IN THE HIGH COURT OF DELHI AT NEW DELHI

% Judgment delivered on: 04.05.2016

\+ **ITA 666/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant
Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.

versus

THE DIRECTOR OF INCOME TAX -I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

WITH

\+ **ITA 667/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant
Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.

versus

THE DIRECTOR OF INCOME TAX-I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

WITH

\+ **ITA 689/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant
Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.
versus

THE DIRECTOR OF INCOME TAX-I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

WITH

\+ **ITA 669/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant
Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.

versus

THE DIRECTOR OF INCOME TAX-I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

WITH

\+ **ITA 671/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant
Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.

versus

THE DIRECTOR OF INCOME TAX-I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

WITH

\+ **ITA 672/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant

Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.

versus

THE DIRECTOR OF INCOME TAX-I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

AND

\+ **ITA 673/2014**

M/S NORTEL NETWORKS INDIA INTERNATIONAL INC. ..... Appellant
Through: Mr. Deepak Chopra, Advocate with Ms. Manasvini Bajpai, Advocate.

versus

THE DIRECTOR OF INCOME TAX-I ..... Respondent
Through: Mr. N.P. Sahni, Senior Standing counsel with Mr. Nitin Gulati, Advocate.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

JUDGMENT

VIBHU BAKHRU, J

1. Nortel Networks India International Inc. (hereafter 'the Assessee') has preferred the present appeals under Section 260A of the Income Tax Act, 1961 (hereafter 'the Act') against orders passed by the Income Tax Appellate Tribunal (hereafter 'ITAT'). ITA Nos. 669/2014, 671/2014 and 672/2014 are appeals preferred by the Assessee against a common

order dated 13th June, 2014 passed by the ITAT in ITA Nos. 1119, 1120 and 1121/Del/2010, which were appeals preferred by the Assessee against a common order dated 22nd December, 2009 passed by the Commissioner of Income Tax (Appeals) [hereafter 'CIT(A)'] in respect of Assessment Years (AYs) 2003-04, 2004-05 and 2005-06. The common order dated 22nd December, 2009 passed by CIT(A) disposed of the appeals preferred by the Assessee against two separate assessment orders both dated 18th December, 2006 passed by the Assessing Officer (hereafter 'AO') under Section 147 read with Section 143(3) of the Act in respect of the AYs 2003-04 and 2004-05 as well as an assessment order dated 31st December, 2007 passed by the AO in respect of assessment year 2005-06.

2. ITA Nos. 666/2014, 667/2014 and 673/2014 impugn a common order dated 13th June, 2014 passed by the ITAT in ITA Nos. 2177, 2178 and 2179/Del/2011 which were appeals preferred by the Assessee against a common order dated 20th January, 2011 passed by CIT(A) in appeals no.78, 79 and 77/2009-10. These appeals were preferred by the Assessee against separate orders dated 29th January, 2010 passed by the AO to give effect to the common order dated 22nd December, 2009 passed by CIT(A) for AYs 2003-04, 2004-05 and 2005-06.

3. ITA No. 689/2014 is directed against ITAT's order dated 13th June, 2014 passed in an appeal preferred by the Assessee against final order dated 17th August, 2011 passed by the AO under Section 144C of the Act in respect of AY 2008-09.

4. By an order dated 24th February, 2015, ITA Nos. 666/2014, 667/2014 and 673/2014 were admitted and the following questions of law were framed:-

> "(i). Whether the Tribunal erred in concluding that the Appellant had a Permanent Establishment (PE) within the meaning of Article 5 of the Double Taxation Avoidance Agreement (DTAA) between India and USA?
>
> (iii). Whether the finding of the Tribunal that the Appellant had a PE in India is perverse and contrary to the facts and material on record?"

5. ITA Nos. 671/2014, 672/2014 and 669/2014 were admitted on 24th February, 2015 and the following questions of law were framed:-

> "(i). Whether the Tribunal erred in concluding that the Appellant had a Permanent Establishment (PE) within the meaning of Article 5 of the Double Taxation Avoidance Agreement (DTAA) between India and USA?
>
> (ii). Whether the Tribunal erred in affirming that the Appellant had a PE (fixed place PE and dependent agent PE) in India in terms of the Liaison Office of Nortel Canada and also in terms of the Nortel Networks (India) Private Ltd" (being installation and service PE)?

(iii). Whether the finding of the Tribunal that the Appellant had a PE in India is perverse and contrary to the facts and material on record?

(iv). Whether, without prejudice, the Tribunal erred in attributing 50% of the alleged profits to the alleged PE of the Appellant in India and whether such approach and quantification was inconsistent with Article 7 of the DTAA?"

6. Similarly, ITA No. 689/2014 was also admitted on 24th February, 2015 and the following questions of law were framed:-

"(i). Whether the Tribunal erred in concluding that the Appellant had a Permanent Establishment (PE) within the meaning of Article 5 of the Double Taxation Avoidance Agreement (DTAA) between India and USA?

(ii). Whether the Tribunal erred in affirming that the Appellant had a PE (fixed place PE and dependent agent PE) in India in terms of the Liaison Office of Nortel Canada and also in terms of the Nortel Networks (India) Private Ltd" (being installation and service PE)?

(iii). Whether the finding of the Tribunal that the Appellant had a PE in India is perverse and contrary to the facts and material on record?

(iv). Whether, without prejudice, the Tribunal erred in attributing 50% of the alleged profits to the alleged PE of the Appellant in India and whether such approach and quantification was inconsistent with Article 7 of the DTAA?

