IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'F' DELHI
BEFORE SHRI R.P. TOLANI AND SHRI K.G. BANSAL

ITA No. 3073(Del)/2009
Assessment year: 1999-00

Raytheon Company, C/o S.R. Batliboi & Co, 8th floor, Golf View Corporate, Twer-B, Sector-42, Sector Rd., Gurgaon, Haryana.	Vs.	Deputy Director of Income tax, Circle 2(1), International Taxation, New Delhi.
(Appellant)		(Respondent)

Appellant by : S/Shri A.J.Majumdar, Advocate,
K.Ganesh Raj, Vikram Yadav,
Vinay Mangal, & Ms. Geeta Khanna,
Chartered Accountants.
Respondent by: Shri Ashwani Kumar Mahajan, CIT,DR

ORDER

PER K.G. BANSAL : AM

This appeal emanates from the order of CIT(Appeals)-XXIX, New Delhi, passed on 30.03.2009 in appeal nos. 405/06-07, 216/06-07 and 43/08-09. The corresponding assessment order was framed by the Deputy Director of Income-tax, Circle 2(1), International Taxation, New Delhi ("the AO"), on 27.12.2006, under the provisions of section 147 read with section 143(3) of the Income-tax Act, 1961 ('the Act' for short). The assessee has taken the following grounds in the appeal:-

> "On the facts and in the circumstances of the case, the ld. Commissioner of Income-tax (Appeals)-XXIX, New Delhi:-

Validity of reopening

1. Erred in holding that the reasons as recorded by the ld. Deputy Director or Income-tax, Circle 2(1), International Taxation, New Delhi ("Assessing Officer"), while initiating proceedings under section 147 of the Income-tax Act, 1961 ('Act') constituted sufficient reasons for arriving at a belief that income of the appellant has escaped assessment during the assessment year under consideration.

2. Erred in holding that the Assessing Officer has rightly rejected the objections filed by the appellant in response to the notice issued under section 148 of the Act.

Treating separate supply and service contracts on indivisible one contract

3. Erred in holding that the two separate contracts for supply of equipments and for installation services and training entered into by the appellant and Airport Authority of India ('AAI') represents a single indivisible turnkey contract for services, installation, commissioning and supply.

4. Erred in holding that the Assessing Officer was correct in arbitrarily bifurcating revenue earned by the appellant during the previous year, between income from supply of equipment and royalty in the ratio of 30 per cent and 70 per cent, respectively.

5. Erred in holding that the Assessing Officer was correct in holding that the major portion (70 per cent) of the contract price for overseas supply of equipments constituted royalty and fees for included services, for grant of right of use of copyright of computer software and services, without appreciating that the contract was predominantly for supply of equipments with embedded software and no such split was provided in the contract.

6. Erred in upholding the action of the Assessing Officer in estimating that 70 per cent of the contract receipts from supply of equipments, constitutes royalty as well as fees for included services taxable under Article 12 of India-US DTAA and 50 per cent of the profit from supply of equipments calculated with reference to 30 per cent of the contract receipts as income attributable to the PE of appellant in India.

Relying on AAR Ruling

7. Was not justified in proceeding to decide the appeal by misunderstanding the fact that the appellant (and not AAI) has obtained Advance Rulings dated 15 December, 2004 (185 Taxation 494) and 28 February 2008 (299 ITR 102) from the Hon'ble Authority of Advance Rulings ("AAR").

8. Erred in supporting his decision by observing that it is supported from three rulings of the AAR that income of the appellant in respect of software and provision of services of installation, testing and training is taxable under the Act, when in fact all the three Rulings of the AAR were based on subsequent separate agreements between appellant and AAI for repair of equipments and modifications and anomaly resolution of computer software supplied under MATS contracts and for independent supply of equipments etc. for Indian Air Force.

9. Erred that the finding in the rulings of the AAR dated 28.7.2008 was clearly applicable to the facts of the appellant's case for the assessment year under consideration and the estimate of taxation of payments of software as well as hardware has to be carried out as indicated by the AAR.

Permanent Establishment in India.

10. Erred in confirming that the appellant had fixed place Permanent Establishment ("PE") in India at the premises of AAI in Delhi and Mumbai, as it had project office in India.

11. Erred in holding that the appellant constitutes an Installation PE as well as service PE in India in terms of Article 5(2)(k) and 5(2)(l) of the India-US DTAA, during the previous year.

12. Erred in holding that the contract for offshore supply of equipment is an integral part of the activities carried out by PE in India and the income from supply of equipment is attributable to the said PE in India.

Taxability based on completed contract

13. Erred in holding that the accrual of income in the case of the appellant has to be determined according to completed contract method, and the income from the contract dated 19.3.1993 should be assessed as the contracts were completed during the previous year.

14. Erred in holding such lump sum consideration for supply of equipments has accrued to the appellant after completion of contract and not at the time the title in the equipments along with embedded software passed to AAI on delivery abroad.

15. Was not justified in holding that 100% of the installation revenues relatable to Mumbai and Delhi airport are attributable to installation PE in India, during the previous year, disregarding the fact that both supplies and services under the above contracts were substantially completed prior to April 1, 1998.

Estimation/working of profit

16. Without prejudice to the above, the ld. Commissioner of Income-tax (Appeals)-XXIX, New Delhi has erred on facts and in law in applying the rate of13.4% from global accounts of year ending December 1998, whereas he ought to have

taken weighted average profit margins for December 1998 and December 1999.

17. Erred in upholding the action of the Assessing Officer in converting incomes and taxes by applying an exchange rate of USD 1= Rs. 42.50, i.e., the exchange rate applicable as on 31 March 1999 ignoring the fact that Rule 115 is not applicable in the case of appellant and that revenue was received by the appellant over the period 1993-94 to 1998-99.

Disallowance of R&D Expenses

18. Erred in upholding the action of the Assessing Officer to disallow research and development expenditure while computing the global profit margins for attributing business income of PE of appellant in India.

Levy of Interest

19. Erred in upholding the action of the Assessing Officer in levying interest under section 234B and 234C of the Act.

20. Erred in upholding the action of the Assessing Officer to levy interest under section 220(2) of the Act in as much as such interest cannot be levied by passing an order under section 154 of the Act."

2. The facts of the case, as mentioned in the assessment order, are that the assessee is a company incorporated in the USA and it is engaged in various businesses such as supply of defence equipments, aircraft landing systems, satellite related equipments etc. M/s Raytheon International Inc. ("RII" for short) is one of the divisions of the assessee company. Its main object is to represent the assessee in various

countries through its offices. In pursuance of this objective, it has maintained an office ("LO" for short) in India since 1995. For this year, the assessee had not filed the return of income under the provisions of section 139(1) of the Act. However, the AO had reason to believe that income chargeable to tax escaped assessment due to failure on the part of the assessee in filing the return. Therefore, reasons were recorded u/s 147 and notice was issued u/s 148 of the Act. In response to this notice, the assessee filed the return on 31.08.2006, declaring total income of Rs. 45,91,740/-. The assessment proceedings were initiated by issuing notice u/s 143(2) on 31.08.2006. This notice was followed by other notices and questionnaires. On the basis of facts gathered in the course of the proceedings and the representations made by the assessee, the tax payable was determined at Rs. 33,98,99,441/- as under:-

> "Income from supply of hardware
>
> The contract price as stated in para 4.1 describes it at accumulative of USD 82.011 million.
>
> In the discussion made above, it has been inter-alia held that
>
> a. Income of the assessee arising from the contract is taxable in the assessment year under consideration.
>
> b. Royalties and FIS constitute 70% of total value of contract and remaining 30% is towards supply of equipment.

Therefore 70% of the total value of contract i.e., USD 82,011,600 is held taxable on gross basis at the rate of 15%.

Total value of royalties/FIS = USD 57,408,120

Tax @ 15% thereof as per DTAA = USD 86,11,218

Converted into INR @ 35.16 the same comes to INR 31,12,95,530……..A

The assessee did not submit the profit margin in respect of equipment supplied to India. By the global accounts submitted by the assessee, the profit arising from the Indian transactions cannot be definitely ascertained hence following the provisions of Rule 10, the financial statement of the assessee has to be recast to arrive at the correct percentage of profit that is likely to accrue to the assessee from its Indian profits. For arriving at the profit from supply of equipment, the annual report of the assessee for the year ending 1998 is resorted to.

Net profit in the global accounts from sales has been shown at 13.4% of the net sales. This is excluding research and development expenses.

Total value of equipment supplied is taken at 30% of the value of the contact which is USD 24,603,480 (30% USD 82,011,600). Converted into INR @ 36.15 the same comes toRs.88,94,15,802/-. Net profit arising out of the above supply shall be Rs. 11,91,81,717/-. 50% of the same is being attributed to Indian operations on account of the fact manufacturing operations were carried out outside India. So net taxable profit from supply of equipment comes to Rs. 5,95,90,858/-.

Taxable @ 48% as business profit Rs. 2,86,03,611……..B

Total tax = A+B= Rs. 33,98,99,441/-”

3. Aggrieved by this order, the assessee filed appeal before the ld. CIT(Appeals), who disposed it off on 30.3.2009. In this order, the ld. CIT(A) also disposed off other appeals of the assessee in respect of orders passed for this year under sections 154, 220(2) and 143(1). All the appeals were partly allowed. Aggrieved by this order, the assessee is in appeal before us. We are concerned with the matters arising in the assessment order passed on 27.12.2006 u/s 147 read with section 143(3).

4. In the course of hearing, it was informed that the assessee had earlier moved an application dated 31.1.2007 before the competent authority for settlement of the case under Mutual Agreement Procedure (MAP). However, no consultation took place on this application. In view thereof, it is insisted by the ld. counsel for the assessee that the tax-liability of the assessee may be determined on merits and the appeal may be proceeded with.

5. The assessee has taken objection regarding the validity of making assessment u/s 147. It is mentioned in ground nos. 1 and 2 that the ld. CIT(A) erred in upholding the reasons recorded by the AO u/s 147 and that he had reason to believe that the income escaped assessment. It is further mentioned that he erred in holding that the AO was right in

rejecting the objections filed by the assessee to the issuance of notice u/s 148. In this connection, the ld. counsel drew our attention towards the reasons recorded by the AO and placed in the paper book on page nos. 230 and 231, which read as under:-

> "The assessee is a company incorporated in USA. The assessee has entered into a contract with Airport Authority of India (AAI) on 04.02.2003 entitled "Contract for Software Maintenance Support". The stipulates:
>
> *"WHEREAS Raytheon had supplied to the AAI the MATS-BD System and AAI is in possession of the said systems since March 1998 for Delhi and June 1999 for Mumbai*
>
> *AND WHEREAS the AAI has been operating and maintaining the said system independently*
>
> *AND WHEREAS the software supplied by Raytheon under the said system need anomaly resolution/modification from time to time.*
>
> *AND WHEREAS Raytheon has proposed to resolve the anomalies and modify the software outside India.*
>
> *NOW this Contract sets forth the terms and conditions for Raytheon to resolve the anomaly/modify the software of the MATS-BD Systems of the AAI."*
>
> From the above, it is clear that the assessee was maintaining and operating the system till June 1999 and thereafter this work was undertaken by the AAI. Further, the system need anomaly resolution/modification from time to time and the formal contract for that purpose was entered into only on 04.02.2003. However, it is clear that the system has been constantly handled by the assessee for anomaly resolution/modification from time to time. The system is the

proprietary of the assessee and it is the assessee alone who can resolve anomaly if any. The contract price of the above said contract is more than USD 6 million and the amount shall not be less than Rs.1,00,000 in the relevant assessment year.

