising and internet marketing. It utilises the internet search engine such as Google, Yahoo etc. to buy space in advertising on the internet on behalf of its clients. The search engine carries out its own programme whereby the assessee books certain words called "key words". Whenever any person searches through the net for a specific "key word", the advertisement of the assessee or its client is displayed. For example, if the "key word" "Hotels in Mumbai" is searched for, the advertisement of 'Taj Hotel' may be displayed among sponsor links on the search engine page. The price charged for such booking depends on type of phrase, its popularity, usage etc. The search engine renders this service outside India through internet. Google does such online advertising business in Asia from its office in Ireland. The search engine service is on a worldwide basis and thus is not relatable to any specific country. The entire transaction takes place through the internet and even the invoice is raised and payment is made through internet. During the year under consideration, the assessee company had made a payment of Rs. 1,09,35,108/- to Google Ireland Ltd. and the said amount was claimed as 'advertisement expenditure'. While making the said payment, no tax at source was deducted by the assessee on the ground that the amount paid to Google Ireland Ltd. constituted business profits of the said company and since the said company did not have a permanent establishment (PE) in India, the amount paid was not chargeable to tax in India. According to the A.O., the services rendered by the Ireland company to the assessee company was in the nature of 'technical services' and hence the assessee company was liable to deduct the tax at source form the payment made against the said services. Since no such tax at source was deducted by the assessee, the deduction claimed by the assessee on account of expenditure incurred on payment of 'advertisement charges to M/s. Google Ireland Ltd. was disallowed by the A.O. by invoking the provisions of sec.40(a)(i).*
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> *4. The disallowance of advertisement expenses made by the A.O. by invoking the provisions of sec.40(a)(i) was challenged by the assessee in*

an appeal filed before the Ld. CIT (A) who confirmed the said disallowance made by the A.O. for the following reasons given in paragraph No.9

> *"....I am unable to accede to the argument of the appellant. It is not in dispute that the payment has been made for the comprehensive services rendered for digital data display in their server and that the same will fall within the meaning of royalty as has been envisaged u/s.9(1)(vi) of the Act. From the facts it is clear that the said Google or for that matter yahoo etc. allot the space to the appellant company and its clients in their server and that whenever any internet user search for certain webs the appellant's or its client's name would appear and its contents be displayed on the computer screen. Thus in the instant case the payment made to the foreign company is for advertising services rendered through the search engine would fall within the definition of royalty as defined u/s.9(1)(iv) of the Act. since the payment is termed as royalty in nature the amount paid on such account would be liable to be taxed in India and such the appellant company was liable to deduct the tax on such payment and since no tax was deducted at source the AO was right in invoking the provisions of section 40(a)(i) of the Act."*

5. The Ld. CIT (A) thus held that the payment made by the assessee to Google Ireland Ltd. for the services rendered was in the nature of 'royalty' chargeable to tax in India and the assessee therefore was liable to deduct the tax at source from the said payment. Since there was failure on the part of the assessee to deduct such tax, the Ld. CIT (A) confirmed the disallowance made by the A.O. u/s.40(a)(i) although on different ground. Aggrieved by the order of the Ld. CIT (A), the assessee has preferred this appeal before the Tribunal.

6. We have heard arguments of both the sides and also perused the relevant material on record. It is observed that a similar issue had come up for consideration before the Tribunal in the case of Yahoo India Pvt. Ltd. and vide its order dated 24th June, 2011 passed in ITA No.506/Mum/2008, the Tribunal decided the same in favour of the assessee for the following reasons given in paragraph No.8 of its order:

> *"8. As already noted by us, the payment made by assessee in the present case to Yahoo Holdings (Hong Kong) Ltd. was for services rendered for uploading and display of the banner advertisement of the Department of Tourism of India on its portal. The banner advertisement hosting services did not involve use or right to use by the assessee any industrial, commercial or scientific equipment and no such use was actually granted by Yahoo Holdings (Hong Kong) Ltd. to assessee company. Uploading and display of banner advertisement on its portal was entirely the responsibility of Yahoo Holdings (Hong Kong) Ltd. and assessee company was only*

required to provide the banner Ad to Yahoo Holdings (Hong Kong) Ltd. for uploading the same on its portal. Assessee thus had no right to access the portal of Yahoo Holdings (Hong Kong) Ltd. and there is nothing to show any positive act of utilization or employment of the portal of Yahoo Holdings (Hong Kong) Ltd. by the assessee company. Having regard to all these facts of the case and keeping in view the decision of the Authority of Advance Rulings in the case of Isro Satellite Centre 307 ITR 59 and Dell International Services (India) P. Ltd. 305 ITR 37we are of the view that the payment made by assessee to Yahoo Holdings (Hong Kong) Ltd. for the services rendered for uploading and display of the banner advertisement of the Department of Tourism of India on its portal was not in the nature of royalty but the same was in the nature of business profit and in the absence of any PE of Yahoo Holdings (Hong Kong) Ltd. in India, it was not chargeable to tax in India. Assessee thus was not liable to deduct tax at source from the payment made to Yahoo Holdings (Hong Kong) Ltd. for such services and in our opinion, the payment so made cannot be disallowed by invoking the provisions of section 40(a) for non-deduction of tax. In that view of the matter we delete the disallowance made by the A.O. and confirmed by the learned CIT (A) u/s 40(a) and allow the appeal of the assessee."