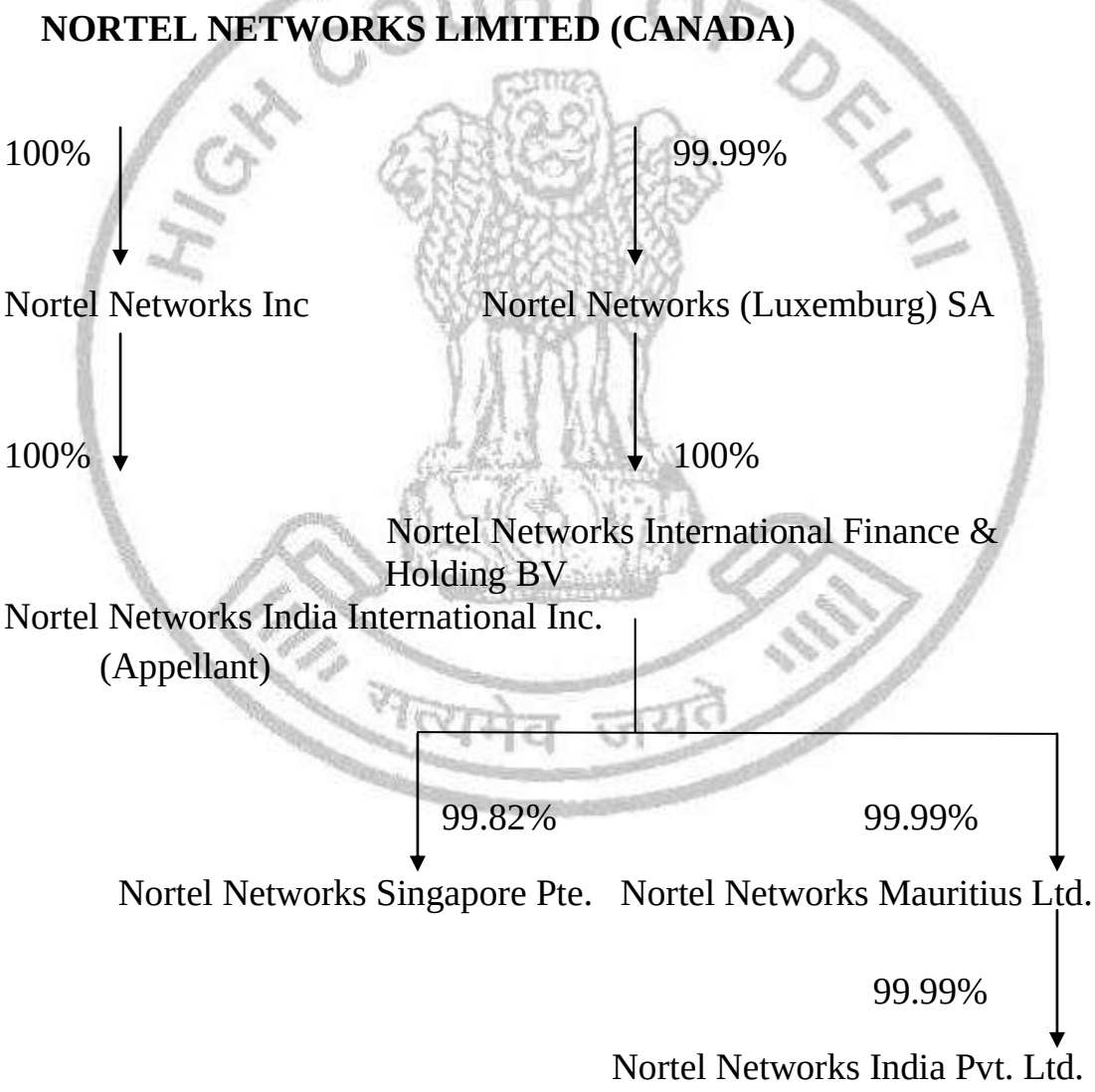
(v). Whether Tribunal erred in confirming the levy of interest under section 234B of the Act?"

7. The principal controversy involved in these appeals (ITA Nos. 669/2014, 671/2014, 672/2014 and 689/2014) is whether the Assessee, a tax resident of United States of America (USA), has a Permanent Establishment (hereafter 'PE') in India and consequently, is chargeable to tax under the Act in respect of its business income attributable to its PE in India.

Factual background

8. The Assessee (formerly known as Nortel Networks RIHC Inc) was incorporated as a company on 7th June, 2002 under the laws applicable in the State of Delaware, USA and is a tax resident of USA. The Assessee is a part of Nortel Group which is stated to be a leading supplier of hardware and software for GSM Cellular Radio Telephone Systems. The Assessee is a step-down subsidiary of Nortel Networks Limited (Canada), a company incorporated in Canada (hereafter 'Nortel Canada'); it is wholly held by Nortel Networks Inc. which in turn is wholly owned subsidiary of Nortel Canada. Nortel Canada also has an indirect subsidiary in India, namely, Nortel Networks India Pvt. Ltd (hereafter 'Nortel India'). Nortel Canada also owns 99.99% of share capital of

Nortel Networks (Luxemburg) SA which in turn holds the entire share capital of Nortel Networks International Finance & Holdings BV (Nortel BV). Nortel BV holds 99.99% shares of Nortel Networks Mauritius Limited, a company incorporated in Mauritius, which in turn holds 99.99% of Nortel India. The above corporate structure of part of the Nortel Group can be better understood by the following diagram :-



9. The Nortel Canada also has a Liaison Office in India (hereafter called 'Nortel LO').

10. Nortel India negotiated and entered into three contracts with Reliance Infocom Limited (hereafter 'Reliance'), namely, Optical Equipment Contract (hereafter 'the Equipment Contract'), Optical Services Contract (hereafter 'the Services Contract') and the Software Contract (hereafter 'the Software Contract') on 8th June 2002. On the same date, Nortel India entered into an agreement assigning all rights and obligations to sell, supply and deliver equipment under the Equipment Contract to the Assessee (hereafter referred to as the 'Assignment Contract'). Reliance and Nortel Canada were also parties to the Assignment Contract and in terms thereof, Nortel Canada guaranteed the performance of the Equipment Contract by the Assessee (Assignee). In terms of the Assignment Contract, Reliance placed purchase orders directly on the Assessee and also made all payments for the equipment supplied directly to the Assessee.

11. The equipments supplied to Reliance were manufactured by Nortel Canada and another Nortel group entity in Ireland (Nortel Ireland). The same was invoiced by the Assessee directly to Reliance and consideration for the same was also received directly by the Assessee. It is asserted by

the AO that the equipment supplied to Reliance was sourced from Nortel Canada and Nortel Ireland at a much higher price than the price charged to Reliance and this resulted in the Assessee suffering a loss during the relevant period.

12. Since according to the Assessee, its income was not chargeable to tax under the Act, it did not file any return for the AYs 2003-04 and 2004-05. The principal issues involved in the AYs 2002-03, 2003-04, 2004-05 and 2008-09 are common. The assessment orders passed by the AO and the appellate orders passed by CIT(A) and the ITAT for AY 2002-03, 2003-04 and 2004-05 are also more or less similar in effect and, therefore, for the sake of brevity only the facts as obtained for AY 2003-04 (ITA 671/2014) are referred to herein.