On the same day i.e., 04.02.2003, AAI has entered into a contract with Gintex India Ltd. for in-country maintenance of the aforesaid systems. This agreement informs that there is another agreement between AAI and Raytheon for Hardware Repair Support for the said systems.

Further, the assessee has not been filing its return of income in India and therefore, the case of the assessee is covered under Explanation 2 to section 147 of the Income-tax Act, 1961, which is reproduced below for ready reference:-

> *Explanation 2- For the purposes of this section, the following shall also be deemed to be cases where income chargeable to tax has escaped assessment, namely:-*
>
> *(a) where no return of income has been furnished by the assessee although his total income or the total income of any other person in respect of which he is assessable under this Act during the previous year exceeded the maximum amount which is not chargeable to income-tax;*
>
> *(b) where a return of income has been furnished by the assessee but no assessment has been made and it is noticed by the Assessing Officer that the assessee has understated the income or has claimed excessive loss, deduction, allowance or relief in the return;*
>
> *(c) where an assessment has been made, but:-*

(i) income chargeable to tax has been under-assessed; or

(ii) such income has been assessed at too low a rate; or

(iii) such income has been made the subject of excessive relief under this Act; or

(iv) excessive loss of depreciation allowance or any other allowance under this Act has been computed.

In view of the foregoing, I have reasons to believe that income chargeable to tax has escaped assessment for the relevant assessment year within the meaning of Section 147 r.w.s. 148 of the Income-tax Act, 1961."

5.1 It is submitted that the AO referred to Software Maintenance & Support Contract dated 4.2.2003 in respect of MATS- BD system, which was set up by the assessee for the Airport Authority of India ("AAI" for short) in March, 1998, in Delhi and June, 1999, in Bombay. On the basis of this contract, he was of the view that after supplying the system, the assessee was carrying on maintenance operation, more so because the system required anomaly resolution and modifications from time to time. Therefore, although the contract was formally entered into on 4.2.2003, the system has been consistently handled by the assessee. The value of the contract is placed at six million US$ and, thus, the amount relatable to this year will not be less than Rs. 1 lakh. It is further mentioned that on the

same day, AAI entered into another contract with Gintex India Ltd. for in-country maintenance of the system, which takes note of another contract between the assessee and the AAI for hardware repair support of the system. The case of the ld. counsel is that the recorded reasons do not have intelligible nexus with the belief that the income chargeable to tax in this year had escaped assessment. The reasons recorded by the AO do not mention that the income arising to the assessee from supply of equipment and software to the AAI at Delhi and Bombay on the basis of a contract ("MATS-BD contract" for short) escaped assessment. The reason recorded by him is that a part of income from hardware and software maintenance contract dated 04.02.2003 escaped assessment. While framing the assessment, no income was assessed from this contract. Instead profits from MATS-BD contract were brought to tax. Therefore, it is argued that the reasons recorded by him do not satisfy the test laid down u/s 147 of the Act. In this situation, the assessment is required to be cancelled as jurisdiction to make assessment has not been properly assumed by the AO. In this connection, reliance has been placed on the decision of Hon'ble Supreme Court in the case of Ganga Saran & Sons (P) Ltd. Vs. ITO & Others, 130 ITR 1 and ACIT Vs. Rajesh Jhaveri Stock Brokers P. Ltd. (2007) 291 ITR 500.

5.2 In reply, the ld. DR submitted that the assessee did not file the return of income u/s 139(1). Therefore, on the basis of information available with the AO, he recorded the reasons and issued notice u/s 148. In response to this notice, the assessee filed the return declaring total income of Rs. 45,91,740/-. The assessee obtained the reasons recorded by the AO and filed objections, which were duly disposed off. Thus, the procedure laid down in the statute and by the Hon'ble Supreme Court in the case of GKN Drive Shaft (India) Ltd. Vs. ITO (2003) 215 ITR 19, regarding disposal of objections, has been duly followed in this case. Our attention is drawn to page no. 10 of the impugned order, in which it is mentioned that the requirement of the expression "reason to believe" used in section 147 is that the AO has some material on record on the basis of which a prima facie belief could be arrived at that income had escaped assessment. He does not have to conclusively prove the escapement of income at this stage, as held by the Hon'ble Supreme Court in the case of Raymond Woolen Mills Ltd. (1999) 236 ITR 34. It is argued that even on the basis of Software Maintenance Support Contract dated 4.2.2003, a man of common prudence could have come to the conclusion that the assessee would have earned revenues from the

AAI in respect of anomaly resolution, modification and maintenance of the MATS-BD system, as it is the proprietary of the assessee and it is the assessee alone who could render such services. Therefore, it is strongly contended that the reasons recorded by the AO have direct nexus with the escapement of income.

5.3 We have considered the facts of the case and submissions made before us. From the reasons recorded by the AO, it is clear that he was of the view that income arising on account of software maintenance, anomaly resolution and modification of the software pertaining to MATS-BD systems escaped assessment. In this connection, he referred to the contract dated 4.2.2003, which also includes a short history of supply of MATS-BD system to the AAI. In particular, it is mentioned that the system for Delhi was supplied in March, 1998, and for Mumbai in June, 1999. It is further mentioned that the software requires anomaly resolution and modification from time to time. It is also mentioned that the assessee made a proposal to resolve the anomaly and to carry out modification outside India for which the terms and conditions are set forth in the contract. The case of the ld. counsel is that the aforesaid contract will start yielding income at the earliest on 4.2.2003, a date

which falls beyond this year. Therefore, the AO had no reason to believe that any income of this year escaped assessment. On the other hand, the case of the ld. DR is that the software was the proprietary of the assessee and only it could carry out anomaly resolution and modification, which according to the agreement were required from time to time. Therefore, on the basis of this averment in the recitals of the agreement, any reasonable person will come to a conclusion that the anomaly resolution and modification were required in past and were carried out by the assessee. Therefore, there existed live link between the recitals and escapement of income. The assessee had not filed the return of income for this year and consequently no assessment had been made. Further, on the basis of contract-price mentioned in the agreement dated 4.2.2003, the AO came to the conclusion that income of this year will not be less than Rs. 1.00 lakh. This conclusion is also reasonable looking to the consideration mentioned in the agreement dated 4.2.2003. Therefore, there was a reason to believe that the income escaped assessment.

5.4 We may now briefly discuss the cases cited by the rival parties. In the case of Ganga Saran & Sons (P) Ltd. (supra), the facts are that the assessee obtained reduction in his taxable income on account of salary

paid to Deo Dutt as also all the perquisites given to him for several years. These were allowed. Subsequently, the files of the assessee and Deo Dutt were brought together and upon scrutiny it was found that –(a) he did not draw his full salary and major portion thereof remained credited with the books of the company; (b) he granted a large loan to the Managing Director, who was his sister's husband; (c) out of the loan he made a gift of Rs. 1,01,101/- to his sister; (d) he made further gifts to his nephews and nieces, and (e) the major portion of his salary and other emoluments, which had not been withdrawn, went to the Managing Director and the members of his family as loans and gifts. On these facts, the AO came to the conclusion that excess claim of salary and perquisites had been made in computation of the income made by the assessee. Therefore, the assessment was reopened u/s 147(a), as it then existed. This provision requires as pre-condition for assuming jurisdiction that –(i) the AO has reason to believe that the income had escaped assessment, and (ii) such escapement is by the reason of omission or failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment. The Hon'ble Court held as under:-

> "We may point out that, in fact, the statements of account of Deo Dutt Sharma with the assessee for the relevant accounting year as also the previous years were with the ITO at the time of original assessment and these statements

> of account clearly showed that out of the amount of remuneration credited to his account, he had made a gift of Rs. 12,550/- to the son of Ganga Saran Sharma on 31st July, 1957, and given a loan of Rs. 2,25,000/- to Ganga Saran Sharma on 25th August, 1958, and the ITO was fully aware that Ganga Saran Sharma was the managing director of the assessee. It is possible and we may assume it in favour of the revenue, that the subsequent gifts made by Deo Dutt Sharma to the wife and daughters-in-law of Ganga Saran Sharma were not disclosed to the ITO at the time of the original assessment, but these gifts being subsequent to the relevant accounting year, the assessee was not bound to disclose the same to the ITO. Moreover, it is difficult to appreciate how the assessee could be said to be under an obligation to disclose to the ITO in the course of its assessment as to how a director who was in sole charge of the management of the business of the assessee and who was being paid remuneration for the services rendered by him to the assessee, had utilized the amount of remuneration received by him. We do not think it possible to sustain the conclusion that the assessee omitted or failed to disclose fully and truly any material facts relating to its assessment.
>
> We must, in the circumstances, hold that neither of the two conditions necessary for attracting the applicability of s. 147(a) was satisfied in the present case and the notice issued by the ITO must be held to be without jurisdiction."

5.5 In the case of Rajesh Jhaveri Stock Brokers (P) Ltd. (supra), the facts are that the assessee is a private limited company. It filed its return of income for assessment year 2001-02 on 30.10.2001, declaring total loss of Rs. 2,70,85,105/- This return was processed u/s 143(1). Thereafter, notice u/s 148 was issued on the ground that the claim of bad debts was not acceptable. The assessee filed return u/s 148 on

12.5.2004, declaring the same loss. A copy of the reasons recorded by the AO was furnished to the assessee in November, 2004. The assessee raised various objections regarding jurisdiction and merits of the reasons. These objections were disposed off on 4.2.2005 holding that initiation of proceedings was valid. The notice was challenged before the Apex Court in writ petition. The Hon'ble Court held as under:-

> "The scope and effect of section 147 as substituted with effect from April 1, 1989, as also sections 148 to 152 are substantially different from the provisions as they stood prior to such substitution. Under the old provisions of section 147, separate clauses (a) and (b) laid down the circumstances under which income escaping assessment for the past assessment years could be assessed or reassessed. To confer jurisdiction under section 147(a) two conditions were required to be satisfied: firstly the Assessing Officer must have reason to believe that income, profits or gains chargeable to income tax have escaped assessment, and secondly he must also have reason to believe that such escapement has occurred by reason of either omission or failure on the part of the assessee to disclose fully or truly all material facts necessary for his assessment of that year. Both these conditions were conditions precedent to be satisfied before the Assessing Officer could have jurisdiction to issue notice under section 148 read with section 147(a). But under the substituted section 147 existence of only the first condition suffices. In other words if the Assessing Officer for whatever reason has reason to believe that income has escaped assessment it confers jurisdiction to reopen the assessment. It is, however, to be noted that both the conditions must be fulfilled if the case falls within the ambit of the proviso to section 147. The case at hand is covered by the main provision and not the proviso.