7. As the issue involved in the present case as well as all the material facts relevant thereto are similar to the case of Yahoo India P. Ltd. (supra), we respectfully follow the decision rendered by the coordinate Bench of this Tribunal in the said case and delete the disallowance made by the A.O. and confirmed by the Ld. CIT (A) by invoking the provisions of sec.40(a)(i) holding that the amount paid by the assessee to M/s. Google Ireland Ltd. for the services rendered for uploading and display of banner advertisement on its portal was in the nature of business profit on which no tax was deductible at source since the same was not chargeable to tax in India in the absence of any PE of Google Ireland Ltd. in India.

9. The above decision, as also another coordinate bench's decision in the case of Yahoo India Pvt Ltd Vs DCIT (140 TTJ 195) which has been relied upon, is certainly an authority in support of the proposition that the payment by Indian arm of foreign owner of search engine portal, in connection with online advertising services, is not in the nature of royalty under Explanation 2 to Section 9(1)(vi) of the Income Tax Act, 1961. However, taxability of the payments made for online advertising to Google, or, for that purpose, to Yahoo or any such similar payment, does not hinge on

applicability of Section 9(1)(vi) alone. Not only Section 9(1)(vi) but entire Section 9 itself is a part of the scope of Section 5(2)(b) which is what we are really concerned with in this case.

10. So far as the taxability of a non resident in India is concerned, the scheme of the Income Tax Act is like this. Under the provisions of Section 5(2), total income of non-resident includes all income, from whatever source derived, which – (a) is received or is deemed to have been received in India by or on behalf of the non-resident; and (b) accrues or arises, or is deemed to accrue or arise, to him in India. Section 9, in turn, sets out the scope of income deemed to accrue or arise in India. Therefore, to examine taxability of an income in the hands of a non resident, these three aspects need to be examined – application of Section 5(2)(a), application of Section 5(2)(b), and application of Section 9 which actually deals with the deeming fiction embedded in Section 5(2)(b). In the present case, it is an admitted position that the payment was not received or deemed to have been received in India. Section 5(2)(a), therefore, has no application in the matter. As regards Section 5(2)(b), i.e. 'income accruing or arising in India' and 'income deemed to accrue or arise in India', let us pick up the scope of 'income accruing or arising in India' first.

11. The expression 'income accruing or arising in India' has not been statutorily defined under the provisions of the Income Tax Act, 1961. However, while dealing with the connotations of this expression under Section 5(2), Hon'ble Supreme Court, in the case of CIT Vs Hyundai Heavy Industries Limited (291 ITR 482), has *inter alia* observed that, **"……as far as the income accruing or arising in India, an income which accrues or arises to a foreign enterprise in India can be only such portion of income accruing or arising to such a foreign enterprise as is attributable to its business carried out in India. This business could be carried out through its branch(s) or through some other form of its presence in India such as office, project site, factory, sales outlet etc. (hereinafter called as "PE of foreign enterprise")……."** . Interestingly,

even though Hon'ble Supreme Court has used the expression 'permanent establishment', this expression is used in the context of Section 5(2), and not in the context of tax treaties- where it has its origin. Hon'ble Supreme Court has explained that, in order to attract taxability in India under Section 5(2)(b), the income must relate to such portion of income of the non-resident, as is attributable to business carried out in India, and the business so carried out in India could be "through its branches or through some other form of presence such as office, project site, factory, sales outlet etc" as "branch or through some other form of its presence in India such as office, project site, factory, sales outlet etc". The term permanent establishment, has its origin in the tax treaties but, by the virtue of judge made law – which is as binding on us as law enacted by the parliament, it is used in the context of domestic law where it is not defined or even elaborated upon. As to how we should construe such an expression, we find guidance from Australian New South Wales Supreme Court's decision in the case of Unisys Corporation Vs Federal Commissioner of Taxation (5 ITLR 658) in which Justice Ian Gzell interpretated domestic law provisions of the Australian Income Tax Assessment Act with reference to treaty laws. In doing so, Hon'ble Supreme Court also took note of the Australian Tax Office Ruling No. 2002/5 (http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR20025/NAT/ATO/00001) which noted that "The 'Permanent establishment' is a concept used both in international and domestic tax law. In Australia it was first used in our tax treaty with the United Kingdom signed in 1946. It appeared specifically in Australia's domestic tax law outside the tax treaty context in 1959" and that "PE is defined in most of Australia's tax treaties to mean, among other things, a fixed place of business through which the business of an enterprise is wholly or partly carried on (or words to similar effect). This is consistent with the primary meaning of PE in the OECD Model Tax Convention on Income and on Capital". What follows from this approach, which appears to be very pragmatic and reasonable to us, is that since the expression 'permanent establishment' is not defined by legislation at all and not adequately defined even by judge made law, it will be appropriate to look at primary meaning of permanent establishment in the context of the tax

treaties, and construe the scope of the expression 'permanent establishment' under the domestic tax law, and in the context of issue before us, accordingly.