13. On 27th March, 2006, the AO issued a notice under Section 148 of the Act calling upon the Assessee to file its return of income for the AY 2003-04. In response to the aforesaid notice, the Assessee filed its return of income on 16th May, 2006 disclosing its taxable income as 'Nil'. Thereafter, the AO issued notice under Section 143(2) of the Act. In response to the aforesaid notices, the Assessee filed its statement of accounts disclosing the loss stated to have been incurred by the Assessee. The Assessee did not file its balance sheet or its audited accounts as

according to the Assessee, it was not required to have its accounts audited in the tax jurisdiction where the Assessee is a resident, namely, Delaware, USA. Thereafter, on 18th December, 2006, the AO passed an assessment order under Section 143(3)/147 of the Act.

Assessment Order dated 18th December, 2006

14. The AO observed that the Assessee had not booked any establishment cost, depreciation or any other indirect costs in its accounts. Further, the Assessee had also not showed any source of funds. The AO noted that the equipment stated to have been supplied by the Assessee to Reliance was purchased from other group companies, namely, Nortel Canada and Nortel Ireland and were supplied to Reliance at almost half the price of the said goods. On the aforesaid basis, the AO concluded that the Assessee did not have any financial or technical ability to perform the Equipment Contract.

15. The AO further concluded that Nortel India and Nortel LO were involved in pre-contract survey, pre-contract negotiation, finalization of documents and carrying out of installation activities and at ground level, there was no difference between the LO and Nortel India and both were operating from the same premises and were providing services to the

group companies including the Assessee. The AO further held that the contracts with Reliance constituted a single turnkey contract which had been artificially divided into three separate contracts. The AO further held that Nortel India also did not have the capacity to undertake the contracts entered into with Reliance and consequently, the same was transferred to other Nortel Group Companies including the Assessee.

16. The AO was of the view that the Assessee had been incorporated solely with the sole motive to evade the taxes arising out of supply contract in India and in substance, the contracts were performed by Nortel Canada along with its LO and Nortel India, who acted in unison to identify, negotiate, appraise, secure, execute, manufacture, supply, install, commission and provide warranty and after sales service in respect of the Optical Fibre project of Reliance. In addition, these companies also provided sales service and training etc. The AO also held that the activities performed by Nortel India were not within the scope of services to be rendered under the Services Contract and the expatriate employees of the Assessee had remained in India for a long period and had rendered services for Nortel India for a period of more than 30 days in a fiscal year and the Assessee had reimbursed large amount of expenses incurred by Nortel India on these expatriate employees.

17. According to the AO, the Assessee was "a shadow company of Nortel Group."

18. On the basis of its findings, the Assessee concluded that Nortel India and Nortel LO constituted the Assessee's PE in India (both Fixed Place PE as well as Dependent Agent PE).

19. In view of the finding that the Assessee was inserted as an intermediary and a shadow company of Nortel Canada solely for the purpose of evading taxes, the AO rejected the accounts furnished by the Assessee and further observed that the accounts provided by the Assessee were not audited and had "no sanctity". He then proceeded to estimate the taxable income of the Assessee based on the accounts of Nortel Group. The AO noticed that the global accounts of the Nortel Group disclosed a gross profit margin of 42.6%. He held that average selling, general and marketing expenses of other similarly placed non-resident companies was 5% of the turnover and, therefore, made an allowance of 5% of such expenses. He also made a further allowance for Head office expenses at 5% of the adjusted profits and estimated the total taxable income of the Assessee at Rs.81,28,06,917/-.

CIT(A)'s Order dated 22nd December, 2009

20. The Assessee appealed against the aforesaid assessment order as also against similar assessment orders passed for AY 2004-05 and 2005-06. These appeals were heard together and disposed of by the CIT(A) by an order dated 22nd December, 2009. The CIT(A) observed that: (a) that the Assessee was assigned the contract for supply of hardware to Reliance Infocom days after its incorporation; (b) this is the only business that appellant had done during the relevant period under consideration; (c) the Assessee did not have any financial or technical capability of its own; (d) the equipment supplied was manufactured by Nortel Canada and Nortel Ireland and shipped directly from Canada/Ireland; (e) that the Assessee had supplied the equipment at approximately half its purchase price, thus, incurring huge trading loss in the transaction. The CIT(A) held that the transactions were to be viewed as a whole and not merely in the form of the agreement. On the basis of the aforesaid findings, the CIT(A) upheld the conclusion of the AO that the Assessee was a paper company incorporated only with a motive to evade income tax liability on the income arising out of the supply contract in India and, therefore, Nortel Canada and the Assessee were to be considered as a single entity.

The CIT(A) further rejected the Assessee's contention that it did not have a business connection in India.

21. On the issue of existence of a PE in India, the CIT(A) held that there were two places in the business model which could be considered to be Assessee's fixed place of business - (i) the location of Nortel India to which employees of Nortel Group were sent on secondment basis to assist in the execution of the project; and (ii) the place of installation of equipment. Further, the CIT(A) also held that office of Nortel LO and Nortel India would also constitute a fixed PE of the Assessee in India as the Assessee and Nortel Canada were one and the same entity.

22. The CIT(A) held that Nortel India constituted a fixed place of business of the Assessee as according to him, the Assessee had employed the services of Nortel India for fulfilling his obligation of installation, commissioning, and after sales service and warranty. In addition, Nortel India had also undertaken all the pre-supply activities such as feasibility survey, negotiation of terms and conditions of supply, finalization of documents and signing of the contract, etc. He also concluded that since the employees of Nortel Group companies visited India in connection with the project, they had performed business of the Assessee through the premises of Nortel India or the LO of Nortel Canada.

23. The CIT(A) referred to clause 6.1.2 of the Equipment Contract which provided for rendering of certain services in relation to the equipment supplied and held that the Equipment Contract did not end with loading of equipment on vessels but also included a number of activities to be carried out in India, the compensation of which was included in the consideration for supply of equipment. The CIT(A) also referred to clause 5.3.2 of the Equipment Contract and on the basis of the said clause held that the consideration for supply of equipment in fact represents the payment of works contract, where installation and customization is carried out in India. He held that Nortel India had not only acted as a service provider of the Assessee but also as a "sales outlet" providing after sales service and any other assistance as requested by the Assessee.

24. On the aforesaid basis, the CIT(A) held that Assessee had (a) a fixed place of business in terms of Article 5(1) of the Indo-US Double Taxation Avoidance Agreement (DTAA); (b) a fixed place of management in India and thus, a PE in terms of Article 5(2)(a) of the Indo-US DTAA; (c) a sales outlet and thus, a PE in terms of Article 5(2)(i) of the Indo-US DTAA; (d) an Installation PE in terms of Article 5(2)(k) of the Indo-US DTAA; (e) a Service PE in terms of Article 5(2)(l)

of the Indo-US DTAA; and (f) a Dependent Agent PE in terms of Article 5(4) of the Indo-US DTAA.

