IN THE HIGH COURT OF KARNATAKA AT BENGALURU

DATED THIS THE 3RD DAY OF SEPTEMBER 2015

PRESENT

THE HON'BLE MR. JUSTICE N.KUMAR

AND

THE HON'BLE MR. JUSTICE G.NARENDAR

W.P.No.39548/2012 (T-IT)

BETWEEN :

M/s Columbia Sportswear Company
14375 NW Science Park Drive
Portland, Oregon 97229,
United States of America
Rep. by Bhargava Huchurao
S/o Honnali Krishnamurthyrao
Huchurao, Aged about 40 years,
R/o Sterling Terraces, D-803,
100 ft Road, Banashankari III Stage,
III Phase, Bangalore-560085
Liaison Office Director,
Columbia Sportswear Company ...PETITIONER

(By Sri Parcy Pardiwala, Senior Counsel for
Sri P.Dinesh, Adv.)

AND :

Director of Income Tax
(International Taxation)

6th Floor, 14/3, Nrupathunga Road
Bangalore-560001 ...RESPONDENT

(By Sri K.V.Aravind, Adv.)

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This writ petition is filed under Articles 226 and 227 of the Constitution of India, praying to call for the records & papers of the petitioners case & after examining the legality & validity thereof quash & set aside the impugned order dated 08.08.2011 vide Ann-A, passed by the authority in AAR.No.862/2009 in the case of the petitioner & further declare that the activities of the India LO qualify for purchase exemption & therefore, would not be taxable in India.

This writ petition coming on for hearing this day, N.Kumar J., made the following:

O R D E R

The petitioner is a company incorporated in the United State of America (USA) and is a tax resident of the USA and it is a multinational company engaged in the business of designing, developing, marketing and distributing outdoor apparel with operations in North America, Europe and Asia. They do not distribute or retail its products in India. The designing of all products is exclusively undertaken from outside India

as by its very nature, the activity is based on customer/user requirement arising from market place and as nothing specific to place of manufacturing. The petitioner's centralized sourcing group located outside India is responsible for all key purchase functions including (a) choosing the producing country; (b) Vendor Selection (c) Co-ordination of global production management and planning and (d) global quality assurance and strategy and policy development.

2. With the permission of the Reserve Bank of India, the petitioner established a liaison office in Chennai in 1995 for undertaking liaison activities in connection with purchase of goods from India. The petitioner purchases products from third party Indian Vendors on principal to principal basis. The Indian liaison office is involved only in activities relating to purchase coordination for the petitioner. As part of these activities, the India liaison office is engaged in vendor identification, review of causing data, uploading of material prices into the Internal Product Data Management

(PDM) system of the petitioner, vendor recommendation and quality control. It also monitors vendors for compliance with petitioner's policies, procedures and standards related to quality, delivery, pricing and Labour practices. It does not supervise, direct or control the production facilities of the Indian Vendors. Consistent with the RBI approval, accorded to it, the India liaison office does not undertake any activity of trading, Commercial or Industrial nature. It has no revenue streams and it does not source products to be sold locally in India.

3. With a view to achieve tax certainty, the petitioner preferred an application before the Authority for Advance Rulings ("the Authority"), under Chapter XIX-B of the Income-tax Act, 1961 seeking determination of certain questions about its tax liability, if any, under the Act in India on account of purchase co-ordination activities of its India liaison office. In the application, they submitted that (a) no income is received or deemed to be received in India by the petitioner under Section 5(2)(a) of the Act; and (b) no income accrues or arises to the petitioner under Section 5(2)(b) of

the Act, as sales are made by the petitioner to wholesale/retail customers wholly outside India and the sale price is received by the petitioner from wholesale/retail customers outside India.