12. Let us first examine as to what is primary meaning of a PE and whether a search engine like Google or Yahoo can be said to have a PE, within its primary meaning, in India. It is important to bear in mind the fact that the concept of PE evolved because in traditional commerce, physical presence was required in the source country if any significant level of business was to be carried on, but, with the development of internet, correlation between the size of business and extent of physical presence in the source country has virtually vanished. In that sense, the traditional concept of PE, which was conceived at a point of time when internet and e commerce was not even on the radar, does not really fit into the modern day world in which virtual presence through internet, in certain respects, is as effective as physical presence for carrying on businesses. At a policy level, taxation may infringe neutrality when it is dependent on the form of presence, i.e. physical presence *vis-a-vis* virtual presence, traditional commerce vis-à-vis ecommerce, direct presence *vis-à-vis* presence through a dependent agent. A search engine's presence in a location, other than the location of its effective place of management, is only on the internet or by way of a website, which is not a form of physical presence. As to whether an website can be PE or not, we find guidance from High Powered Committee Report which, while recognizing the need to make form of presence tax neutral but realizing the limitations of the scope of existing principles and rules, has also observed that, "The Committee, therefore, supports the view that the concept of PE should be abandoned and a serious attempt should be made within OECD or the UN to find an alternative to the concept of PE". Clearly, conventional PE tests fails in this virtual world even when a reasonable level of commercial activity is crossed by foreign enterprise. It is a policy decision that Government has to take as to whether it wants to reconcile to the fact that conventional PE model has outlived its utility as an instrument of invoking taxing rights upon reaching a reasonable level of

commercial activity and that it does fringe neutrality as to the form of commercial presence i.e. physical presence or virtual presence, or whether it wants to take suitable remedial measures to protect its revenue base. Any inertia in this exercise can only be at the cost of tax certainty.

13. In the light of the above discussions, even as per the High Power Committee, a website *per se*, which is the only form of Google's presence in India – so far as test of primary meaning i.e. basic rule PE is concerned, cannot be a permanent establishment under the domestic law. We are in considered agreement with the views of the HPC on this issue.

14. This view further finds support from the Commentary on OECD Model Convention, which, inter alia, observes as follows:

> ***"Electronic commerce***
>
> *42.1 There has been some discussion as to whether the mere use in electronic commerce operations of computer equipment in a country could constitute a permanent establishment. That question raises a number of issues in relation to the provisions of the Article.*
>
> ***42.2 Whilst a location where automated equipment is operated by an enterprise may constitute a permanent establishment in the country where it is situated (see below), a distinction needs to be made between computer equipment, which may be set up at a location so as to constitute a permanent establishment under certain circumstances, and the data and software which is used by, or stored on, that equipment. For instance, an Internet web site which is a combination of software and electronic data, does not in itself constitute tangible property. It therefore does not have a location that can constitute a "place of business" as there is no "facility such as premises or, in certain instances, machinery or equipment" (see paragraph 2 above) as far as the software and data constituting that web site is concerned. On the other hand, the server on which the web site is stored and through which it is accessible is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server.***
>
> ***42.3 The distinction between a web site and the server on which the web site is stored and used is important since the enterprise that operates the server may be different from the enterprise that carries on business through the web site. For example, it is common***

for the web site through which an enterprise carries on its business to be hosted on the server of an Internet Service Provider (ISP). Although the fees paid to the ISP under such arrangements may be based on the amount of disk space used to store the software and data required by the web site, these contracts typically do not result in the server and its location being at the disposal of the enterprise (see paragraph 4 above), even if the enterprise has been able to determine that its web site should be hosted on a particular server at a particular location. In such a case, the enterprise does not even have a physical presence at that location since the web site is not tangible. In these cases, the enterprise cannot be considered to have acquired a place of business by virtue of that hosting arrangement. However, if the enterprise carrying on business through a web site has the server at its own disposal, for example it owns (or leases) and operates the server on which the web site is stored and used, the place where that server is located could constitute a permanent establishment of the enterprise if the other requirements of the Article are met.

42.4 Computer equipment at a given location may only constitute a permanent establishment if it meets the requirement of being fixed. In the case of a server, what is relevant is not the possibility of the server being moved, but whether it is in fact moved. In order to constitute a fixed place of business, a server will need to be located at a certain place for a sufficient period of time so as to become fixed within the meaning of paragraph 1.

42.5 Another issue is whether the business of an enterprise may be said to be wholly or partly carried on at a location where the enterprise has equipment such as a server at its disposal. The question of whether the business of an enterprise is wholly or partly carried on through such equipment needs to be examined on a case-by-case basis, having regard to whether it can be said that, because of such equipment, the enterprise has facilities at its disposal where business functions of the enterprise are performed.

42.6 Where an enterprise operates computer equipment at a particular location, a permanent establishment may exist even though no personnel of that enterprise is required at that location for the operation of the equipment. The presence of personnel is not necessary to consider that an enterprise wholly or partly carries on its business at a location when no personnel are in fact required to carry on business activities at that location. This conclusion applies to electronic commerce to the same extent that it applies with respect to other activities in which equipment operates automatically, e.g. automatic pumping equipment used in the exploitation of natural resources.

42.7 Another issue relates to the fact that no permanent establishment may be considered to exist where the electronic commerce operations

carried on through computer equipment at a given location in a country are restricted to the preparatory or auxiliary activities covered by paragraph 4. The question of whether particular activities performed at such a location fall within paragraph 4 needs to be examined on a case-by-case basis having regard to the various functions performed by the enterprise through that equipment. Examples of activities which would generally be regarded as preparatory or auxiliary include:

— providing a communications link
— much like a telephone line
— between suppliers and customers;
— advertising of goods or services;
— relaying information through a mirror server for security and efficiency purposes;
— gathering market data for the enterprise;
— supplying information.