25. Insofar as the attribution of income is concerned, the CIT(A) concurred with the AO that Rule 10 of the Income Tax Rules, 1962 was applicable. He further held that the accounts provided by the Assessee could not be accepted for computing the income as the transaction between the Assessee and Nortel Canada was not on an Arm's Length basis. However, the CIT(A) held that the expenses relatable to the PE were liable to be allowed as a deduction while estimating the profits attributable to the Assessee's PE in India and, accordingly, directed the AO to do so. The CIT(A) further held that keeping in view the facts of the case, 50% of the profits of the Assessee's estimated profits could be attributed to the PE in India.

Proceedings before the ITAT

26. Both, the Assessee and the Revenue preferred appeals against the order dated 22nd December, 2009. The Assessee was principally aggrieved by the CIT(A)'s decision upholding that the Assessee had a PE in India and attributing a part of its profits, computed on estimated basis, to its PE and assessing the same as chargeable under the Act. On the

other hand, the Revenue was aggrieved to the extent that CIT(A) had reduced the proportion of profits attributable to the Assessee's PE in India. The ITAT concurred with the AO and the CIT(A) that the contracts entered into between Nortel India and Reliance Infocom were a part of a 'turnkey contract' which had been artificially split up into three separate contracts. The ITAT further upheld the conclusion that the Assessee was only a shadow company of Nortel Group and was getting its work *inter alia* executed through Nortel India. The contracts were pre-negotiated by Nortel India and in view of the above, the ITAT concurred with the AO and the CIT(A) that Nortel India constituted a fixed place of business and a dependent agent PE of the Assessee in India. The ITAT also concurred with the view that the LO of Nortel Canada was rendering all kinds of service to Group companies including the Assessee and constituted a fixed place PE of the Assessee.

27. The ITAT rejected the Assessee's contention that the sale of equipment was completed overseas and the installation was done under a separate contract. The ITAT held that "*the assessee through Nortel India and LO approached the customer, negotiated the contract, bagged the contract, supplied equipment, installed the same, undertook acceptance test after which the system was accepted. The equipment remained in the*

virtual possession of Nortel Group till such time the equipment is set up and acceptance test is done."

28. The ITAT also held that the employees of the group companies visited India in connection with the project and this indicated that the employees of the Nortel Group carried on the business of the Assessee through the premises of Nortel India or the LO. As regards the attribution of income to the Assessee's PE in India, the ITAT concurred with the CIT(A)'s view that 50% of the estimated profits were attributable to the Assessee's PE in India. Accordingly, the appeals filed by the Revenue and the Assessee were dismissed.

Submissions

29. Mr Chopra, learned counsel appearing for the Assessee submitted that the contract for supply of equipment was a separate contract and was performed by the Assessee independently. He submitted that the said contract could have been entered into directly but Reliance insisted on having an Indian company as a single point of contact and, therefore, the contract was initially entered into between Nortel India and Reliance and, subsequently, assigned to the Assessee. He emphasized that Reliance is a party to the assignment contract and such assignment was also

contemplated under the Equipment Contract. He submitted that the purchase orders were placed directly by Reliance on the Assessee and the payments for the supply were also made directly by Reliance to the Assessee. Mr Chopra further referred to the definition of "price list" under the Equipment Contract and submitted that the prices for equipment as listed in Schedule A to the Equipment Contract were "*FCA relevant international airport basis INCOTERM 2000, including costs of exportation procedures from the country/ies of export and insurance from the Vendor's (i.e. Nortel India) warehouse up to Substantial Completion*" and this meant that the Vendor was liable to deliver the equipment to the carrier at the port of shipment. He contended that in the circumstances, the Equipment Contract only obliged the Assessee to deliver the equipment overseas and no part of the Assessee's activities were to be performed in India.

30. Next, Mr Chopra contended that Nortel India was an independent Assessee and any income attributable to Nortel India was liable to be assessed in its hands and not in the hands of the Assessee. He referred to the decision of the Supreme Court in the case of ***DIT (International Taxation), Mumbai v. Morgan Stanley and Co. Inc.*****: (2007) 292 ITR 416 (SC)** and ***Director of Income Tax and Ors. etc v. M/s. E. Funds IT***

***Solution and Ors. etc*: (2014) 364 ITR 256 (Delhi)** in support of his contention that a subsidiary of a foreign company could not be construed as its PE. He further submitted that no expatriate employee of the Assessee had visited India in connection with the Equipment Contract since the equipment was manufactured and supplied from overseas and there was no requirement to depute personnel to India.

31. Mr Chopra submitted that there was no material or evidence on record which would suggest that any fixed place in India had been made available to the Assessee for execution of its activities. Therefore, the AO's conclusion that Assessee had a fixed place PE in India is palpably erroneous. He further submitted that it was Nortel India who had negotiated the contract on its behalf and, therefore, its activities prior to assignment of contract could not be considered as the Assessee's activities. He submitted that since Reliance had insisted that the contract be secured with an Indian company, Nortel India had undertaken the responsibility and secured the contracts which included the Services Contract that was to be executed by Nortel India. In the circumstances, the conclusion that Nortel India had acted on behalf of the Assessee was erroneous.

32. Insofar as the existence of an installation PE is concerned, Mr Chopra argued that in terms of the services agreement, Nortel India was to carry out all activities relating to installation, erection and commissioning. Since installation was not a part of scope of the works contracted to the Assessee, there was no question of the Assessee having any installation PE in India.

33. Mr N.P. Sahni, Senior Standing Counsel appearing on behalf of the Revenue supported the decision of the ITAT.

Reasoning and Conclusion

34. The questions framed in ITA Nos.671/2014, 672/2014, 669/2014 and 689/2014 are similarly worded except in ITA No.689/2014 wherein an additional question regarding levy of interest under Section 234B of the Act is also framed. However, no contentions were advanced on either side with regard to levy of interest under Section 234B of the Act and consequently, the same is not being considered.

35. The first three questions framed in the aforesaid appeals relate to the dispute whether the Assessee has a PE in India and the fourth question relates to the issue of attribution of income to the Assessee's alleged PE in India.