> So long as the ingredients of section 147 are fulfilled, the Assessing Officer is free to initiate proceeding under section 147 and failure to take steps under section 143(3) will not render the Assessing Officer powerless to initiate reassessment proceedings even when intimation under section 143(1) had been issued."

5.6 In the case of Raymond Woollen Mills Ltd.(supra), a case decided u/s 147(a), the decision of the court is as under:-

> "In this case, we do not have to give a final decision as to whether there is suppression of material facts by the assessee or not. We have only to see whether there was prima facie some material on the basis of which the Department could reopen the case. The sufficient or correctness of the material is not a thing to be considered at this stage. We are of the view that the court cannot strike down the reopening of the case in the facts of this case. It will be open to the assessee to prove that the assumption of facts made in the notice was erroneous. The assessee may also prove that no new facts came to the knowledge of the Income-tax Officer after completion of the assessment proceeding. We are not expressing any opinion on the merits of the case. The questions of fact and law are left open to be investigated and decided by the assessing authority. The appellant will be entitled to take all the points before the assessing authority. The appeals are dismissed. There will be no order as to costs."

5.7 It may be mentioned here that section 147, as applicable to the case in so far as we are concerned, reads as under:-

> "If the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year, he may, subject to the provisions of sections 148 to 153,

> assess or reassess such income and also any other income chargeable to tax which has escaped assessment and which comes to his notice subsequently in the course of the proceedings under this section, or re-compute the loss or the depreciation allowance or any other allowance, as the case may be, for the assessment year concerned (hereafter in this section and in sections 148 to 153 referred to as the relevant assessment year):
>
> Provided that where an assessment under sub-section (3) of section 143 or this section has been made for the relevant assessment year, no action shall be taken under this section after the expiry of four years from the end of the relevant assessment year, unless any income chargeable to tax has escaped assessment for such assessment year by reason of the failure on the part of the assessee to make a return under section 139 or in response to a notice issued under sub-section (1) of section 142 or section 148 or to disclose fully and truly all material facts necessary for his assessment, for that assessment year."

5.8 The provision contained in this section is materially different from the provision contained in section 147(a) as it existed prior to the amendment of section 147 by Taxation Laws (Amendment) Act, 1987, coming into force from assessment year 1989-90. This change has been taken note of by the Hon'ble Supreme Court in the case of Rajesh Jhaveri Stock Brokers (P) Ltd.

5.9 Coming to the relevant facts, the assessee had not filed the return of income u/s 139(1). Therefore, the provision contained in clause (a) of

Explanation 2, referred to by the AO, is applicable provided the income of the previous year exceeds the maximum amount not chargeable to income-tax. The assessee is a company and, therefore, it is liable to pay tax on any income and the provision regarding 'maximum amount which is not chargeable to income-tax" is not applicable. Since the assessee has not filed the return u/s 139(1) and no assessment has been made prior to this assessment, the provision contained in first proviso to this section is also not applicable. Therefore, the only condition to be seen is whether the AO had reason to believe that any income chargeable to tax escaped assessment. In this connection, the AO based his "reason to believe" on the contract dated 4.2.2003, which inter-alia mentions that the systems supplied to AAI in March, 1998, and June, 1999, require anomaly resolution and modification from time to time. From this, the AO concluded that such services were required from the date of supply of the systems up to the date of this agreement. Looking to the consideration mentioned in the agreement, he also came to the conclusion that income of the assessee from such services will not be less than Rs. 1.00 lakh. We are of the view that these are reasonable conclusions which a man of normal prudence can draw from the recitals of the agreement dated 4.2.2003. It may be mentioned that the recital also contains averment to the effect that the

AAI has been operating and maintaining the said systems independently. However, this recital is only in respect of operation and maintenance and not in respect of anomaly resolutions and modifications which are ostensibly required from time to time. Therefore, this recital regarding operation and maintenance does not come in conflict with the recital regarding anomaly resolution and modification of the systems. In the case of Raymond Woollen Mills, the Hon'ble Supreme Court held that it is not for the AO to prove conclusively that income had escaped assessment at this stage. What is required is to be seen is whether there are on a prima-facie basis reasons to believe that the income escaped assessment. Therefore, subsequent non-taxation of service charges from service rendered in respect of anomaly resolution and modification of systems need not be considered here, as the same is not relevant at this stage of the proceedings. The facts of the case of Ganga Saran & Sons (P) Ltd. (supra) are clearly distinguishable for the reason that the assessee had declared all the facts known till the close of the previous year and he was not bound to disclose subsequent gifts or loans. Moreover, the assessee was a regular assessee and similar facts had been disclosed in the returns over a period of time. In the instant case, the assessment has been made for the first time in this year on the basis of notice issued u/s 148. There

is no question of disclosure of information in such a situation. Further, the validity of issuance of notice u/s 148 does not depend upon disclosure of all material facts as it has been held earlier that the only condition to be seen is whether the AO had the "reason to believe". In the case of Rajesh Jhaveri Stock Brokers (P) Ltd., the court distinguished between the provision contained in section 147 as applicable now and the provision contained in the omitted section 147(a). It has been held that so long as ingredients of section 147 are fulfilled, the AO is free to initiate proceedings u/s 147. In that case, the return filed by the assessee had been processed u/s 143(1) before recording of reasons u/s 147 and, therefore, it was held that since no opinion is formed while processing the return u/s 143(1), there is no question of change in opinion. In this case, no return of income had been filed by the assessee prior to recording of reasons and issuance of notice u/s 148. Therefore, the case of the revenue stands on stronger footing than the case of aforesaid Rajesh Jhaveri. We have already held that recitals to agreement dated 4.2.2003 will lead any man of common prudence to come to a conclusion that the assessee had earned income from anomaly resolution and modification of systems in this year. Therefore, we are of the view that the AO was well within

his right to issue notice u/s 148 for making assessment for the first time in this case.

6. Ground no. 3 is in respect of the issue as to whether the two contracts regarding supply of equipment and software and supply of services for installation, training etc. constitute two separate and distinct contracts or part of one contract. It is mentioned that the ld. CIT(A) erred in holding that the two separate contracts form a single indivisible turn-key contract for supply, installation and commissioning of the air traffic system ("ATS" for short).

6.1 In this connection, the ld. counsel referred to the two contracts placed in the paper book from page nos. 1 to 155 and 156 to 194. Both these agreements have been entered into with the AAI on 19.03.1993. The recital to the first agreement inter-alia states that the NAA invited offers for the supply and installation of ATS at Bombay and Delhi together with transfer of technology under its notice No. BB/DP/MOD/1/91-NAA dated March 19, 1991. The assessee had offered to supply the equipments and services for the ATS in accordance with Price Adjustment Bid REK: 5876:92:294 dated 7.7.1992 and the NAA has accepted its offer.

Thereafter, Article 1 furnishes definition of 19 terms for the purpose of the agreement.

6.2 Article 2 deals with the scope of the agreement. It is mentioned that the ATS to be provided under the agreement is specified in Exhibit-A, statement of work, attached hereto and incorporated herein by reference. It is further mentioned that under a separate contract, the assessee shall be responsible for installation and training in support of the ATS. It is also mentioned that the work covered by the contract shall commence immediately upon the effective date of this contract and shall be completed in stages on or before the dates mentioned in time schedule of completion of work. The assessee shall bear in mind that time is the essence of the contract and time schedule including progress time schedule as provided for in this contract or such extended time schedule, as is mutually agreed, shall be strictly adhered to. It is also mentioned that in case the assessee delays System Site Acceptance Test ("SAT" for short) as specified in terms of this contract beyond 30 days after its specified completion date, the NAA shall be entitled to recover from the assessee or deduct from the payment due to the assessee as liquidated damages an amount equal to 1% of the contract price for each week of delay beyond

the aforesaid 30 days specified for completion of the work, up to a maximum of 7.5% of the contract price. It is also mentioned that the assessee agrees to provide the necessary information to operate, maintain and repair the equipment delivered under the contract. The documents furnished by the assessee to the NAA which are in the possession of the assessee prior to the date of this contract, or which are deployed mainly on the basis of proprietary concept contained in these documents, shall be the property of the assessee. The NAA shall be entitled only to use such documents and copies in connection with operation, repair and maintenance of the ATS. All other documents and copies thereof developed independently by the assessee in connection with the work shall be the property of the assessee. The NAA may however use such documents and copies for any purpose for the use of the ATS. In respect of computer software technical documentation required to operate the equipments to be sold to the NAA under this contract, the assessee shall grant to the NAA a license to use computer software and technical documentation for use of the ATS. The license shall provide that such computer software and documentation : (i) includes property of Her Majesty the Queen in Right of Canada and are to be used or copied only for the purpose of operating the article or thing in which they are contained. The assessee shall mark

the article or thing containing the computer software and technical documentation with the legend ……. The assessee agrees that technical data referred to above shall only be used, reproduced, adapted or modified by the NAA for the purpose of Bombay & Delhi ATS. The license agreement shall be entered into with the assessee or other proprietors of such rights for use at other locations of the NAA. The assessee shall not unreasonably withhold his agreement for such license and shall ensure that other proprietors of such rights shall not unreasonably withhold their agreements for such license. Such agreement shall be subject to a license fees which shall be fair and reasonable. It is also provided that royalities and fees for patents covering materials, articles, apparatus, devices, equipments or processes used in the works shall be deemed to have been included in the contract price. The assessee shall satisfy all demands that may be made at any time for such royalities or fees and he alone shall be liable for any damages or claims for patent infringements and shall keep the NAA indemnified in this regard. The assessee shall at his own cost and expense defend all suits and proceedings that may be instituted for alleged infringement for any patents involved in the works and in case of an award of damages, he shall pay for such award. In the event of any suit or other proceedings

instituted against NAA, the same shall be defended at the cost and expense of the assessee, who shall also satisfy any decree or order of award made against NAA. But it shall be understood that no such equipment, sub-system, work, material or thing has been used by NAA for any purpose or in any manner other than that for which they have been furnished and installed by the assessee. It is also mentioned that the assessee shall implement a plan for transferring software technology for the radar data processing system ('RDPS' for short) and the flight data processing system ('FDPS' for short). The plan shall include a transfer of technology to the NAA staff and to Indian industry. The contractor shall train six NAA system software engineers at its facilities in the United States for a period of six months. These engineers shall participate in a series of software courses covering computer languages, UNIX, and software development methodology. NAA engineers will work directly with the contractor's personnel on the software development and testing. In addition, the training programme includes a three week course of instruction, which is to be given in India. This course includes a discussion on the system architecture, design and implementation. Topics relating to aspects of software maintenance shall be included. A team of four engineers drawn from Indian industry will

also receive similar training. In respect of software source code, it is agreed that as a part of transfer of technology, the assessee shall deliver the computer source code for the RDPS and FDPS software. Usage of software source and any resulting executable images is limited to systems delivered under this contract to the NAA for the MATS-BD Program (Bombay and Delhi) by the assessee. The assessee will also enter into an agreement with the NAA and an organisation or company representing Indian industry concerning software training and use of software source code prior to 30 days before critical design review ("CDR" for short).

6.3 Article 3 of the agreement inter-alia provides for the delivery point of all the equipments, spares, tools and test equipments to be CIP (as per INCOTERMS) Bombay and Delhi Airports. For the equipments to be installed outside Bombay and Delhi Airports, delivery shall be to the designated point of installation. It is also provided that responsibility for customs clearance and securing other approvals for shipment of equipments, materials and supplies into India shall be that of the NAA.