42.8 Where, however, such functions form in themselves an essential and significant part of the business activity of the enterprise as a whole, or where other core functions of the enterprise are carried on through the computer equipment, these would go beyond the activities covered by paragraph 4 and if the equipment constituted a fixed place of business of the enterprise (as discussed in paragraphs 42.2 to 42.6 above), there would be a permanent establishment.

42.9 What constitutes core functions for a particular enterprise clearly depends on the nature of the business carried on by that enterprise. For instance, some ISPs are in the business of operating their own servers for the purpose of hosting web sites or other applications for other enterprises. For these ISPs, the operation of their servers in order to provide services to customers is an essential part of their commercial activity and cannot be considered preparatory or auxiliary. A different example is that of an enterprise (sometimes referred to as an "e-tailer") that carries on the business of selling products through the Internet. In that case, the enterprise is not in the business of operating servers and the mere fact that it may do so at a given location is not enough to conclude that activities performed at that location are more than preparatory and auxiliary. What needs to be done in such a case is to examine the nature of the activities performed at that location in light of the business carried on by the enterprise. If these activities are merely preparatory or auxiliary to the business of selling products on the Internet (for example, the location is used to operate a server that hosts a web site which, as is often the case, is used exclusively for advertising, displaying a catalogue of products or providing information to potential customers), paragraph 4 will apply and the location will not constitute a permanent establishment. If, however, the typical functions related to a sale are performed at that location (for example, the conclusion of the contract with the customer, the processing of the payment and the delivery of the products are performed automatically through the

equipment located there), these activities cannot be considered to be merely preparatory or auxiliary.

42.10 A last issue is whether paragraph 5 may apply to deem an ISP to constitute a permanent establishment. As already noted, it is common for ISPs to provide the service of hosting the web sites of other enterprises on their own servers. The issue may then arise as to whether paragraph 5 may apply to deem such ISPs to constitute permanent establishments of the enterprises that carry on electronic commerce through web sites operated through the servers owned and operated by these ISPs. Whilst this could be the case in very unusual circumstances, paragraph 5 will generally not be applicable because the ISPs will not constitute an agent of the enterprises to which the web sites belong, because they will not have authority to conclude contracts in the name of these enterprises and will not regularly conclude such contracts or because they will constitute independent agents acting in the ordinary course of their business, as evidenced by the fact that they host the web sites of many different enterprises. It is also clear that since the web site through which an enterprise carries on its business is not itself a "person" as defined in Article 3, paragraph 5 cannot apply to deem a permanent establishment to exist by virtue of the web site being an agent of the enterprise for purposes of that paragraph."

15. The interpretation of the expression 'permanent establishment', even in the context of tax treaties, does not, therefore, normally extend to websites unless the servers on which websites are hosted are also located in the same jurisdiction. The underlying principle is this. While website *per se*, which is a combination of software and electronic data, does not constitute a tangible property as it cannot have a location which constitutes place of business, a web server, on which the web site is stored and through which it is accessible, is a piece of equipment having a physical location and such location may thus constitute a "fixed place of business" of the enterprise that operates that server. A search engine, which has only its presence through its website, cannot therefore be a permanent establishment unless its web servers are also located in the same jurisdiction. That's not the situation here and it is not the case of the revenue that servers are located in India.

16. In all fairness, however, we must also take note of the fact that the Government of India has expressed its reservations on the OECD view and stated as follows:

"33. India does not agree with the interpretation given in para 42.2; it is of the view that website may constitute a permanent establishment in certain circumstances.

34. India does not agree with the interpretation given in para 42.3; it is of the view that , depending on facts, an enterprise can be considered to have acquired a place of business by virtue of hosting its website on a particular server at a particular location."

17. Coming to the reservations expressed by Government of India, the first issue that needs to be considered is as to what is the role of 'reservations' and 'observations' in judicial examination. In our humble understanding, the 'reservations' so expressed or 'observations' so made to the commentary is relevant only to the extent that in interpreting any tax treaty, entered into after expressing those 'reservations' or making those 'observation', to that extent, related commentary cannot be taken as *contemporanea exopsitio*. It is so for the following reasons. When an expression or a clause is picked up from the OECD Model Convention, the normal presumption is that the persons using the said clause or expression are also aware about the meanings assigned to the said clause or expression by the OECD and have used it in the same sense and for the same purpose. Hon'ble Andhra Pradesh High Court in the case of CIT v. Vishakhapatnam Port Trust (1983) 144 ITR 146 (AP), referred to the OECD Commentary on the technical expressions and the clauses in the model conventions, and referred to, with approval, Lord Redcliffe's observation in Ostime v. Australian Mutual Provident Society (1960) 39 ITR 210, 219 (HL) which have described the language employed in those documents as the 'international tax language'. These documents are thus in the nature of *contemporanea expositio* inasmuch as the meaning indicated in these documents to the clauses and expressions in the tax treaties can be inferred as the meaning normally understood in, to use the words of Lord Redcliffe, 'international tax language' developed by the organizations like OECD. Therefore, when an expression or a clause from the OECD Model Convention is used even in a bilateral tax treaty involving a non OECD country, one may generally proceed on the basis that it