36. The controversy whether the Assessee has a PE in India is interlinked to the finding that Nortel India had discharged some of the obligations of the Assessee under the Equipment Contract. Whilst, the Income Tax Authorities have held that the contracts entered into with Reliance – the Equipment Contact, Software Contract and Services Contract – are essentially a part of the singular turnkey contract, the Assessee contends to the contrary. Further, the Income Tax Authorities have held that a part of the Equipment Contract assigned to the Assessee was, in fact, performed by Nortel India. This too, is stoutly disputed by the Assessee. The question whether the Assessee has a PE in India is clearly interlinked with the issue whether Nortel India or Nortel LO had performed any of the functions or discharged any of the obligations assumed by the Assessee.

37. It is not disputed – on the contrary it has been expressly admitted – that the contracts entered into with Reliance were negotiated by Nortel India and neither Nortel LO nor the Assessee were involved in negotiations with Reliance. There is also no material on record which would indicate that Nortel LO or the Assessee had participated in any negotiation with Reliance. The facts on record indicate that Nortel India had negotiated the contracts with Reliance, and Nortel Canada had

executed a deed of guarantee (referred to as a 'Parent Guarantee') guaranteeing the performance of all the three contracts.

38. It has been argued on behalf of the Assessee that the agreement for supply of hardware (Equipment Contract) could have been directly executed between Reliance and the Assessee but Reliance had insisted on an Indian company being responsible for the entire works. Therefore, at the insistence of Reliance, in the first instance, the agreements were executed between Nortel India and Reliance, with Nortel Canada as a surety.

39. Thus, it is an admitted position that Nortel India had negotiated for the contracts and had entered into agreements that were to be performed not by Nortel India but by other entities of the Nortel group. According to the Assessee, the only reason for Nortel India executing the contracts was the insistence on the part of Reliance to have an entity in India responsible for the contracts. In this view, the contention advanced on behalf of the Assessee that Nortel India had acted for itself and not on behalf of any other group entity cannot be accepted and the findings of the Income Tax Authorities that Nortel India had negotiated the contract on behalf of the Nortel group as a whole cannot be faulted.

40. The Income Tax Authorities concluded that the Assessee was a shadow company of Nortel Canada and both the companies were essentially a singular entity. In other words, the Income Tax Authorities had disregarded the corporate structure of the Assessee and had proceeded on the basis that its identity is the same as Nortel Canada. It is now well settled that the corporate veil can be lifted only in exceptional and limited circumstances. Indisputably, in cases where it is found that the corporate structure has been devised only for evasion of taxes, the courts have permitted piercing of the corporate veil and this is a well accepted exception to the rule of a company being a juristic entity having a separate identity (see : ***In Re: Sir Dinshaw Maneckjee Petit*: AIR 1927, Bombay, 371**). However, piercing a corporate veil can be justified only in circumstances where it is found that a company has been incorporated only to evade taxes; the company has no real substance; and there is no commercial expediency for incorporating the company. In the present case, the Income Tax Authorities found the Assessee to be a mere paper company with no independent resources. Admittedly, the Assessee has also not carried out any other activity except supplying equipment pursuant to the contracts negotiated by Nortel India with Reliance and, in a later year, with BSNL. The Assessee has neither produced any material nor advanced any commercial reason for incorporation of the Assessee.

Significantly, the Assessee was incorporated a day prior to execution of the agreements and, clearly, when the award of contract from Reliance was a certainty. Admittedly, the equipment supplied to Reliance was manufactured by Nortel Canada and Nortel Ireland and shipped directly to Reliance. It is important to note that the performance of the Equipment Contract was also guaranteed by Nortel Canada. In the circumstances, the view of the authorities below that the Assessee is a mere shadow company - in other words an alter ego of Nortel Canada - is certainly a plausible view and cannot be held to be perverse.

41. In the aforesaid context, it would be appropriate to assume that the Equipment Contract was performed by Nortel Canada - as has been held by the AO and CIT(A) and concurred with by the ITAT - and on that footing, it is to be examined whether any income from supply of equipment could be taxed under the Act.

42. Section 4 of Act is a charging section and provides for levy of income tax in respect of total income of the previous year of every person. Section 5 of the Act outlines the scope of total income and provides that the total income of a person who is a non-resident in any previous year includes income from whatever source, which: *(a) is received or is deemed to be received in India in such year by or on behalf*

of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year. Section 9 of the Act specifies the income that are deemed to accrue or arise in India. Section 9 (1) of the Act specifies incomes which are deemed to accrue and arise in India. At this stage, it is necessary to refer to Section 9(1)(i), clause (a) of Explanation 1, Explanation 2 and Explanation 3 to Section 9(1)(i) which are quoted below:-

> "**Section 9** (1)The following incomes shall be deemed to accrue or arise in India-
>
> (i) 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:
>
> [Explanation 1] –For the purposes of this clause—(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;
>
> [*Explanation 2*—For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident, –
>
> (a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

(b)has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c)habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Explanation 3—Where a business is carried on in India through a person referred to in clause (a) or clause (b) or clause (c) of Explanation 2, only so much of income as is attributable to the operations carried out in India shall be deemed to accrue or arise in India."

43. It is apparent from the plain reading of Section 9(1) of the Act that all income which accrues or arises through or from any business connection in India would be deemed to accrue or arise in India. In ***CIT v. R.D. Aggarwal & Co.*: (1965) 56 ITR 20 (SC)**, the Supreme Court observed that business connection would mean *"a relation between a business carried on by a non-resident and some activity in the taxable territories which are attributable directly or indirectly to the earnings, profits or gains of such business"*. However, by virtue of Explanation 1 to Section 9(1) of the Act, only such part of the income which is reasonably attributable to operations carried out in India would be taxable. Thus, if it is accepted that the Assessee has received only the consideration for the equipment manufactured and delivered overseas, it would be difficult to uphold the view that any part of Assessee's income is chargeable to tax

under the Act as no portion of the said income could be attributed to operations in India.

44. There is little material on record to hold that Nortel India habitually exercises any authority on behalf of the Assessee or Nortel Canada to conclude contracts on their behalf. There is also no material on record which would indicate that Nortel India maintained any stocks of goods or merchandise in India from which goods were regularly delivered on behalf of the Assessee or Nortel Canada. Thus, by virtue of Explanation 2 read with Explanation 3 to Section 9(1)(i) of the Act, no part of Assessee's income could be brought to tax under the Act. It is only when a non-resident Assessee's income is taxable under the Act that the question whether any benefit under the Double Taxation Avoidance Treaty is required to be examined.