4. Further, it was submitted by the petitioner that no income can be deemed to accrue or arise in India under Section 9(1) of the Act as the petitioner does not have a business connection in India since the activities of the India liaison office are strictly restricted to purchase function. They also submitted that no income would be deemed to accrue or arise in India through or from operations which are confined to the purchase of goods for the purpose of exports as per the exceptions carved out in Explanation 1(b) of Section 9(1)(i) of the Act. They also submitted that there is no permanent establishment that exists in India under the agreement for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income and capital gains entered into between the Government of India and

the Government of USA. It carries out only purchase coordination functions which are covered by the specific permanent establishment exclusionary clause under Article 5(3)(d) of the Treaty, which excludes from the definition of a permanent establishment and set up solely for the purpose of purchasing goods or merchandise, or of collecting information for the non-resident enterprise. In the alternative, they submitted that even if a permanent establishment was said to exist for the petitioner, no profits could be attributed to the common head establishment by reason of mere purchase by that permanent establishment of goods or merchandise for the enterprise by virtue of article 4 of Article 7 under the Treaty.

5. The petitioner and the Revenue authority by the impugned order proceeded on the presumption that designing and manufacturing were obviously carried out by the petitioner itself in India in relation to products

purchased by them in India and therefore, opined that a portion of the income relating thereto accrued to the petitioner in India. Further they held that the India liaison office constitutes a permanent establishment of the petitioner in India under Article 5 of the Treaty and that in terms of Article 7 of the Treaty, income is attributable to the India liaison office from activities and that the same would be taxable in India. Challenging the aforesaid order, this writ petition is filed.

6. The learned counsel for the petitioner assailing the impugned order contended that in view of Section 9(1)(i) explanation (1)(b) of the Income tax Act, in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export. Therefore, it carves out an exception to Section 9, which deals with income deemed to have been accrued or arisen in India.

Further, he contends that Article 7 of the Total Taxation Treaty entered into between India and USA provides for taxation in respect of the profits of an enterprise in the other State, but only so much of them as is attributable to that permanent establishment and sales in the other State of goods or merchandise of the same or similar kind as those sold through the permanent establishment or other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment. As in the instant case, there is no sale at all, the question of earning profits is not there and therefore, tax is not attracted. Insofar as the permanent establishment is concerned, he refers to Article 5(3)(d), which provides that notwithstanding the provision under this Article, the term "permanent establishment" shall be deemed not to include the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the

enterprise. Therefore, he submits that as the petitioner is not purchasing goods for merchandise in India and even if he is collecting information for the purpose of business in future, it does not fall with the permanent establishment. In that view of the matter, it is submitted that seen from any angle, the finding recorded by the advance ruling authority is contrary to the aforesaid statutory provisions and requests to be set-aside. In support of this, he referred to a few judgments of this Court.

7. Per contra, the learned counsel appearing for the Revenue submitted that the petitioner is not engaged only in purchasing goods. They are identifying the manufacturers. They are instructing him about the requirements of an outside purchaser and therefore, even if the income is received outside India, it is deemed to have accrued in India liable to tax in view of Section 5(2) of the Act and therefore, he submits that

though the entire amount is not taxable, a portion of it is attributable to liaison office and therefore, it is taxable in India.

8. Therefore, the question that arises for our consideration in this writ petition is:

(a) Whether the Indian liaison office involves a permanent arrangement for the application under Article 5.1 of the DTAA?

(b) Whether any portion of the income attributable to the liaison office on account of the activity of vendors co-operation of global production management and planning and equitable quality assurance strategy, quality development and is liable to tax?