is used in the same meaning and with the same connotations as assigned to it by the OECD Model Convention Commentary. Of course, even *contemporanea expositio* is not a binding interpretation of statutory provisions and there are serious limitation in its legal application, but when it comes to interpreting a tax treaty, the position is entirely different and this principle has much bigger role to play because interpreting a tax treaty is a case in which emphasis has to be on true intentions rather than on literal meaning. As observed by Federal Court of Canada, in Gladden v. Her Majesty the Queen 85 DTC 5188, at p. 5190, "Contrary to an ordinary taxing statute, a tax treaty or convention must be given a liberal interpretation with a view to implementing the true intentions of the parties". True intentions of the parties to an agreement, which a tax treaty inherently is *[See observations of Harman, J. in Union Texas Petroleum Corporation v. Critchley (1988) STC 69, to the effect that "I consider that I should bear in mind that this double tax agreement is an agreement. It is not a taxing statute, although it is an agreement about how taxes should be imposed"],* are best appreciated with reference to the meaning of those terms as commonly understood at the point of time when treaty was entered into. However, with the expression of 'reservations' or 'observations' on the commentary, to that extent, this presumption about commonly understood meaning of the expressions comes to an end.

18. In the view of discussions above, the Government of India's reservations on the OECD Commentary are relevant only to the extent that OECD Commentary, to that extent, cannot be treated as a fair index of intention of the Government of India and as *contemporanea expositio* in respect of tax treaties entered into by India after so expressing its reservations. Beyond that, in our humble understanding, these reservations have no role in judicial analysis.

19. In any event, even the reservations expressed by the Government of India merely states the view that website may constitute a permanent establishment in certain circumstances, but it does not specify what are

those circumstances in which, according to tax administration, a website could constitute the permanent establishment. In effect, these reservations only reserve a right to set out the circumstances in which a website *per se* can be treated as permanent establishment, even though these reservations do not really constitute actionable statements. We find it difficult to fathom the underlying principle embedded in this reservation, and to understand somewhat vague and ambiguous stand of the tax administration on this issue. In our considered view, therefore, even on merits, the reservations so expressed by India, as on now and without anything more, cannot have any practical impact on a website being treated as a permanent establishment.

20. In the light of the above discussions, in our considered opinion Google's presence in India through its website cannot be said to constitute permanent establishment in India under the basic rule and thus conditions of Section 5(2)(b), read with Hon'ble Supreme Court's judgment in the case of Hyundai Heavy Industries *(supra)*, are not satisfied to the extent that no profits can be said to accrue or arise in India. We, however, make it clear that our observations are confined to the basic rule PE and these will have no application on extended PE provisions, such as dependent agent permanent establishment i.e. DAPE, which are relevant only in the context of tax treaties – something with which we are not really concerned at this stage.

21. That takes us to the question whether second limb of Section 5(2)(b), i.e. income 'deemed to accrue or arise in India', can be invoked in this case. So far as this deeming fiction is concerned, it is set out, as a complete code of this deeming fiction, in Section 9 of the Income Tax Act, 1961, and Section 9(1) specifies the incomes which shall be deemed to accrue or arise in India. In the Pinstorm's case *(supra)* and in Yahoo's case *(supra),* the coordinate benches have dealt with only one segment of this provision i.e. Section 9(1)(vi), but there is certainly much more to this deeming fiction. Clause (i) of section 9(1) of the Act provides that all income accruing or arising whether directly or indirectly through or from any 'business connection' in

India, or through or from any property in India or through or from any asset or source of income in India, etc shall be deemed to accrue or arise in India. However, as far as the impugned receipts are concerned, neither it is the case of the Assessing Officer nor has it been pointed out to us as to how these receipts have arise on account of any business connection in India. There is nothing on record do demonstrate or suggest that the online advertising revenues generated in India were supported by, serviced by or connected with any entity based in India. On these facts, Section 9(1)(i) cannot have any application in the matter. Section 9(1)(ii), (iii), (iv) and (v) deal with the incomes in the nature of salaries, dividend and interest etc, and therefore, these deeming fictions are not applicable on the facts of the case before us. As far as applicability of Section 9(1)(vi) is concerned, coordinate benches, in the cases of Pinstorm (supra) and Yahoo (supra), have dealt with the same and , for the detailed reasons set out in these erudite orders – extracts from which have been reproduced earlier in this order, concluded that the provisions of Section 9(1)(vi) cannot be invoked. We are in considered and respectful agreement with the views so expressed by our distinguished colleagues. That leaves us only with Section 9(1)(vii) which provides as follows:

Section 9 (1) (vii)

The following income shall be deemed to accrue or arise in India

(vii) income by way of fees for technical services payable by—

(a) the Government; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:]

Provided that nothing contained in this clause shall apply in relation to any income by way of fees for technical services payable in pursuance of an agreement made before the 1st day of April, 1976, and approved by the Central Government.]

[Explanation 1 : For the purposes of the foregoing proviso, an agreement made on or after the 1st day of April, 1976, shall be deemed to have been made before that date if the agreement is made in accordance with proposals approved by the Central Government before that date.]

Explanation [2] : For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".

Explanation to Section 9(1)

For the removal of doubts, it is hereby declared that for the purposes of this section, income of a nonresident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India".