45. In ***Ishikawajima-Harima Heavy Industries v. Dir. Of Income Tax*****: (2007) 288 ITR 408 (SC)**, the Supreme Court considered a case where Petronet LNG Limited and five members of a consortium had entered into an agreement for setting up a Liquefied Natural Gas (LNG) receiving, storage and de-gasification facility at Dahej in the State of Gujarat. The contract was a turnkey project and the role of each member/consortium of contractors was separately specified. The contract

involved offshore supply, offshore services, onshore supply, onshore services and construction and erection of the facility. The contract price included consideration for offshore supplies and offshore services which was specified separately. The disputes arose as to liability to pay tax relating to consideration for offshore supplies and offshore services. Whereas the appellant (a member of the consortium of contractors) contended that the contract was a divisible one and it did not have any liability to pay tax in respect of consideration for offshore services and offshore supplies, the Revenue contended to the contrary. According to the Revenue, the contract in question was a composite one and could not be split up for the purposes of considering whether the income arising therefrom was taxable under the Act. The relevant extracts from the said judgment are reproduced below:-

> "**30.** 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 contract by itself may not be of much significance. The project is a turnkey project. The contract may also be a turnkey contract, 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. Obligations under the contract are distinct ones. Supply

obligation is distinct and separate from service obligation. Price for each of the component of the contract is separate. Similarly, offshore supply and offshore services have separately been dealt with. Prices in each of the segment are also different.

31. 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.

32. The contract indisputably was executed in India. By entering into a contract 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.

xxxx xxxx xxxx xxxx xxxx

39. The territorial nexus doctrine, thus, plays an important part in assessment of tax. Tax is levied on one transaction where the operations which may give rise to income may take place partly in one territory and partly in another. The question which would fall for our consideration is as to whether the income that arises out of the said transaction would be required to be proportioned to each of the territories or not.

40. Income arising out of operations in more than one jurisdiction would have territorial nexus with each of the jurisdictions on actual basis. If that be so, it may not be correct to contend that the entire income "accrues or arises" in each of the jurisdiction. ……

xxxx xxxx xxxx xxxx xxxx

76. In construing a contract, the terms and conditions thereof are to be read as a whole. A contract must be construed keeping in view the intention of the parties. No doubt, the applicability of the tax laws would depend upon the nature

of the contract, but the same should not be construed keeping in view the taxing provisions.

xxxx xxxx xxxx xxxx xxxx

98. We, therefore, hold as under:

(A) Re: Offshore supply

(1) That only such part of the income, as is attributable to the operations carried out in India can be taxed in India.

(2) Since all parts of the transaction in question i.e. the transfer of property in goods as well as the payment, were carried on outside the Indian soil, the transaction could not have been taxed in India.

(3) The principle of apportionment, wherein the territorial jurisdiction of a particular State determines its capacity to tax an event, has to be followed.

(4) The fact that the contract was signed in India is of no material consequence, since all activities in connection with the offshore supply were outside India, and therefore cannot be deemed to accrue or arise in the country.

(5) There exists a distinction between a business connection and a permanent establishment. As the permanent establishment cannot be said to be involved in the transaction, the aforementioned provision will have no application. The permanent establishment cannot be equated to a business connection, since the former is for the purpose of assessment of income of a non-resident under a Double Taxation Avoidance Agreement, and the latter is for the application of Section 9 of the Income Tax Act.

(6) Clause (a) of Explanation 1 to Section 9(1)(i) states that only such part of the income as is attributable to the operations carried out in India, are taxable in India.

(7) The existence of a permanent establishment would not constitute sufficient "business connection", and the

permanent establishment would be the taxable entity. The fiscal jurisdiction of a country would not extend to the taxing of entire income attributable to the permanent establishment.

(8) There exists a difference between the existence of a business connection and the income accruing or arising out of such business connection.

(9) Para 6 of the Protocol to the DTAA is not applicable, because, for the profits to be 'attributable directly or indirectly', the permanent establishment must be involved in the activity giving rise to the profits.

(B) Re: Offshore services:

(1) Sufficient territorial nexus between the rendition of services and territorial limits of India is necessary to make the income taxable.

(2) The entire contract would not be attributable to the operations in India viz. the place of execution of the contract, assuming the offshore elements form an integral part of the contract.

(3) Section 9(1)(vii) of the Act read with Memo cannot be given a wide meaning so as to hold that the amendment was only to include the income of non-resident taxpayers received by them outside India from Indian concerns for services rendered outside India.

(4) The test of residence, as applied in international law also, is that of the taxpayer and not that of the recipient of such services.

(5) For Section 9(1)(vii) to be applicable, it is necessary that the services not only be utilized within India, but also be rendered in India or have such a “live link” with India that the entire income from fees as envisaged in Article 12 of DTAA becomes taxable in India.

(6) The terms 'effectively connected' and 'attributable to' are to be construed differently even if the offshore services and the permanent establishment were connected.

(7) Section 9(1)(vii)(c) of the Act in this case would have no application as there is nothing to show that the income derived by a non-resident company irrespective of where rendered, was utilized in India.

(8) Article 7 of DTAA is applicable in this case, and it limits the tax on business profits to that arising from the operations of the permanent establishment. In this case, the entire services have been rendered outside India, and have nothing to do with the permanent establishment, and can thus not be attributable to the permanent establishment and therefore not taxable in India.

(9) Applying the principle of apportionment to composite transactions which have some operations in one territory and some in others, is essential to determine the taxability of various operations.

(10) The location of the source of income within India would not render sufficient nexus to tax the income from that source.

(11) If the test applied by the Authority for Advanced Rulings is to be adopted here too, then it would eliminate the difference between the connection between Indian and foreign operations, and the apportionment of income accordingly.

(12) The services are inextricably linked to the supply of goods, and it must be considered in the same manner."

46. It is clear from the above that even in cases of a turnkey contract, it is not necessary that for the purposes of taxability, the entire contract be considered as an integrated one. And, it does not follow that the amount payable for supply of goods overseas would be chargeable to tax under the Act.

47. As noticed earlier, there seems to be no dispute that the title to the equipment passed in favour of Reliance overseas. However, the AO, CIT (A) and ITAT did not consider the same to be relevant as according to them, the equipment continued to be in the possession of the "Nortel Group" till its final acceptance by Reliance. In our view, even if it is accepted that the equipment supplied overseas continued to be in possession of Nortel India till the final acceptance by Reliance, the same would not imply that the Assessee's income from supply of equipment could be taxed under the Act. Clause (a) of Explanation 1 to Section 9(1)(i) of the Act postulates the principle of apportionment and only such income that can be reasonably attributed to operations in India would be chargeable to tax under the Act. The position in ***Ishikawajima-Harima Heavy Industries*** (*supra*) was also similar. There too, the equipments were supplied overseas and the contractor continued to retain control of equipment and material till the provisional acceptance of the work or the termination of the contract. The relevant clause which was considered by the Supreme Court in that case is as under:-

> "22.1 *Title to equipment and materials and contractor's equipment*:
>
> Contractor agrees that title to all equipment and materials shall pass to the owner from the supplier or subcontractor pursuant to section E of exhibit H (General Project

> Requirements and Procedures). Contractor shall, however, retain case, custody, and control of such equipment and materials and exercise due care thereof until (a) provisional acceptance of the work, or (b) termination of this contract, whichever shall first occur. Such transfer of title shall in no way affect the owner's rights under any other provision of this contract."