9. The aforesaid substantial questions of law arose for consideration before this Court couple of times. In the case of ***The Commissioner of Income-tax and another V/s. Nike Inc*** in ITA No.976/2008 and connected matters decided on 7th March, 2013, after

referring to Sections 5, 9 and several judgments of the Apex Court on the point has held as under:

> *16. In the background of this legal position when we examine the facts of this case, the assessee is not carrying any business in India. They have established a liaison office. The object of establishing the said office is to identify the manufacturers, give them the technical know-how and see that they manufacture goods according to their specification which would be sold to their affiliates. The person who purchases the goods pays the money to the manufacturer, in the said income, the assesee has no right. The said income cannot be said to be a income arising or accruing in the Tax Territories vis-a-vis the assessee. In fact, the evidence on record shows that Nike, USA bears the entire expenses of the liaison office. The buyer who is a non-resident may in turn pay some consideration to the assessee outside India, the contract between the assessee and the buyer if at all is entered outside India.*

Therefore, even if any income arises or accrues to the assessee, it is outside India. Therefore, explanation (1) to sub-section (2) of Section 5 expressly states income accruing or arising outside India shall not be deemed to be received in India within the meaning of the Section. However, under Section 9, all income accruing or arising whether directly or indirectly through or from any "business connection" shall be deemed to be accrued or arises in India. Now by Explanation (2) "business connection" has been explained which includes any business activities carried out by a person who acting on behalf of the non-resident as an habitual exercise in India. An authority to conclude Contracts on behalf of non-resident unless his activities are limited to the purchase of the goods or merchandise for the non-resident. If the said definition is read with Clause (b) of Explanation 1 to Sub-Section (1) of Section 9 in the case of a non-resident, no income shall be deemed to accrue or arise in India to him whether directly or indirectly through or from any "business connection",

which are confined for the purpose of export. In the first place, the assessee is not purchasing any goods. The assessee is enabling the manufacturers to purchase goods of a particular specification which is required by a foreign buyer to whom the manufacturer sells. As the orders are placed by the assessee with the manufacturer and the goods are manufactured according to their specification which is the requirement of the buyer and even if it is held, though the goods are supplied to the buyer, it is deemed to be supplied to the assessee, the whole object of this transaction is to purchase goods for the purpose of export. Once the entire operations are confined to the purchase of goods in India for the purpose of export, the income derived therefrom shall not be deemed to accrue or arise in India and it shall not be deemed to be an income under Section 9 of the Act. If we keep the object with which the proviso to clause (b) of Explanation 1 to Sub-section (1)(i) of Section 9 of the Act was deleted, the

object is to encourage exports thereby the Country can earn foreign exchange. The activities of the assessee in assisting the Indian manufacturer to manufacture the goods according to their specification is to see that the said goods manufactured has an international market, therefore, it could be exported. In the process, the assessee is not earning any income in India. If at all he is earning income outside India under a contract which is entered outside India, no part of their income could be taxed in India either under Section 5 or Section 9 of the Act. In that view of the matter, the order passed by the Tribunal does not suffer from any infirmities, which calls for interference. Therefore, the substantial question of law framed in this case is answered in favour of the assessee and against the Revenue.

10. Again in the case of ***Director of Income Tax and another Vs. M/s. Mondial Orient Ltd.,*** in I.T.A. No.204/2010 and other connected matters decided on 9th June, 2013, this Court held as under:

12. The aforesaid provisions makes it clear what are the incomes which are deemed to accrue or arise in India for the purpose of levying tax. However, explanation (1)(a) introduces a deeming clause, i.e., though income accrues or arises in India as mentioned in the aforesaid provisions, for the purpose of this clause which shall be deemed not to have accrue or arise in India, i.e., the income earned by an assessee through or from operations which are confined to the purchase of goods in India for the purpose of export. In other words, if an assessee earns income through or from operations out of purchase of goods in India for the purpose of export only it is deemed not to accrue or arise in India. The argument is, for attracting this provision the assessee must be a purchaser of goods and after such purchase he should export the goods. Then only he can have the benefit of this provision. Nowhere in this section it is mentioned that the assessee should purchase the goods in India for the purpose of export. On the contrary it is expressly mentioned any income accruing or

arising in India to him through or from operations which are confined to purchase of goods in India for the purpose of export alone is exempt from payment of tax. In other words if an assessee carries on operations which results in purchase of goods in India for the purpose of export and the income so accrued or arising out of such transactions are exempted from payment of income tax. The whole object of this provision being to encourage export of merchandise from India which enables Indian manufacturer to earn and when it is exported the country would earn foreign export. An incentive is given to a non-resident to carry on business in India. Otherwise the explanation would have no meaning and that is precisely what the Tribunal has held.