22. In view of the above provision, even if services rendered by the foreign enterprise, by way of online advertising services, constitutes technical services, the same can be taxed under Section 9(1)(vii). It is also not necessary that services should be rendered in India. It is also relevant that the definition of 'fees for technical services' under the India Ireland Double Taxation Avoidance Agreement (India Irish tax treaty, in short) is also on the same lines, as in the Income Tax Act, and does not have a 'make available' clause. The 'fees for technical service', which is also taxable in the source jurisdiction under the India Irish tax treaty at a rate not exceeding 10%, is defined, under Article 12(2)(b), as "payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel

……..". The scope of FTS in the tax treaty is thus not any narrower than the scope under the domestic tax law. It is, therefore, essential to examine whether or not the online advertising services in question can be said to be technical services of the nature which can be covered by the scope of Explanation 2 to Section 9(1)(vii).

23. While business model of various forms of online advertising can perhaps be explained in very simple terms, but actual rendering of this service is a complex, technology driven process, protected by patents and sharpened by ongoing research and development work. A web search engine like Google, as we have noted earlier as well, maintains real-time and constantly updated information on all sources of information on the internet, and, at the same time it produces, on SERPs (search engine result pages) generated, the advertisements and sponsored results. Of course, online advertising could also be by way of banners and with the help of an adserver. There is no dispute, however, that whatever be the form of advertising service, whether by sponsored results or by web banner or by any other similar mode, these search engines or ad servers, which are patented and provide valuable services, which are essentially technical in nature. It is this kind of advertising service for which the payments were made by the assessee. Providing a sponsored search result, as also placing a banner advertisement on another person's website, is clearly a service rendered to the advertiser. Therefore, the crucial question really is whether these online advertising services, by producing the sponsored results in the search results or by web banners through adservers, could be covered by the connotation of 'technical services' as set out in Explanation 2 to Section 9(1)(vii).

24. While there is no specific definition assigned to the technical services, and Explanation 2 to Section 9(1)(vii), as also Article 12 (2)(b) merely states that 'fees for technical services' will include considering of *"rendering of any managerial, technical or consultancy services".* It is significant that the

expression 'technical' appears alongwith expression 'managerial' and 'consultancy' and all the three words refer to various types of services, consideration for which is included in the scope of 'fees for technical services'. The significance of this company of words lies in the fact that, as observed by a coordinate bench of this Tribunal in the case of Kotal Securities Ltd Vs DCIT (50 SOT 158), "when two or more words which are susceptible to analogous meaning are used together they are deemed to be used in their cognate sense. They take, as it were, their colours from each other, the meaning of more general being restricted to a sense analogous to that of less general". Just as a man is known by the company he keeps , a word is also to be interpreted with reference to be accompanying words. Words derive colour from the surrounding words. Broom's Legal Maxims (10th Edn.) observes that "It is a rule laid down by Lord Bacon, that *copulatio verborum indicat acceptationem in eodem sensu* i.e. the coupling of words together shows that they are to be understood in the same sense. It is, therefore, clear on principle that as long as words are used together in a statutory provision, they take colour from each other and restrict its meaning to the genus of these words. In this way, the meaning of words is restricted because of other words in the same group of words, and the meaning is so restricted to the species or genus of those other words. Genus of these words should be clearly discernible from the lowest common factor in those words. The lowest common factor in 'managerial, technical and consultancy services' seems to be the human intervention, because while these three words are of wide scope and are in varied field, the only common thread in these words seems to be that the services, which are essentially professional services in nature, can be rendered with human interface. A managerial or consultancy service can only be rendered with human interface, while a technical service can be rendered with human interface as also without human interface. A technical service, for example, could be automated analysis of a chemical compound without any scope of any human contribution at any stage, and a technical service could also be physical examination by an expert chemical analyst, with or without the help of machines, of the same chemical compound. However, when we try to restrict

the meaning of technical services to the services which are covered by managerial and technical services as well, services without human interface will have to be taken out of its ambit. It is, therefore, clear on principle that as long as words are used together in a statutory provision, they take colour from each other and restrict its meaning to the genus of these words which is evident by the lowest common factor in those words. The lowest common factor in 'managerial, technical and consultancy services' being the human intervention, as long as there is no human intervention in a technical service, it cannot be treated as a technical service under Section 9(1)(vii). There is one more approach to this issue, even though the results will be the same. The other way of looking at these three words on the basis of the principle of *noscitur a sociis* is, as was done by Hon'ble Delhi High Court in the case of CIT Vs Bharti Cellular Limited (319 ITR 139), is that the common characteristic of the majority of the words be read as limitation on the scope of the other words. While doing so, Their Lordships had observed as follows:

> 13. ……In the said Explanation *[i.e. Explanation 2 to Section 9(1)(vii)]* the expression fees for technical services means any consideration for rendering of any managerial, technical or consultancy services. The word technical is preceded by the word managerial and succeeded by the word consultancy. Since the expression technical services is in doubt and is unclear, the rule of *noscitur a sociis* is clearly applicable.
>
> The said rule is explained in Maxwell on The Interpretation of Statutes (Twelfth Edition) in the following words:-
>
> > Where two or more words which are susceptible of analogous meaning are coupled together,*noscitur a sociis*, they are understood to be used in their cognate sense. They take, as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general.
>
> This would mean that the word technical would take colour from the words managerial and consultancy, between which it is sandwiched.
>
> The word managerial has been defined in the Shorter Oxford English Dictionary, Fifth Edition as:- of pertaining to, or characteristic of a manager, esp. a professional manager of or within an organization, business, establishment, etc.