48. In the present case, the CIT(A) had concluded that Assessee's obligations were not limited to supply of the equipment overseas but also included other obligations that were to be performed in India. He further held that the amounts received by the Assessee also included consideration for performance of certain activities in India. This is stoutly disputed by the Assessee. This dispute is pivotal for determining whether any part of the Assessee's income is chargeable to tax in India.

49. Section 3 of the Services Contract which provide for the scope of work and services to be performed under the Service Contract and the relevant extracts from the said section are reproduced below:-

> "3.1.1 The Vendor has to provide to Reliance the Services set forth in the relevant Purchase Order pursuant to and in accordance with this Optical Services Contract. All Services shall comply with the Specifications and the Standards. The Vendor shall coordinate its efforts hereunder with all Subcontractors, Third Party providers and the Other Contractors, to ensure compliance with any and all supply and transportation requirements and all Governmental Entities. All

Services, requiring certification shall be certified by independent and appropriate professionals licensed or properly qualified to perform such certification in an appropriate jurisdictions, reasonably acceptable and at no cost to Reliance, if such certification is required by Applicable Law or the Specifications. Vendor shall provide to Reliance, necessary installation Certificates, as per EPCG regulations for which the Parties will mutually agree on a format and procedure and for which Reliance shall reimburse Vendor for reasonable actual fees paid to any chartered engineers providing such certification.

xxxx xxxx xxxx xxxx xxxx

3.2.1 Vendor shall provide all Services purchased under a Purchase Order and in accordance with the relevant Specifications on an end-to-end basis to ensure successful completion of the Work (provided, however, that installation and commissioning Services shall be limited to the Services requested ordered in the applicable Purchase Order), which Services include but are not limited to:

(a) Product installation and commissioning (including commissioning testing) Services including, but not limited to, ready for installation inspection and validation and as-built documentation (redline versions); and

xxxx xxxx xxxx xxxx xxxx

3.2.2 At Reliance's request Vendor shall mobilize and commit sufficient resources necessary to successfully implement the Initial Optical ,Reliance Network Which will include up to two hundred (200) expatriates, with the approval of Reliance, as required, including subject matter experts (Subject to the experience requirements set forth in Section 3.10 below)."

50. A bare perusal of the Services Contract clearly indicates that the task of installation, commissioning and testing was contracted to Nortel

India and thus, the operations pertaining to installation and commissioning were not performed by Nortel India on behalf of the Assessee or Nortel Canada but on its own behalf. Thus, neither the Assessee nor Nortel Canada can be stated to have performed any installation or commissioning activity in India.

51. Next, it will be important to consider whether the consideration received by the Assessee for supply of equipment also subsumed consideration for other activities that were performed in India. The CIT(A) has held that "*the supply contract does not end with loading of equipment on the ship but includes a number of activities which are carried on in Indian territories and compensation/remuneration for that is also included in the consideration*". This dispute, as observed earlier, is at the heart of the controversy in this matter.

52. The equipment supplied by the Assessee is indisputably as per the terms of the obligations under the Equipment Contract. The recitals of the said contract reads as under:-

> "A. Reliance desires to purchase from the Vendor certain Equipment appropriate for the efficient and effective installation, operation, management and maintenance of the Optical Reliance Network including the Initial Optical Reliance Network; and

> B. The Vendor, desires to provide to Reliance such Equipment and shall including, without limitation manufacture, supply and deliver such Equipment, in accordance with the terms and conditions set forth herein."

53. Paragraph 1.2 of the Equipment Contract indicates the objectives of the said contract and reads as under:-

> "Reliance requires equipment that fully supports: (a) the Initial Optical Reliance Network and the Optical Reliance Network, including all cost, performance and functional requirements set forth in the relevant Documents; (b) Interoperability; and (c) Reliance's business requirements described in the Documents (collectively, the "objectives") The Vendor represents warrants and covenants that the Equipment shall be fully compatible with and fully supports ,the Objectives as shall be demonstrated to Reliance, in part, in the Acceptance Tests."

54. Article 3 of the Equipment Contract provides for the scope of work, responsibilities and milestones. A bare reading of the Equipment Contract also indicates that the vendor had other obligations such as coordinating its efforts with the sub-contractors; maintaining a fully equipped centre and depot with the requisite tools, spares and test equipment to ensure spares replacement within a period of 48 hours for critical spares and 15 working days for normal spares; warranty services; and a toll free access to vendor's technical assistance centres. The vendor was also obliged to provide equipment for a Test Bed Laboratory at no

extra cost to Reliance. However, there is no material to indicate that any of the obligations other than supply of equipment was performed by the Assessee or on its behalf in consideration of the amounts received by the Assessee. According to the Assessee, it had supplied the subject equipment and received the consideration for the same.

55. Article 5 of the Equipment Contract contains provisions for Pricing and Invoicing. Sub Article 5.1 is captioned "Price List" and paragraph 5.1.1 of the Equipment Contract reads as under:-

> "5.1.1 The prices as set forth in the Price List shall be applicable to all purchases by Reliance of Equipment, including without limitation spare and replacement parts."

56. The expression "Price List" is defined under the contract to read as under:-

> "**Price List**
>
> means a table of list prices (FCA, "relevant international airport basis, INCOTERM 2000, including costs for exportation procedures from the country/ies of export and insurance from the Vendor's warehouse up to Substantial Completion) applicable to Equipment supplied by Vendor to Reliance as amended from time to time as set forth herein. The Price List as of the Effective Date is set forth in Exhibit A."

57. The Assessee has consistently asserted that "*FCA, relevant*

international airport basis, INCOTERM 2000, from the country/ies of export and insurance from Vendor's warehouse to Substantial Completion" meant that the supplier was liable to deliver the equipment to the carrier at the port of shipment/airport of departure which in the present case would be outside India. The said interpretation has not been disputed on behalf of the Revenue.