6.4 Article 4 deals with the consideration and its payments for the contract. The same is depicted in the table given below:-

Country	Program Price	Credit Agency Fees	Total Price
United States	$52,027,100	$1,087,100	$53,114,200
Canada	$15,303,000	$1,294,600	$16,597,600
Spain	$6,093,200	$169,000	$6,262,200
United Kingdom	$5,431,600	$606,000	$6,037,600
Total Contract	$78,854,900	$3,156,700	$82,011,600

The aforesaid payment is to be made on 10 different dates between 30.11.1993 and 30.9.1995, upon completion of a particular activity starting from completion of preliminary design review ('PDR' for short) and ending with system site acceptance test completion.

6.5 Article 5 inter-alia provides that the assessee shall at his cost arrange, secure and maintain insurance as may be necessary and for all such amounts to protect his interest and the interest of NAA against all risks during the period of contact. It will be his responsibility alone. Any loss

or damage to the equipment during clearance, handling, transportation, installation and testing, till such time the total system is taken over by the NAA shall be to the account of the assessee. The transfer of title shall not in any way relieve the contractor of this responsibility during the period of the contract. All costs on account of insurance liabilities will be on contractor's account and will be included in the contract price.

6.6 Article 9 inter-alia deals with the transfer of property, and it is provided that the property in equipments, sub-systems, systems to be applied to the NAA shall pass to it when the same are dispatched for delivery. Thereafter, the assessee shall be in possession of and will have the custody of equipments, sub-systems and systems for the purpose of transportation to site, its installation and site acceptance test. It shall hold the same on behalf of NAA and shall not deal with the same in any manner except for the purpose of this contract. The assessee shall hold the equipments etc. handed over to him by NAA as trustee on behalf of it without having any lien or charge against the equipment at any stage. It is also provided that notwithstanding the transfer of property in the equipments, the systems etc., the assessee shall not be absolved from

responsibility to execute the works in its entirety as if the contract was an entire and indivisible turn-key basis work contract.

6.7 As mentioned earlier, another agreement, termed as "service contract" by the assessee, was entered into between the assessee and the AAI on the same day, i.e. 19.3.1993. Recital to this contract is the same as in supply contract. Article 1 of this contract furnishes definitions of 19 terms. Article 2 is in connection with the scope of the contract. It is inter-alia mentioned that installation service and training to be performed in India by the assessee under this contract are specified in Exhibit-A, statement of work, sections 8, 9.1.3., 9.1.4., 9.1.7, 9.1.8, (In India portion), 9.1.9 and 9.1.10, which is attached with the agreement. The consideration of the contract is placed at US$ 23,04,400. The payments are to be made in eight installments starting from 30.09.1994 and ending on 30.9.1995 depending upon the milestone starting with mobilization and ending with Bombay SAT. The other terms are the same as in the first supply contract.

6.8 The ld. CIT(Appeals) dealt with this issue on page nos. 22 to 35 of his order. Initially, he summarized the findings of the AO which are that

the contracts are for modernization of the ATS at Delhi and Bombay. The ATS includes flight information service, air traffic control service, air control service, approach control service, altering service, air traffic advisory service and airport control service. The tender document is a detailed one in four volumes, which includes pre-qualification, technical, commercial and financial in nature. The bidders are deemed to have visited the site and examined the tender documents thoroughly, and obtained all information for the execution of the work. The project is awarded on a turn-key basis as mentioned in the document. It requires designing, manufacturing, supplying, installing, integrating, testing and commissioning of modern, efficient and automated ATS. It also provides for training of air traffic controllers and engineers for operating and maintaining the system. Thus, fully working system, meeting the requirements has to be handed over to the NAA. Thereafter, he considered the arguments of the ld. counsel and mentioned that the question is one of fact and the cases relied upon by the assessee may not be of any help unless it is fully established that the facts are in pari-materia. He referred to the rulings of Authority for Advance Ruling in respect of subsequent contracts between the assessee and the AAI. It has been mentioned that although these rulings are in respect of subsequent

contracts, they throw important light on the nature of work done by the assessee. It has been held that the payments made to the assessee-company in respect of software and providing services of installation, testing and training are taxable in India both under the Act and the DTAA. These rulings were furnished on 4.3.2003, 26.4.2006 and 20.2.2007. It is clarified by the ld. CIT(A) that the finding of non-existence of the PE is only in respect of these agreements only. Finally, it has been held that the two agreements constitute one agreement in the nature of a works contract for hading over functioning ATS at Delhi and Bombay to the AAI. The payments received by the assessee are, thus, to be considered for taxation in India on the basis of aforesaid finding.

6.9 Before us, the ld. counsel submitted that the assessee entered into two contracts with the AAI on 19.3.1993. The first contract is for supply of equipments, materials and software for the ATS. All the supplies were to be made from abroad for a consideration of US$82 millions. The consideration was also payable outside India. The second contract is for the purpose of installation of the ATS and training of the personnel. The consideration of this contact was about US$ 2.3 millions. The AO and the

ld. CIT(Appeals) are of the view that these two contracts constitute one composite turn-key works contract.

6.10 It is further submitted that the taxation of business income of a non-resident person is governed under the Income-tax Act and the DTAA. The relevant sections of the Act are 5(2) and 9(1)(i). Under the former provision, the income received or deemed to be received, accruing or arising or deemed to accrue or arise in India is brought to tax. Section 9 deals with the income which is deemed to accrue or arise in India. Therefore, it has to be seen whether there existed in India a business connection of the assessee through which its business was carried on. This has to be examined in the light of the decision of Hon'ble Supreme Court in the case of R.D.Agarwal, 56 ITR 20. Further, if such a business connection exists, only that portion of income can be brought to tax under the Act as is reasonably attributable to the operations carried out in India. Under Article 7 of the DTAA, the profits of an enterprise can be brought to tax only if its business is carried out wholly or partly through a PE. Again only so much of the profits can be brought to tax which are attributable to the PE. Thus, it will be seen that both under the Income-tax Act and the treaty, the profit is to be apportioned between the taxable

territories. In the case of Ishikawajima Harima Heavy Industries Ltd. Vs. Director of income-tax, Mumbai (2007) 288 ITR 408 (SC), it has been held that where different severable parts of a composite contract are performed in different jurisdictions, the principal of apportionment can be applied to determine how much profit will be taxable in one or the other jurisdiction. In such a composite contract, it is necessary to find out the taxability of different and distinct operations carried out under it. In the case of the assessee there are two separate contracts, one dealing with the supplies and the other with installation etc. and training. Separate considerations have been fixed for the two contracts. Therefore, even if it is construed that there is only one turn-key contract, the income will have to be determined in different years on the basis of distinct and separate activities, taking into account the system of accounting followed by the assessee.

6.11 In reply, the ld. DR referred to the decision of Hon'ble Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd. (supra), in which there was a composite turn-key project for setting up a liquefied natural gas receiving, storage and regasification facility in Gujarat to be carried out by a consortium. The responsibility of each

member of the consortium was fixed and separate consideration was also fixed for each one of them. Coming to the case at hand, it is submitted that under the two contracts, the assessee was to modernize the existing ATS. The assessee was assigned this work and the parameters were mentioned in the tender floated by the AAI. There was an existing ATS which was to be modernized to meet the present requirements of the AAI. Under Article 4, the assessee was responsible for providing equipments, installation, testing and support to the commissioning of MATS-BD system. For this purpose, it was responsible for establishing, implementing and maintaining a project management plan. Further, it was responsible for providing a monthly project status report to the AAI. It was also responsible to attend a quarterly progress review meeting for presenting a project status report. It was also responsible for conducting technical system reviews and meetings with the NAA, which inter-alia included system specification review, PDR and CDR. On the completion of the CDR, the requirements of hardware and software were to be frozen and placed under configuration control. This clearly shows that the contract was not merely a supply contract but a job contract granted and undertaken to upgrade the existing ATS. Further, the schedule of payments shows that it is not connected with the supplies but

with certain events such as completion of review, FAT completion, installation or site acceptance test. Therefore, the consideration is not attached to the supply of goods, software etc. Thus, it is nothing but a works contract, the income from which accrues at the time of acceptance of the ATS by the AAI. It is also submitted that the decision under the Sales-tax Act distinguishing between sale and works contact is admittedly not acceptable under the Income-tax Act, which is governed under the provisions of the Act and the treaty.

6.12 We have considered the facts of the case and submissions made before us. We are not at the moment dealing with the taxation of the consideration received by the assessee in respect of the supply and installation etc. contracts. The question is- whether, the two agreements constitute one agreement. The question may be only of academic interest because it is the accepted position of both the parties that the taxation aspect has to be seen under the Act and the treaty. Nonetheless, since this question has been raised by the assessee, it needs to be answered by us. On perusal of the two contracts, it is seen that the basic purpose of the contracts was to modernize the ATS at Bombay and Delhi. For this purpose, the assessee was required to supply equipments and software.

It was also required to install the agreed equipment and software at Delhi and Bombay and conduct site acceptance test. On carrying out this test, the AAI was to take over the ATS and operate them. The contract regarding supply of equipments and software would have been of no consequence without installation and performance of SAT as these processes are complicated, which could be undertaken only by the assessee. Further, the dates of payment mentioned in the supply contract were connected both with carrying out certain work, namely, completion of preliminary design review etc., factory acceptance test completion, installation and site acceptance test. Therefore, it will be difficult to segregate this contract from installation/service contract. It is another matter that two separate contracts were executed for the sake of some convenience of both the parties. However, the essential purpose was to set up the ATS at Delhi and Bombay, for which hardware and software was supplied by the assessee, installation was carried out leading to site acceptance test. The training for the personnel of the AAI as well as Indian industry was also to be carried out for preparing them to handle the ATS. Accordingly, we are of the view that the two contracts constitute one contract. Having come to the aforesaid conclusion, we may point out that the contact is a complex one which requires designing, supply

of hardware and software, installation and training. Therefore, the following analysis mentioned in the decision of Hon'ble Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd. (supra) will have to be kept in mind while coming to the conclusion about the taxability of the consideration received by the assessee:-

> "For the purpose of taxation, the authority had proceeded on the basis that the element of tax consisted of : (i) onshore supply and onshore services; and (ii) construction of offshore supply and offshore services. It is not denied or disputed, as indicated hereinbefore, that in respect of the first element of onshore supply and onshore service, and construction tax would be payable in India.
>
> Two basic issues which, thus, arise for our consideration are: (a) the taxation of the price of goods supplied, by way of offshore supply price of which is specified in exhibit D, clause 2.1; and (b) the taxation of consideration paid for rendition of services described in the contract as offshore services at exhibit D.
>
> The contract is a complex arrangement. Petronet and the appellant are not the only parties thereto, there are other members of the consortium who are required to carry out different parts of the contract. The consortium included an Indian company. The fact that it has been fashioned as a turnkey contact by itself may not be of much significance. The project is a turnkey project. The contact may also be a turnkey contact, but the same by itself would not mean that even for the purpose of taxability the entire contract must be considered to be an integrated one so as to make the appellant to pay tax in India. The taxable events in execution of a contract may arise at several stages in several years. The liability of the parties may also arise at several stages. The obligations under the contract are distinct ones. The oh supply obligation is distinct and separate from the service

obligation. The price for each of the component of the contact is separate. Similarly offshore supply and offshore services have separately been dealt with. The prices in each of the segment are also different.