> The word manager has been defined, inter alia, as:- a person whose office it is to manage an organization, business establishment, or public institution, or part of one; a person with the primarily executive or supervisory function within an organization etc; a person controlling the activities of a person or team in sports, entertainment, etc.
>
> It is, therefore, clear that a managerial service would be one which pertains to or has the characteristic of a manager. It is obvious that the expression manager and consequently managerial service has a definite human element attached to it. To put it bluntly, a machine cannot be a manager.
>
> 14. Similarly, the word consultancy has been defined in the said Dictionary as the work or position of a consultant; a department of consultants. Consultant itself has been defined, inter alia, as a person who gives professional advice or services in a specialized field. It is obvious that the word consultant is a derivative of the word consult which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Consult has also been defined in the said Dictionary as ask advice for, seek counsel or a professional opinion from; refer to (a source of information); seek permission or approval from for a proposed action. It is obvious that the service of consultancy also necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant.
>
> 15. From the above discussion, it is apparent that both the words managerial and consultancy involve a human element. And, both, managerial service and consultancy service, are provided by humans. Consequently, applying the rule of *noscitur a sociis*, the word technical as appearing in Explanation 2 to Section 9 (1) (vii) would also have to be construed as involving a human element.

25. We may also point out that while this judgment did not meet approval of Hon'ble Supreme Court, in the judgment reported as CIT Vs Bharti Cellular Limited (330 ITR 239), on the short factual aspect regarding fact of human intervention. It was for recording the factual findings on this aspect that the matter was remitted to the file of the Assessing Officer. However, so far as the principle laid down by Hon'ble Delhi High Court on the application of principle of *noscitur a sociis* in restricting the scope of 'technical services' to 'technical services with a human interface' was concerned, Their Lordships of Hon'ble Supreme Court took note of the said principle and left it intact. The stand taken by Hon'ble Delhi Court, in our humble

understanding, stands approved. Of course, what constitutes a technical service without human interface is essentially a question of fact and each case will have to be examined on its own facts. However, as long as there is no human intervention in a technical service, in the light of law so laid down, it cannot be treated as a technical service under Section 9(1)(vii).

26. Let us now once again revert to the facts of this case. The service which is rendered by the Google is generation of certain text on the search engine result page. This is a wholly automated process. There is no dispute that in the services rendered by the search engines, which provide these advertising opportunities, there is no human touch at all. The results are completely automated and, as evident from the screenshots we have reproduced earlier in this order, these results are produced in a fraction of a second- 0.27 seconds in the screenshot reproduced earlier. For the reason that there is no human touch involved in the whole process of actual advertising service provided by Google, in the light of the legal position that any services rendered without human touch, even if it be a technical service, it cannot such a technical service which is covered by the limited scope of Section 9(1)(vii), the receipts for online advertisement by the search engines cannot be treated as fees for technical services taxable as income, under the provisions of the Income Tax Act, in the hands of the Google. The wordings of Explanation 2 to Section 9(1)(vii) as also that of the definition of fees for technical services under Article 12(2)(b) being similar in material respects, the above legal proposition equally applies to the definition under article 12 (2)(b) of India Irish tax treaty. The income earned by Google, in respect of online advertising revenues discussed above and based on the facts on record, cannot be brought to tax as income deemed to accrue or arise under section 9(1)(vii), i.e. last limb of Section 9(1), as well.

27. Once we come to the conclusion that the online advertising payments made to Google Ltd cannot be brought to tax in India, under section 5(2) r.w.s. section 9 of the Income Tax Act, we can conclude that these amounts

are not exigible to tax in India at all. The facts relating to Yahoo being admitted similar in material aspects, the same conclusion holds good in respect to Yahoo as well. We may, however, point out that since Yahoo is a USA based Delaware company and since Indo USA tax treaty provides for a make available clause which restricts the source taxation of only such technical services, referred to as ' included services' in Indo US tax treaty, as make available the technical knowledge etc. The connotations of expression 'make available' were examined by the Tribunal in the case of Raymond Ltd. vs. Dy. CIT (86 ITD 793). The Tribunal, after elaborate analysis of all the related aspects, observed that "Thus, the normal, plain and grammatical meaning of the language employed, in our understanding, is that a mere rendering of services not roped in unless the person utilising the services is able to make use of technical knowledge, etc. by himself in his business and or for his own benefit and without recourse to the performer of services, in nature". The Tribunal also held that rendering of technical services cannot be equated with making available the technical services. There are at least two non-jurisdictional High Court decisions, namely Hon'ble Delhi High Court in the case of DIT Vs Guy Carpenter & Co Ltd (2012 TII 14 HC DEL INTL) and Hon'ble Karnataka High Court in the case of CIT Vs De Beers India Pvt Ltd (TS-312-HC-2012), which uphold the same principle, and there is no contrary decision by Hon'ble jurisdictional High Court or byHon'ble Supreme Court. Accordingly, as is the settled legal position, unless services rendered by the service provider results in transfer of technology and enable the recipient of service to make use of technical knowledge by himself, and without recourse to the service provider, mere rendition of such services cannot be brought to tax as fees for technical service. Clearly, so far as online advertising is concerned, there no transfer of any technology of any kind, and as such any payment for such service is outside the ambit of source taxation under Article 12. For this reason also, the payments made to Yahoo could not be brought to tax in India.