11. Therefore, what follows is Section 9 of the Income-tax Act deals with income deemed to accrue or arise in India. It provides that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from

any property in India, or through or from any asset or source of income in India or through the transfer of a capital asset situate in India shall be deemed to accrue or arise in India. However, explanation 1(b) to the said Section carves out an exception. It provides that in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export. Therefore, it is clear that when a non-resident purchases goods in India for the purpose of export, no income accrues or arises in India for such non-resident for it to be taxed.

12. Article 7(1) of the Tax Convention with the Republic of India and the USA reads as under:

> *"1.The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as*

aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to

(a) that permanent establishment;

(b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or

(c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.

13. A reading of the aforesaid provision makes it clear that if a permanent establishment carries on business of sales in India or other business activities of the same or similar kind through that permanent establishment, then only, the profits of the enterprise will be taxed. Therefore, there is no tax liability if purchase is made for the purpose of export. The permanent establishment referred to therein is also defined in Article 5. It provides that for the purposes of

this convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. It is an inclusive definition of what is included in the term 'permanent establishment' which is clearly set out in sub-article (2). However, sub-article (3) starts with a non-obstante clause. It makes it clear that the term 'permanent establishment' shall be deemed not to include any one or more of the following as set out in sub-article (3). Clause (d) of sub-article (3) speaks about the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise. In other words if the permanent establishment is established for the purpose of purchasing goods or merchandise for the purpose of collecting information for the enterprise, it is not a permanent establishment as defined under Article 5(1) read with Article 7. According to the Advance Ruling

Authority what sub-article 3(d) excludes is the place of business solely for the purpose of purchasing goods or of collecting information for the enterprise.

14. In the instant case, the liaison office of the petitioner identifies a competent manufacturer, negotiates a competitive price, helps in choosing the material to be used, ensures compliance with the quality of the material, acts as go-between, between the petitioner and the seller or the manufacturer, seller of the goods and even gets the material tested to ensure quality in addition to ensuring compliance with its policies and the relevant laws of India by the suppliers. Therefore, it is of the view that the aforesaid activities carried on by the liaison office, cannot be said to be an activity solely for the purpose of purchasing the goods or for collecting information for the enterprise. We find it difficult to accept this reasoning. If the petitioner has to purchase goods for the purpose of export, an

obligation is cast on the petitioner to see that the goods, which are purchased in India for export outside India is acceptable to the customer outside India. To carry on that business effectively, the aforesaid steps are to be taken by the seller i.e., the petitioner. Otherwise, the goods, which are purchased in India may not find a customer outside India and therefore, the authority was not justified in recording a finding that those acts amounts to involvement in all the activities connected with the business except the actual sale of the products outside the country. In our considered information, all those acts are necessary to be performed by the petitioner – assessee before export of goods. Consequently, the reasoning of the authority that for the same reasons, the liaison office in question would qualify to be a permanent establishment in terms of Article 5 of the DTAA is also erroneous. That liaison office is established only for the purpose of carrying on business of purchasing goods for the purpose of export

and all that activity also falls within the meaning of the words "collecting information" for the enterprise. In that view of the matter, we are of the view that the impugned order is unsustainable. Hence, we pass the following order:

(a) Writ petition is ***allowed***.

(b) The impugned order passed by the authority is hereby quashed.

(c) The substantial question of law framed is answered in favour of the assessee/petitioner and against the Revenue/respondent.

(d) No costs.

Sd/-
JUDGE

Sd/-
JUDGE

SPS