The very fact that in the contract, the supply segment and service segment have been specified in different parts of the contract is a pointer to show that the liability of the appellant thereunder would also be different.

The contract indisputably was executed in India. By entering into a contact in India, although parts thereof will have to be carried out outside India would not make the entire income derived by the contractor to be taxable in India. We would, however, deal with this aspect of the matter a little later.

The scope of work is contained in clause 2.1 of exhibit A appended to the contract which includes supply of equipment, materials and facilities. The said exhibit spells out different systems to be set in place. It imposes an obligation on the contractor to supply equipment required therefor. It was to arrange for the engineering services in relation thereto. It was also required to render various other services within India. Exhibit D, however, provides for the prices to be paid in respect of offshore supplies and offshore services, onshore supply and onshore services, construction and erection. The payment schedule has also been separately specified in respect of each of the components separately.

It is not in dispute that title in the equipment supplied was to stand transferred upon delivery thereof outside India on high-seas basis as provided for in article 22.1. Similarly, article 13.1 provides for a lump sum contract price, whereas article 13.3.2 specifically refers to the cost of offshore supplies. The provisions with regard to offshore supplies and offshore services were to be read with the provisions contained in exhibit D which formed the basis of customs duty. Clause 13.4 refers to exhibit D as the basis for price escalation.

> The question of imposition of tax on income arising from a business connection may, thus, have to be considered keeping in view the aforementioned factual backdrop."

7. Before proceeding with ground nos. 4, 5 and 6 regarding taxation of income from the supply contract in India, we may take up ground nos. 10, 11 and 12 regarding the PE in India. It is mentioned that the ld. CIT(Appeals) erred in confirming that the assessee had PE in India with the premises of AAI in Delhi and Mumbai, and its own project office. It is further mentioned that he erred in holding that the assessee has installation as well as service PE in India under articles 5(2)(k) and 5(2)(l) of the DTAA. It is also mentioned that he erred that the contract for offshore supply of equipment is an integral part of activities carried out through PE in India and, thus, the income is attributable to the PE.

7.1 The AO has dealt with this issue on page nos. 18 to 21 of his order. It is mentioned that the essence of the contract is to upgrade the existing ATS so as to meet the requisite performance criteria. For doing the work under the contract, the assessee had to carry out detailed feasibility assessment and thereafter negotiate the contract with AAI. It also involved the installation of the system. These activities involved

continuous presence of assessee's technical manpower even prior to the making of the contract. Such presence was required after supply of the equipment also as its possession was taken up by the assessee for the purpose of installation. Thereafter, the equipment was installed and the system was tested in India. The assessee has also undertaken the supply of spares for the next 15 years. The contract was negotiated and signed in India. It was subject to jurisdiction of Indian courts. The property in the systems got transferred to the AAI only after its acceptance. The liaison office of one of the group companies existed in India which was involved in execution of the contract and its follow-up. In any case, it has been admitted by the assessee that it has an installation PE but this PE had nothing to do with the supply contract. In the context of these facts, it has been held that the assessee has a business connection in India u/s 9(1)(i). Looking to the magnitude of the activities involved even from preparation of tender onwards, the assessee had substantial presence in India. The market and support services were provided by the liaison office of the group company. The installation work continued for more than 120 days. The personnel of the assessee stayed in India for more than 90 days. Therefore, it has been held that the assessee had PE in India under article 5(2) of the DTAA.

7.2 The ld. CIT(A) has dealt with this issue on page nos. 35 to 53 of the impugned order. He referred to the findings of the AO and the provision contained in article 5 of the DTAA. Thereafter, he examined the issue in the light of provision contained in paragraph nos. (1), 2(a), 2(k) and 2(l) of the DTAA. It is mentioned that the assessee was engaged in the activities of supply of equipment and software, installation and commissioning thereof for modernizing the ATS in Delhi and Mumbai. According to the AO, these activities have been carried on from the ATS at Delhi and Mumbai, which are fixed places. These places may not belong to the assessee or may not be rented by the assessee but what is required is that the assessee should have a fixed place of business so that its personnel have access to carry out activities of the business. The place may include the place of management under paragraph 2(a) installation or assembly project under paragraph 2(k) if activities continued for more than 120 days in a 12 months period or place from there services are rendered which continued for more than 90 days under paragraph 2(l). The ATS formed fixed place of business under paragraph 1. Therefore, it has been held that the assessee had a PE under article 5(1), 5(2)(a), 5(2)(k) and 5(2)(l).

7.3 After referring to the decision in the case of Ishikawajima Harima Heavy Industries Co. Ltd. (supra), Hyundai Heavy Industries, 291 ITR 482 (SC) and Motorola Inc., 95 ITD 269, it has been mentioned that the supply contract in those cases was not related to the PE in India. In this case, the essence of the contract is to completely renovate the existing ATS, which constitutes the PE of the assessee. The contract was not a stand-alone supply contract. Therefore, it has been held that profits from the supply contract are taxable in India.

7.4 Before us, the ld. counsel submitted that prior to manufacturing of the equipments, the assessee had very few responsibilities to be discharged in India. The major work of preparation of project management plan, submission of monthly project status report, development of preliminary design and development of critical design were carried out abroad. The employees of the assessee-company had to visit India and in particular the ATS in Delhi and Mumbai or the office of AAI for three to four days at a time for conducting quarterly progress review meetings, system specification review, meetings with personnel of NAA, PDR and CDR meetings. Raytheon International Inc., a group company, had a liaison office in India since 1995. However, even the ld. CIT(Appeals) came

to the conclusion that the AO has not been able to substantiate that any business of the assessee was conducted from this office. The project office or the site office was not opened by the assessee in India. Therefore, it is argued that the short visits of the employees in India for the purposes mentioned above do not lead to inference that the assessee had a PE in India.

7.5 In reply, the ld. DR submitted that the assessee entered into a contract with AAI for modernization of ATS at Delhi and Mumbai. These stations had pre-existing ATS at the airports, which were to be substantially upgraded. For this work, the assessee was required to carry out the works of designing, manufacturing, supplying, installing, testing and commissioning of the equipment. It was also to provide training to the personnel of AAI and private companies for handing the ATS. Thus, the first stage of the work was the designing of the confugration of the upgraded ATS as per requirement of the AAI. After deciding this matter, the requirement of equipment had to be ascertained. This required various reviews mentioned in exhibit A of the supply contract, i.e., conducting technical systems reviews and meeting with the NAA for system specification review, PDR and CDR. The assessee was required

to attend a quarterly progress review meeting also for the purpose of presenting project status report. For this purpose, the NAA was to provide assistance to the assessee. The case of the ld. DR is that various reviews were to be conducted so as to collect preliminary data about the requirement of the equipment and software. Such reviews could be done at the ATS located in Delhi and Mumbai airports. In this situation, the pre-existing ATS at the airports became the fixed place available to the assessee, which constituted the PE under Article 5(1). It is clarified that the fixed place need not be owned by the assessee and the only requirement is that a fixed place should be available to the assessee for carrying out its business operations. It is further submitted that the assessee was having a project office in India. It was required to attend several meetings with the AAI, as mentioned above, and these meetings were conducted in India either at the project office or at ATS. Therefore, even if project office is not linked with the supply of equipment, it does constitute a place of management, being the PE under Article 5(2)(a). It is also submitted that the assessee was required to undertake installation of the equipment, testing and commissioning thereof, which will constitute PE under Article 5(2)(k) as it continued for more than 120 days. The assessee was also required to provide training to the personnel of AAI

and private companies and these activities continued for a period of more than 90 days. Therefore, there was a PE in terms of Article 5(2)(l) of the DTAA. It is clarified that since the reviews had to be conducted right from the beginning for which ATS was made available to the assessee, the PE existed under Article 5(1) from the day when system specification review started.

7.6 We have considered the facts of the case and submissions made before us. The facts are that AAI had ATS in Delhi and Mumbai airports. Due to increase in traffic, these became inadequate and required substantial upgradation. For this purpose, the first activity was to conduct system specification review. Once the system had been defined, it had to be designed and, therefore, a preliminary design review had to be made. This design had to be discussed with the AAI for freezing the design, necessitating critical design review. Once the system was frozen, hardware and software requirements also got frozen, leading to supply of equipment, software, installation, testing etc. The admitted position is that system specification review was conducted in India and for this purpose, the personnel of the assessee had access to the existing ATS. On examining the existing system and the system to be installed,

various design reviews had to be undertaken. It is the case of the assessee that the work of system specification review, PDR and CDR required occasional visits of the personnel of the assessee, but all the work in relation thereto, after initial inspection, was conducted outside India. On the other hand, the case of the ld. DR is that since ATS were available to the assessee, the same constituted the PE under article 5(1) from the day system specification review started. We are of the view that system specification review, PDR and CDR do not require any prolonged stay of the employees of the assessee in India. The system specification review requires data from the AAI regarding the capacity to be installed. The design reviews can be carried out outside India which may require subsequently approval of the AAI. There is no evidence on record that apart from inspection, the ATS were made freely available to the assessee to be occupied by its personnel for system specification review, PDR or CDR. Therefore, in such a situation it cannot be said that the assessee had a PE in India from the date of first meeting held for system specification review, being the ATS at Delhi and Mumbai airports.

7.7 It is also the admitted fact that the goods were shipped from outside India to the AAI. The property in the goods, as per agreed terms, passed to the assessee at the port of shipment, i.e., outside India. The AAI was responsible for clearance of goods in India. Thereafter, the possession was handed over to the assessee for safe custody, installation etc. of the equipment in which the software had been loaded. Further facts are that the assessee insured the goods at the port of shipment. It also insured goods after taking custody in India as it was made responsible for any damage to the goods till the stage of performance test. However, the cost of insurance is stated to be part of the consideration of the contract. This means that the cost of insurance had already been added to the cost of equipment and software. Thus, in reality the insurance cost was borne by the AAI. However, it also emerges clearly that after clearance of goods in India, the possession was handed over to the assessee and it became responsible for any damage to the goods. In other words, the equipment and the software embedded therein were handled by the assessee once these were cleared in India. Obviously storage would require space and also overall supervision of the equipment to ensure that no damage occurred to it by negligence or otherwise. The storage as well as supervision was the responsibility of the assessee and as mentioned

earlier, the storage space was available to the assessee in India. These activities cannot be said to be preliminary or auxiliary in nature as the equipments were required to be installed. Therefore, it is held that once the goods were cleared in India, the PE came into existence. In view of this finding, it is not necessary for us to go to the matters regarding installation PE etc. Accordingly, it is held that the PE of the assessee came into existence from the date the equipment was received in India by the AAI, cleared by it and handed over to the assessee for the purpose of installation. Ground nos. 10, 11 and 12 are disposed off accordingly.