28. In view of the above discussions, we are of the considered view, on the

limited facts of the case as produced before us,, the receipts in respect of online advertising on Google and Yahoo cannot be brought to tax in India under the provisions of the Income Tax Act, as also under the provisions of India US and India Ireland tax treaty. This observation is subject to the rider that so far as the PE issue is concerned, we have examined the existence of PE only on the basis of website *simplicitor*, and on no other additional basis, as no case was made out for the same. In any case, revenue has not brought anything on record, either at assessment stage or even before us, to suggest that Google or Yahoo had a PE in India, and as held by a Special Bench of this Tribunal in the case of Motorola Inc Vs DCIT (95 ITD 269 SB), "DTAA is only an alternate tax regime and not an exemption regime" and, therefore, "the burden is first on the Revenue to show that the assessee has a taxable income under the DTAA, and then the burden is on the assessee to show that that its income is exempt under DTAA". No such burden is discharged by the Revenue. Accordingly, there is no material before us to come to the conclusion that Google or Yahoo had a PE in India, which, in turn, could constitute the basis of their taxability in India.

29. Now that we have come to the conclusion that Google and Yahoo did not have any tax liability in India, in respect of the advertising revenues in question, the next question that we need to deal is whether or not assessee still had a tax withholding obligation in respect remittances for these online advertising payments, and whether assesse's failure to withhold taxes even when the recipient did not have tax liability could be visited with disallowance under section 40 (a)(i). It is only elementary that when recipient of an income does not have the primary tax liability in respect of an income, the payer cannot have vicarious tax withholding liability either. This position is independent of the payer having moved an application under section 195 or not, or on the payer or the payee having obtained an advance ruling in their favour or not. The law is now very well settled in this regard by Hon'ble Supreme Court's judgment in the case of GE India Technology Centre Pvt Ltd Vs CIT (327 ITR 456) wherein Their Lordships have

categorically held that, "where a person responsible for deduction is fairly certain, then he can make his own determination as to whether the tax was deductible at source and, if so, what should be the amount thereof". In the said case, Their Lordships have, rejecting revenue's reliance on Hon'ble Supreme Court's judgment in Transmission's case (supra) – which has also been referred to by the Assessing Officer, observed as follows:

> ……In Transmission Corporation case (supra) a non-resident had entered into a composite contract with the resident party making the payments. The said composite contract not only comprised supply of plant, machinery and equipment in India, but also comprised the installation and commissioning of the same in India. It was admitted that the erection and commissioning of plant and machinery in India gave rise to income taxable in India. It was, therefore, clear even to the payer that payments required to be made by him to the non-resident included an element of income which was exigilble to tax in India. The only issue raised in that case was whether TDS was applicable only to pure income payments and not to composite payments which had an element of income embedded or incorporated in them. The controversy before us in this batch of cases is, therefore, quite different. In Transmission Corporation case (supra) it was held that TDS was liable to be deducted by the payer on the gross amount if such payment included in it an amount which was exigible to tax in India. It was held that if the payer wanted to deduct TDS not on the gross amount but on the lesser amount, on the footing that only a portion of the payment made represented "income chargeable to tax in India", then it was necessary for him to make an application under Section 195(2) of the Act to the ITO(TDS) and obtain his permission for deducting TDS at lesser amount. Thus, it was held by this Court that if the payer had a doubt as to the amount to be deducted as TDS he could approach the ITO(TDS) to compute the amount which was liable to be deducted at source. In our view, Section 195(2) is based on the "principle of proportionality". The said sub-Section gets attracted only in cases where the payment made is a composite payment in which a certain proportion of payment has an element of "income" chargeable to tax in India. It is in this context that the Supreme Court stated, "If no such application is filed, income-tax on such sum is to be deducted and it is the statutory obligation of the person responsible for paying such 'sum' to deduct tax thereon before making payment. He has to discharge the obligation to TDS". If one reads the observation of the Supreme Court, the words "such sum" clearly indicate that the observation refers to a case of composite payment where the payer has a doubt regarding the inclusion of an amount in such payment which is exigible to tax in India. In our view, the above observations of this Court in Transmission Corporation case (supra) which is put in italics has been completely, with respect,

misunderstood by the Karnataka High Court to mean that it is not open for the payer to contend that if the amount paid by him to the non-resident is not at all "chargeable to tax in India", then no TDS is required to be deducted from such payment. This interpretation of the High Court completely loses sight of the plain words of Section 195(1) which in clear terms lays down that tax at source is deductible only from "sums chargeable" under the provisions of the I.T. Act, i.e., chargeable under Sections 4, 5 and 9 of the I.T. Act.

30. In view of the above discussions, as also bearing in mind entirety of the case, we are of the considered view that there was no failure in deduction of tax at source by the assessee before us inasmuch as the assessee did not have any obligation to deduct tax at source under section 195 for the simple reason that income embedded in impugned payments was not exigible to tax in India. Accordingly, the disallowance under section 40(a)(i) was uncalled for. Learned CIT(A) rightly deleted the impugned disallowance. We uphold the conclusions arrived at by the CIT(A) and decline to interfere in the matter.

31. In the result, the appeal is dismissed. Pronounced in the open court today on 12th day of April, 2013.

Sd/xx ***Sd/xx***
George Mathan **Pramod Kumar**
(Judicial Member) (Accountant Member)

Kolkata, the 12th day of April, 2013

Copies to : *(1) The appellant*
(2) The respondent
(3) CIT
(4) CIT(A)
(5) The Departmental Representative
(6) Guard File

By order etc

Assistant Registrar
Income Tax Appellate Tribunal
Kolkata benches, Kolkata