8. Ground nos. 4 to 9 are in respect of bifurcating the revenues of the assessee earned from the supply contract with AAI between supply of equipment and software. It is mentioned that the ld. CIT(A) erred in upholding the finding of the AO that the revenue can be bifurcated in terms of supply of equipment and software in the ratio of 30:70. It is further mentioned that he erred in holding the finding of the AO that 70% of the contract price constituted royalty or fees for included services, representing the right to use copyright of computer software and services, without appreciating that the contract was predominantly for supply of equipment in which the software was embedded. It is also

mentioned that he erred in upholding the finding that royalty etc., as aforesaid, was taxable under Article 12 of the DTAA and 50% of the balance amount representing profit from supply of equipment was taxable in India. It is also mentioned that he misunderstood the fact that the assessee (and not the AAI) had obtained ruling in the matter from the Authority for Advance Ruling. It is also mentioned that he erred in supporting his decision from three other rulings of AAR based upon subsequent agreements between the assessee and the AAI. It is also mentioned that he erred on relying on the ruling of AAR dated 28.07.2008.

8.1 At this juncture, it is essential to describe the findings of the lower authorities. The ld. CIT(Appeals) referred to the two contracts entered into by the assessee with the AAI on 19.03.1993. The important points regarding these contracts have been mentioned on page nos. 14 to 22 of the impugned order. Thereafter, he summarized the findings of the AO that the contract was for modernization of ATS at Delhi and Mumbai. The ATS includes flight information service, air traffic control service, area control service, approach control service, air traffic advisory service, airport control service etc. The tender document is a detailed one and consists of four volumes. The bidders were required to visit the site and

examine the tender document thoroughly so that they became fully conversant with the nature and legal conditions etc. of the work to be executed in the building and equipment provided by the NAA. The contract was awarded on a turn-key basis, which is mentioned in the tender document as well as in the contract. The contract required designing, manufacturing, supplying, installing, integrating, testing and commissioning of a modern, efficient and automatic ATS. It also provides for training of the employees of the AAI and private companies for the use of the ATS. The AO came to the conclusion that it was an integrated contract. The assessee had filed applications before the AAR on which rulings were furnished on 15.12.2004 and 28.2.2008. Although these rulings are in respect of subsequent agreements but they throw important light on the nature of work done by the assessee. There is also one more ruling from the Authority reported in 304 ITR 216, which is in line with the earlier rulings that while no profit accrues to the assessee in respect of sale of equipment, the payment received in respect of software and services of installation, testing and training are chargeable as royalty and fees for technical services. These rulings are based on the finding that there is no PE in respect of these agreements. However, the facts of instant contract are somewhat different. The

agreement before the AAR was in respect of repair, modification, and anomaly resolution of software etc. There was no supply of any hardware. The finding of the AO in respect of this contract is that the same has been undertaken for modernization of pre-existing ATS. The dominant intention is to provide services and the supply of equipment is only incidental to such services. The equipment and technology are the proprietary of the assessee for which it holds patents and the AAI has only been provided limited right to use such technology and equipment. Coming to the splitting of the revenue, the AO has relied on the ruling of the AAR in the case of Mitsubishi Corporation, (2005) 279 ITR 165.

8.2 On consideration of the findings of the AO and the submissions of the assessee, it is mentioned that the rulings of the AAR throw important light on the facts of the case and the legal position except in regard to the existence of PE. The finding of the AAR is that since the personnel of the assessee stayed in India for less than 40 days, the PE will not come into existence. This is a finding under Article 5(2)(k) of the DTAA. The Authority also ruled out the existence of PE in respect of supply of hardware. However, the instant contract is for supply of equipment and software as well as for installation thereof. It also

provides for support services. The remuneration for patent rights and royalties etc. covering the material and processes has been included in the contract price. Therefore, it is held that the AO correctly proceeded to determine the taxation of revenues received in respect of supply of hardware and software. He was also justified in bifurcating the revenues in terms of hardware and software. The assessee relied on a number of decisions that revenue for software was not taxable as royalties etc. However, these decisions were rendered prior to the ruling of the AAR in the case of the assessee, rendered on 28.07.2008. Therefore, the taxation of revenues in respect of software as royalty has been upheld. Coming to taxation of revenue from supply of hardware, the ld. CIT(Appeals) considered the facts of the case, provision contained in Article 5 and the rival submissions. It is mentioned that there is no evidence on record that liaison office of the group company constituted fixed place of business of the assessee in India. However, the assessee has been engaged in a host of activities for modernization of the ATS at Delhi and Mumbai. These activities were carried out from fixed place, being area traffic control tower and airport area in Delhi and Mumbai. Although these places do not belong to the assessee, but that is not the requirement of the DTAA. What is required is that the assessee should have access to

a fixed place from which the business is carried out. The finding of the AO is that the assessee has a project office in India which is linked with the supply of equipment. Under the DTAA, a place of management is included in the PE. Further, an installation or assembly project or providing services in connection therewith also constitute a PE under Article 5(2)(k) if such activity continues for a period of more than 120 days in 12 month period. The activities in Delhi and Mumbai airports continued for more than 120 days. Therefore, the assessee had a PE in India. Apart from the above, if the personnel of an assessee stay in India for more than 90 days within any 12 month period for imparting services, such stay by itself constitutes the PE under Article 5(2)(l). Since the assessee had a PE in India and the activities were carried out from the PE, which are not preparatory and auxiliary in nature, it has been held that profits from supply contract are taxable.

8.3 Coming to attributation of income, it has been mentioned that the income has to be attributed to the PE in consonance with the domestic law. The income accrued to the assessee on completion of both the ATS in Delhi and Mumbai. The acceptance test in Mumbai was performed in May, 1998, in which certain defects were found, which were rectified in

June, 1999. Therefore, the activities in respect of the agreements were concluded in financial year 1998-99 and profit therefrom is liable to be taxed in assessment year 1999-00. Such profits are to be taxed under Article 7 of the DTAA in terms of completed project basis. The assessee has not followed any regular system of accounting in respect of Indian operation. In view thereof, the finding of the AO regarding taxation of profit on project completion basis has been upheld.

8.4 Before us, the ld. counsel submitted that in order to decide these grounds it is necessary to refer to the contents of the two contracts. In so far as supply contract is concerned, the terms are similar to the case of Motorolla Inc. Vs. Dy. CIT, (2005) 95 ITD 269 (Del) (SB). The title of the contract, namely, modernization of air traffic control system…." Is not conclusive of the fact that it is purely a works contract. A modernization project like this will necessarily involve supply of machinery and equipment forming part of the system, installation, commissioning and testing of the system as a whole. The machinery may include flight monitoring radar etc. When we look to the contract, it is found that the statement of work defines the equipment to be supplied and the services to be performed. It includes the responsibilities of the

assessee to maintain a project plan, submission of monthly project report, attending quarterly project review meeting, conducting technical system review and attending meeting with the NAA in respect of these works. After finalization of CDR, the requirement of hardware and software designs were frozen. The assessee had to manufacture equipment as frozen under CDR and load it with the software specified in the critical design review. The equipment was manufactured outside India and it was loaded with software outside India. Thereafter, it was examined by AAI outside India to ensure that it is in conformity with the specification under CDR. The equipment was supplied outside India on CIP INCOTERMS. As per the agreement, the property in the equipment passed on to AAI on shipping. The payment was also received outside India as per agreed terms. Therefore, even if the work is a turn-key project, the accounting of the profits in respect of various identifiable activities (to be called landmarks) cannot be postponed till conducting of the performance test at the two airports. The fact that the AAI entrusted the equipment to the assessee after clearing the goods in India does not alter this position in any manner as the possession of the assessee in India was only for the purpose of safe keeping of the equipment owned by the AAI. The fact that insurance costs were paid by the assessee also

does not make any difference to the situation as admittedly such costs formed part of the overall contract price. The ld. counsel delved on this point further by mentioning that if the insurance had been paid by the AAI, the cost of the equipment and software would have been reduced by an equivalent amount. Therefore, it was only a matter of fixing the overall price of the goods and it did not in any manner lead to the conclusion that the property in goods remained or got re-vested in the assessee after shipping the goods outside India. The assessee did not have any PE in India. All activities in respect of manufacturing of equipment, loading it with software and shipping were carried out side India. Therefore, even if the ATS is taken to be the PE of the assessee in India, as held by the ld. CIT(A), no activity can be attributed to the PE till this stage. Therefore, no profit can be attributed to the PE, being the ATS or for that matter any other PE envisaged by the ld. CIT(Appeals).

8.5 Coming to the bifurcation of the consideration towards the supply of equipment and royalty on software, it is submitted that the contract does not contain any stipulation regarding separate prices of the equipment and the software. Therefore, no such allocation can be made. The software was loaded on to the equipment and it formed part and parcel of the

equipment. Therefore, the whole of the supply contract was an integrated contract of supply of equipment with software. In such a situation, no price can be allocated to the software. Further, the assessee had not parted with the right in software as AAI is entitled to use the software, copy it, modify it etc. only for the purpose of ATS, i.e., working the equipment. The AAI is not entitled to sell any right in the software to any one else and can also not use it for any purpose other than working the ATS. Therefore, even if the bifurcation could be made, the price received for the use of software, as allocated by the ld. CIT(A), does not amount to royalty. Again, since the assessee did not have any PE till the time of shipping the goods, the profit attributed as royalty is not taxable in India as it is only paid in respect of the user of software.

8.6 In the course of hearing, the assessee was questioned as to whether the assessee had bifurcated the value of the supply contract in terms of equipment and software for its own purpose or any other purpose. It was submitted that the same had not been done. Some kind of bifurcation was furnished, which could not be supported in any manner with reference to any record. The assessee was not able to file any evidence regarding the bifurcation made by the customs authorities also for the purpose of the levy

of customs duty. Thus, the assessee is not in a position to say anything objectively about the values of equipment and software separately supplied under this contract.

9. In reply, the ld. DR submitted that the supply and service contract have been made on the same date, i.e., 19.3.1993. The supply contract makes a reference to the contract for installation and training. Therefore, the assessee was fully aware that not only the equipment and software are to be supplied but also to be installed by it. The contract also states in express terms that it is an indivisible turn-key works contract. Therefore, it is obvious that one contract has been artificially divided into two contracts. In other words, if the contracts are read as a whole, they constitute one contract for modernization of pre-existing ATS at Delhi and Mumbai.

9.1 Coming to transfer of property in goods, references were made to the provisions contained in Sale of Goods Act, 1930. The general rule is that unless a different intention appears, the property in goods passes at the time when it is so intended by the parties. However, in case of specific goods, if the seller is bound to do something to the goods for the purpose

of putting them in a deliverable state, the property does not pass until such thing is done and notice thereof is given to the buyer. Further, in the case of sale of specific goods in a deliverable state, the property does not pass until the seller weighs, measures, tests or does some other act with reference to the goods for the purpose of ascertaining the price when he is bound to do so. The case under consideration not only involves the supply of goods and software but also its installation, testing and commissioning. The mere supply of goods is meaningless until the latter activities are also performed. Therefore, the property in goods passes only when all these activities have been completed. These activities were completed in India and not outside India. Further, the supply was made under CIP (As per INCOTERMS) at Delhi and Mumbai airports. According to the contract, the property in equipment etc., passes to the NAA at the time of shipment of the goods. Thereafter, the possession of the goods was given to the assessee again to be held for and on behalf of the NAA. In these circumstances, it is not correct to say that the property in goods passed outside India. The reason is that even after dispatch of goods, risks and responsibilities continued to vest in the assessee. The assessee was under obligation to maintain insurance to protect its interest and the interest of NAA against all risks. The assessee was to bear

any loss or damage to the equipment during clearance, transportation, installation, testing etc. till such time the system was taken over by the NAA. The transfer of the title did not relieve the assessee of its responsibilities. Therefore, the assessee continued to bear substantial risks even after shipping the goods. Under the Sale of Goods Act, unless otherwise agreed, the goods remain at seller's risk until property therein is transferred to the buyer, but when the property therein is transferred to the buyer, the goods are at the buyer's risk, whether delivery has been made or not. In this case, the risk remains vested in the assessee and, therefore, it cannot be said that the property has been transferred to the buyer at the time of shipping.

9.2 Coming to the bifurcation of the consideration towards equipment and software, it is submitted that as per the contract, the assessee was to provide various documents and information to the AAI to operate, maintain and repair the equipment and the documents were to remain the property of the assessee. The NAA was granted a license to use the software and technical documents for operating the ATS but property therein remained vested in Her Majesty Queen in Right of Canada. The agreement also provides that the royalty, and fee for patent covering

materials, articles, apparatus, devises, equipments or processes are deemed to be included in the contract price. The assessee was under obligation to provide source code in respect of Radar Data Processing Services (RDPS) and Flight Data Processing Services (FDPS) software to the AAI. The assessee has not provided any bifurcation of the contract price in terms of hardware and software despite a specific request by the Bench. Such bifurcation was not furnished even to the lower authorities. The AO, in absence of any detail, treated 70% of the contract price towards the software and taxed it as royalty. A reference has also been made to the decision in the case of Microsoft Corporation dealing with supply of software off the shelf, in which the consideration has been held to be royalty. It is argued that the case of the revenue in the case of the assessee stands on a better footing as a highly customized software and not off the shelf software has been supplied. Therefore, it is argued that the AO rightly bifurcated the consideration. He also rightly brought to tax profits from supply of equipment as accruing in India and the amount received in lieu of software as royalty.

10. We have considered the facts of the case and submissions made before us. The facts are that after examining the tender documents and

the state of the existing ATS, the assessee entered into a contract with the AAI for supply, installation, commissioning of the ATS as per the requirements of tender document. The process involved establishing the PDR so as to ascertain the requirement of hardware and software. This was to be discussed with AAI to come to the final requirement of software and hardware designs, i.e., establishing CDR. Once the CDR was agreed upon, the requirement of hardware and software was frozen. The hardware was manufactured outside India. The assessee was also in possession of requisite software being its own property or obtained under license from others. The software was loaded on to the equipment. The whole system was examined by the AAI outside India for its approval. Thereafter, the equipment loaded with software was shipped to India under CIP (INCOTERM). The AAI cleared the goods in India and handed it over to the assessee for installation and commissioning. Under the contract, the assessee had to bear insurance costs not only at the time of shipment but also after clearance of goods in India till the commissioning and handing over the ATS to the AAI after conducting performance test. The insurance cost formed part of overall contract. However, the assessee was responsible for damage to goods at the time of clearance or transportation to the site, its installation and commissioning. The question

is,-whether the assessee is liable to pay tax in respect of profit accruing from the supply contract, and if yes, in what manner?

11. We have considered the facts of the case and submissions made before us carefully. A number of questions arise for determination by us. The first question is-whether, the consideration in respect of equipment and software could be segregated for determining their taxability? The admitted facts in this regard are that the equipment ascertained after CDR was fabricated outside India. The software required to work the equipment was also designed outside India. The software was loaded on the equipment. Thereafter, the equipment and the software were shipped to India CIP INCOTERMS. The case of the assessee is that installation of the ATS required undertaking of a number of steps starting from ascertainment of equipment and software and ending with the installation at the airports. There were various milestones in executing the whole of the contract, which could be separately identified. The assessee has been following mercantile system of accounting. Therefore, profit, if any, has to be ascertained on completion of each milestone. Even if the contract is taken to be for executing a turn-key project, the recognition of profit and its taxation cannot be postponed till successful testing of the ATS

installed by the assessee. The supply of equipment and software constitutes one milestone as both were supplied together and property therein passed to the AAI at the port of shipment as per common intention of the parties. Further, since the software was installed in the equipment and shipped as such, the consideration for equipment and software could not be segregated. The contract also did not provide for separate considerations. On the other hand, the case of the ld. DR is that the project is in the nature of works contract undertaken on a turn-key basis. The supply of equipment and software by themselves were of no consequence to the AAI as it was interested in the functioning ATS of requisite capacity, which the assessee undertook to install. Therefore, the profits accrued on completion of the contract when the functioning ATS was handed over to the AAI. In the alternative, it has been submitted that if profits are to be ascertained on the basis of milestones in execution of the contract, then the consideration in respect of equipment and software will have to be segregated because they are quite distinct assets in nature and their taxability has to be decided on different considerations. We may add here that in the course of hearing, the assessee was asked as to whether segregation as aforesaid has been made by the assessee for its own internal purpose or for the purpose of payment

of customs duty or any other purpose. It was submitted that no such exercise was undertaken. The assessee was also not able to produce any order from customs authorities passed at the time of clearance of the equipment and the software at the customs port in India from which we could have an idea whether that authority had segregated the consideration in terms of equipment and software due to differential rate of duty.

11.1 In the case of Rotem Company (2005) 279 ITR 165 (AAR), relied upon by the ld. DR, the facts are that a consortium, of which Mitsubishi Corporation is the leader, filed a tender for manufacture, supply, testing and commissioning of passenger rolling stock for Delhi Metro Rail Corporation (DMRC) in pursuance of an international tender floated by the latter. The tender was accepted. Thereafter, the consortium and the DMRC entered into a contract in respect of the said work on 22nd May, 2001. The consideration for the total contract was placed at Indian rupees 311,04,39,836/- and US$ 26,09,97,269, which is apportioned amongst various cost centres (A to J), and further apportioned amongst various milestones. The instructions to the tenderers contained instructions for apportionment of fixed lump sum price to the cost centre

and milestones under each cost centre. The members of the consortium were entitled to receive interim payment on achieving one or more of milestones. The applicants state that it is a composite contract for manufacture, supply and commissioning of high speed trains for DMRC which involves all stages from designing and commissioning and that it is not for rendering any services. No license or patent concerning the machinery or copyright of its design is granted to the DMRC. The supply of designs and drawings to the DMRC is to ensure that the trains supplied are of the agreed specifications. It further submits that the contract is for sale and supply and not for rendering services and no part of the fixed lump sum price can be regarded as fee for technical services (FTS). The ld. AAR considered the facts of the case, various decided cases and came to the conclusion, inter-alia, that the lump sum consideration for works of design, manufacture, supply, testing and commissioning of passenger rolling stock to the DMRC includes element of fee for technical services and, thus, it would be correct to disintegrate the contract for the purpose of taxation of each component. Incidentally, we also find from the ruling in the case of Airports Authority of India, (2008) 304 ITR 216 (AAR), relied upon by the ld. counsel in some other context, that the applicant entered into a contract on 20.2.2007 for

supply of S-SDD on behalf of the Indian airports. The contract includes transfer and delivery of S-SDD, which includes software documentation, software, hardware, installation, testing and training at the total cost of US$ 2348120, out of which US$ 169102 will be towards hardware and US$ 2149018 will be towards the cost of software and a fee of US$ 30000 for installation, testing and training. This contract is also in the nature of a turn-key contract although of a smaller amount. The contract trifurcates the consideration towards hardware, software and installation etc. This shows that in a contract of the kind undertaken by the assessee, if there is a composite consideration, the same can be conveniently segregated in different components. Therefore, on the facts of the case and subsequent contracts of the assessee with the AAI, we do not find any difficulty in coming to a conclusion that the consideration for equipment and software could have been segregated. Since as per arguments made before us, if profits from supply contract are held to be taxable separately, as the supply is a milestone in the whole contract, then the treatment meted out to profits on sale of equipment and consideration received for supply of software will have to be different, as the two assets are of different nature involving different profitabilities. This necessitates the segregation of consideration into equipment and

software. Accordingly, we are unable to agree with the ld. counsel that the consideration for equipment and software cannot be segregated in a contract where a composite price is placed on these two components. What is baffling is that the assessee is unwilling to produce the assessment made by customs authorities at the time of clearance, who would have necessarily segregated the consideration as above for the reason that rates of customs duty will be different in respect of equipment and software. The stated reason is that such documents are not available because it was the responsibility of the AAI to clear the goods/software under the contract. Nonetheless, it is also a fact under the agreement the tax liability devolves upon the AAI and in view thereof, it would not have been difficult for the assessee to obtain the orders of customs authorities for production before the Income-tax authorities, as it would be in the interest of AAI also. Thus, as mentioned above, the consideration can be segregated and the consequence of inability to produce the orders of customs authorities or any other reliable evidence will lead to the conclusion that such segregated amounts will have to be estimated in absence of any objective facts on record placed by the assessee. As will be seen later, the facts in this regard are distinguishable from the facts of Motorola Inc., relied upon by the ld. counsel.

11.2 This brings us to the question of allocation of the consideration by the lower authorities at 30% in case of equipment and 70% in case of software. As mentioned earlier, the assessee has not produced any evidence in respect of the segregation of the consideration. We have mentioned about the ruling in the case of AAI in R.C. No. AAR/755/2007. In that contract the consideration for hardware was US$ 169102 and for software it was US$ 2348120. In other words, the consideration for software was about 13.9 times the consideration for hardware. In this case, the AO has computed the consideration for software at about 2.3 times the consideration for the equipment. While it is admitted that the composition of hardware and software in the two contracts may be different, nonetheless the figures mentioned above show that the values placed by the ld. CIT(Appeals) are not arbitrary or highly excessive. In absence of any evidence filed by the assessee before any of the authorities, we have no reason to interfere with the allocation made by the ld. CIT(Appeals).

12. The second question is-whether, in a turn-key contract, in which the assessee is under obligation to supply the equipment and the software and also install them, the profit should be taxed on completion of each

milestone or at the time of handing over the functioning system to the contracting party? We have already furnished the summary of the contract in various sub-paragraphs of paragraph no. 6. The details of payment to be made to the assessee in different countries have also been furnished in paragraph no. 6.4. It has also been mentioned that the payments are to be made on 10 different dates between 30.11.1993 and 30.09.1995, upon completion of a particular activity starting from completion of PDR and ending with performance of site acceptance test. The ATS at Delhi was tested in March, 1998 and the ATS at Mumbai was tested in June, 1998. The previous year for this assessment year comprises the period 1.4.1998 to 31.3.1999. Therefore, the work regarding Mumbai ATS only was partly carried out in this year. The work regarding Delhi ATS had been completed in the immediately preceding year. The assessee has not maintained separate India specific accounts. In other words, only worldwide accounts have been maintained in which the results of India operations have been merged. The policy for recognizing revenue is stated to be on the basis of the milestone achieved and, thus, the revenue is recognized in respect of a milestone when right to receive the consideration has accrued. The case of the ld. counsel is that even if the contract is held to be a turn-key project, the recognition of the revenue

cannot be postponed till the site acceptance test, in view of various milestones achieved in the intervening period. On the other hand, the case of the ld. DR is that the instant contract is a works contract for upgrading the existing ATS. Mere supply of equipment and software will be of no consequence to the AAI till it has been installed and acceptance test has been performed.

12.1 We have already held that the property in goods and software has passed to the AAI on shipment thereof outside India. The payment schedule also shows that all payments have been made outside India. We have also referred to the decision of Hon'ble Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd. and extracted a portion of the judgment in paragraph no. 6.12. In brief, the Hon'ble Court mentioned that the contract is a complex arrangement and there are other members of the consortium also who are required to carry out different parts of the contract. Terming the contract as turn-key contract would not mean much for the purpose of taxability. The taxable events in the execution of a contract may arise in several stages in several years. The obligations under the contract are distinct ones. The supply obligation is distinct and separate from service obligation and the price for each

component of the contract is separate. The fact that supply segment and service segment find place in different parts of the contact is a pointer to show that the liability of the assessee thereunder would be different. It is not in dispute that the title in the equipment stands transferred upon delivery outside India. Therefore, the question of imposition of tax on income may have to be considered keeping in view the aforesaid factual backdrop. Accordingly, it was held that since all parts of the transaction in respect of off-shore supply, i.e., the transfer of property in goods as well as the payments, were carried on outside India, the transaction could not have been taxed in India. The only difference pointed out by the ld. DR in the facts is that there were a number of other parties in the consortium who performed different parts of the contract, while in the case at hand the responsibility vests solely in the assessee to carry out all parts of the transaction. According to us, this distinction does not make any difference to the taxability of amounts received as consideration for different identifiable activities for which consideration is payable separately. Since the activities are distinct and consideration for supply of equipment and the software has been separately mentioned, the ratio of the aforesaid decision will be applicable to the facts of this case. In that case, there were two parts in the same contract regarding supply and

services, whereas there are two separate contracts in this case regarding supply and services. However, we have already concluded that the two contracts are inextricably linked so as to form a single contract. Nonetheless, in this single contract separate considerations have been fixed for supply and services at two different places. Such was also the situation in the case of Ishikawajima Harima Heavy Industries Ltd. Accordingly, it is held that the profits will become taxable on completion of a milestone when the right to receive the consideration accrues to the assessee. Incidentally, this is also stated to be the method followed by the assessee for recognition of the revenue.

13. The third question is-whether, various rulings of the AAR could have been relied upon by the ld. CIT(Appeals)? In this connection, it would be worthwhile to refer to some of the rulings obtained by the AAI in connection with various contracts with the assessee. In Ruling No. 624/2003, (2005) 273 ITR 437 (AAR), it has been held that since hardware and other equipments were subject matter of outright sale in favour of the AAI, the consideration received by the assessee does not fall within the meaning of income from the furnishing of services. The payment would be the business profits within the meaning of article 7.

Admittedly, the Raytheon Company does not have a PE in India and, therefore, the consideration will not be taxable in India. It has been further held that the consideration received for repair of software answer the description of fees for included services within the meaning of article 12(4)(a) and, therefore, it will be taxable in India. The ruling as aforesaid was more or less adopted in AAR No. 754/2007 in respect of software and it was also mentioned that the rate applicable will be 10% of the consideration. The ruling in respect of non-taxability was also repeated in AAR No. 753/2007 as the revenue was not in a position to prove that the assessee had PE in India. These rulings are reported in (2008) 299 ITR 102 (AAR). In AAR 755/2007 reported in (2008) 304 ITR 216 (AAR), it has been held that consideration for software and technical services rendered in connection with installation, testing and training in relation to the supply of software would amount to fees for included services under article 12(4)(a), attracting tax @ 15%. In ruling AAR No. 819/2009 dated 18.3.2010, the earlier rulings were repeated in respect of software and equipment. The ruling in respect of software consideration reads as under:-

> "8.2 The fact that the applicant-AAI itself has not been provided with the technology for developing the software as such does not really make a difference. The expression used is: "make available technical knowledge, experience or

> skills". The substance of the transaction, in our view, is rendering of technical and consultancy services which make available to AAI the technical knowledge, experience and skills possessed by Raytheon in the field and the provision of software system is only part of that exercise. The delivery of software and the specification of the cost of software cannot be viewed in isolation. Software is a part of the package of setting up upgraded automation system and as stated earlier, it has no value unless the supplier shares the technical knowledge, informations and experience with the user and suitably equip the personnel of AAI to handle the system by themselves. It needs training and imparting of valuable informations and instructions. Viewed in this background, we are of the view that the payment made towards software can be legitimately brought within the fold of Art. 12(4)(b) of the Tax Treaty, if not Art. 12(3). As regards installation services, there is no dispute about its taxability."

13.1 However, in ruling AAR 821/2009 dated 29.01.2010 in the case of Dassault Systems K.K., the ld. AAR mentioned that the reproduction and adaptation envisaged under the agreement can contextually mean only reproduction and adaptation for the purpose of commercial exploitation. The copyright being a negative right, it would only be appropriate and proper to test it in terms of infringement. What has been excluded under section 52(aa) is not commercial exploitation, but only utilizing the copyrighted product for one's own use. The exclusion should be given due meaning and effect otherwise the provision will be practically redundant. In fact, as the law stands now, the owner need not necessarily grant license for mere reproduction or adaptation of work

for one's own use. Even without such license, the buyer of the product cannot be said to have infringed the owner's copyright. When the infringement is ruled out, it would be difficult to reach the conclusion that the buyer/licensee of product has acquired a copyright therein.

13.2 The ld. counsel also referred to the decision of the Special Bench of the Tribunal in the case of Motorola Inc. Vs. Dy. CIT, (2005) 95 ITD 269 and drew our attention to paragraph no. 162, which reads as under:-

> "162. A conjoint reading of the terms of the supply contract and the provisions of the Copyright Act, 1957 clearly shows that the cellular operator cannot exploit the computer software commercially which is the very essence of a copyright. In other words, a holder of a copyright is permitted to exploit the copyright commercially and if he is not permitted to do so then what he has acquired cannot be considered as a copyright. In that case, it can only be said that he has acquired a copyrighted article. A small example may clarify the position. The purchaser of a book on income-tax acquires only a copyrighted article. On the other hand, a recording company which has recorded a vocalist has acquired the copyright in the music rendered and is, therefore, permitted to exploit the recording commercially. In this case the music recording company has not merely acquired a copyrighted article in the form of a recording, but has actually acquired a copyright to reproduce the music and exploit the same commercially. In the present case what JTM or any other cellular operator has acquired under the supply contract is only the copyrighted software, which is an article by itself and not any copyright therein."

13.3 In the course of hearing, the Bench also referred to the decision of "H Bench of Delhi Tribunal in the case of Grace Mac Corporation, Microsoft Corporation and Microsoft Regional Sales Corporation Vs. ACIT, (2011) 8 ITR (Trib.) 522. In this case, it has been held that a computer programme is a literary work under Copyright Act, 1957, and if any or all rights (including granting of a license) are transferred for a consideration, the amount received will be in the nature of royalties. It is also mentioned that a programme is in the nature of a process which executes instruction in the given order. Therefore, any consideration received would amount to royalty under the Act and the DTAA. The case of the ld. DR is that the aforesaid decision supports the case of the revenue. The decision deals with the license granted in respect of shrimp wrapped software, which is sold across the counter. The software in this case is highly specialized one and, therefore, the facts of this case stand in a stronger footing. On the other hand, the ld. counsel for the assessee distinguished the case by stating that the ratio of the decision is not applicable to the facts of this case because the software is peculiar to the equipment supplied by the assessee and, thus, it cannot be sold off the shelf.

13.4 With the aforesaid discussion, we now proceed to decide various grounds. Ground nos. 7, 8 and 9 are to the effect that the ld. CIT(Appeals) was not justified in relying on the rulings obtained by the AAI in respect of assessee's subsequent contracts with it. In this connection, two things are to be noted. Firstly, the ruling was obtained by the AAI and not by the assessee although the ruling covered similar matters in respect of contracts between same parties. Secondly, section 254-S inter-alia provides that the advance ruling pronounced by the Authority shall be binding only on the applicant who sought it and on the Commissioner and Income-tax authorities subordinate to him in respect of the applicant. Further, the ruling is binding only in respect of the transaction in relation to which the ruling has been sought. On the basis of this provision, the ld. counsel can very well argue that the transaction in the ruling pronounced by the Authority is different from the transaction in this case. Further, the ruling has been obtained by the AAI and not the assessee. Therefore, the ruling is not binding on the assessee. However, if the transactions are same or similar with no distinguishing feature and the appellate authority finds the reasoning given by the authority is convincing, then the ruling can certainly be used as an aid

to come to the decision although it may not have any binding effect. Ground nos. 7, 8 and 9 are disposed off accordingly.

14. This bring us to ground no. 6 regarding quantification of income in respect of supply of equipment and software. We have already held that property in goods passed outside India when these were shipped on CIP INCOTERM. The shipment took place prior to this year. Thus, the property in the goods passed before the beginning of this year. The payment was also made in an earlier year outside India. The position in regard to supply of software is also the same. The supply of equipment and software constitute a milestone in the contract. Therefore, even without going into the merits of the claim of taxability of profit embedded in supply of equipment and software, it is clear that the income does not accrue or arise in the year under consideration. Accordingly, it is held that profits on supply of equipment and software are not taxable in this year. Ground no.6 is decided accordingly.

14.1 We have also held that the PE of the assessee came into existence when the equipment was handed over to it by the AAI after clearance for the purpose of installation. The ATS in Delhi was handed over to the

AAI in March, 1998 after conducting site acceptance test. This is prior to the relevant previous year. However, the ATS in Mumbai was handed over in June, 1998. Therefore, the profits in respect of the installation contract and services rendered in this connection in Mumbai are taxable in this year. Ground nos. 13, 14 and 15 are decided accordingly.

14.2 Thus, the matter regarding the computation of profit in respect of installation contract has to be decided de-novo by the AO and ground nos. 16, 17 and 18 are decided accordingly.

14.3 As the matter has been restored to the file of the AO, there is no need at present to decide ground nos. 19 and 20 regarding charging of interest under sections 234B, 234C and 220(2) of the Act. The AO shall decide these matters afresh while computing the income, after giving the assessee an opportunity of being heard.

15. In the result, the appeal is treated as partly allowed as indicated above.

The order was pronounced in the open court on 17th June, 2011.

Sd/- sd/-

(R.P. Tolani) (K.G.Bansal)
Judicial Member Accountant Member
Date of order: 17th June, 2011.
SP Satia

Copy of the order forwarded to:-
Raytheon Company, C/o S.R.Batliboi &Co., Gurgaon.
Dy. Director of Income-tax, Cir. 2(1), Intl. Taxation, New Delhi.
CIT(A)
CIT
The DR, ITAT, New Delhi. Assistant Registrar.