58. In terms of the Assignment Contract, the Assessee assumed all rights and obligations of Nortel India under the Equipment Contract *"to sell, supply and deliver the Equipment to the Purchaser under the Equipment Contract"*.

Section 1 of the Assignment Contract is quoted below for ready reference:-

> "Section 1. Assignment and Assumption. Assignor hereby assigns to the Assignee all the rights, entitlements, covenants and obligations of the Assignor under the Equipment Contract to sell, supply and deliver the Equipment to the Purchaser under the Equipment Contract and the Assignee hereby assumes, and agrees with all of the parties hereto, to perform, observe and be bound by each and all of the foregoing obligations and covenants of Assignor. Notwithstanding the foregoing assignment and assumption, except as set forth in the next sentence, as between Assignor and Purchaser, the parties agree that Assignor shall continue to be bound by all of the terms and conditions of the Equipment Contract and shall remain fully

> liable to Purchaser under the Equipment contract to the same extent as if the foregoing assignment and assumption had not occurred. Purchaser agrees that from and after the Effective Date of this Assignment, Purchaser shall place all Purchase Orders and Change Orders for the supply of Equipment directly with Assignee and Assignor shall have no liability or obligations under this Assignment with respect to such Purchase Orders and Change Orders (the "Liability Exception").”

59. It is apparent from the above that the Assessee only assumed the obligation to sell, supply and deliver equipment in terms of the Equipment Contract and was paid in terms of the pricing mechanism as agreed to under the Equipment Contract. It is also material to note that Nortel India continued to be responsible for performance of the Equipment Contract except for performance of Purchase Orders and Exchange Orders for supply of equipment which were placed directly by Reliance on the Assessee. Although, the Assessee had repeatedly asserted that all other obligations for testing, installation and commissioning was done by Nortel India, for which Nortel India had been paid separately, no material or evidence was gathered by the AO to contradict the same. There is no material to indicate that equipment for Test Bed Laboratory, which was to be supplied at no additional cost to Reliance had been procured by Nortel India at additional cost or that Nortel India was not remunerated for all the services rendered by it to Reliance. In terms of the

Equipment Contract, adequate stock of spares was required to be maintained in India, however, there is no material to indicate that such stock was maintained in India by the Assessee or that such stock was maintained by Nortel India, not on its own behalf but on behalf of the Assessee, without being sufficiently remunerated. Thus, in absence of any such evidence or material, it is difficult for us to concur with the view that certain activities were performed in India for which the consideration was received by the Assessee.

60. It is also necessary to observe that even if the AO was of the view that Nortel India was not adequately remunerated for the Assignment Contract, the AO was required to make an appropriate transfer pricing adjustment in the hands of Nortel India.

61. Thus, in our view, the question whether the Assessee has a PE in India is not material as it is not possible to hold that any part of the income of the Assessee could be apportioned to operations carried on in India.

62. Having stated the above, for the sake of completeness, we may also examine the controversy whether the Assessee has a PE in India and whether any part of the Assessee's income could be attributed to such PE.

63. Undisputedly, even if it is accepted that some portion of the obligations undertaken by the Assessee were performed in India, the Assessee's income arising from the performance of the Equipment Contract could be brought to tax only to the extent as permissible under the relevant DTAA - DTAA between India and USA or DTAA between India and Canada.

64. Both the OECD and US Model Conventions specify that only such portion of business profits that is attributable to the PE of a foreign enterprise would be taxable in the other contracting state. The UN Model Convention also provides for additionally bringing such business profits that could be attributed to the PE by force of attraction to a PE; that is, income from sale of goods and merchandise or through business activities carried on in a State which are similar to goods and merchandise sold through the PE or activities carried on through a PE would also be subject to tax in the contracting state in which the PE is situated. Paragraphs 1 of Article 7 of the Model Conventions are relevant and are re-produced below:

"OECD MC

Article 7

Business Profits

1. 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 that are attributable to the permanent establishment in accordance with the provisions of paragraph 2 may be taxed in that other State.

UN MC

Article 7

Business Profits

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 that 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 that other State of the same or similar kind as those effected through that permanent establishment.

US MC

Article 7

Business Profits

"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 business profits of the enterprise may be taxed in the other State but only so much

of them as is attributable to that permanent establishment."

65. Article 7 of the Indo-USA DTAA 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.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable

to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by

way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes of this Convention, the profits to be attributed to the permanent establishment as provided in paragraph 1(a) of this Article shall include only the profits derived from the assets and activities of the permanent establishment and shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where profits include items of income which are dealt with separately in other Articles of the Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

7. For the purposes of the Convention, the term "business profits" means income derived from any trade or business including income from the furnishing of services other than included services as defined in Article 12 (Royalties and Fees for Included Services) and including income from the rental of tangible personal property other than property described in paragraph 3(b) of Article 12 (Royalties and Fees for Included Services).”

66. India and Canada have also entered into a DTAA. Paragraph 1 of Article 7 of the Indo-Canada DTAA is slightly different from paragraph 1 of Article 7 of the Indo-US DTAA - which is similar to paragraph 1 of Article 7 of the UN model convention - in as much as other business activities carried on in the other State of the same or similar kind as those effected through the permanent establishment are not subject to tax in the state where the PE is situated.

67. Thus, if we proceed on the assumption that a part of the Assessee's income is attributable to activities carried out in India through a business connection, the question whether the Assessee had a PE in India during the relevant AYs would become relevant. This is so because, if the Assessee did not have any PE in India then its business income would not be taxable under the Act even though a part of the same can be attributed to activities in India.

68. Article 5 of the Indo-US DTAA defines PE as under:-

> **"Article 5**
>
> **PERMANENT ESTABLISHMENT**
>
> 1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

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

(g) a warehouse, in relation to a person providing storage facilities for others;

(h) a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on;

(i) a store or premises used as a sales outlet;

(j) an installation or structure used for the exploration or exploitation of natural resources, but only if so used for a period of more than 120 days in any twelve-month period;

(k) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve-month period;

(l) the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or

(ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)].

3. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include any one or more of the following:

(a) the use of facilities solely for the purpose of storage, display, or occasional delivery of goods or merchandise belonging to the enterprise;

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

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

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

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have a preparatory or auxiliary character, for the enterprise.

4. Notwithstanding the provisions of paragraphs 1 and 2, where a person–other than an agent of an independent status to whom paragraph 5 applies–is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that

enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if:

(a) he has and habitually exercises in the first-mentioned State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;

(b) he has no such authority but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise, and some additional activities conducted in that State on behalf of the enterprise have contributed to the sale of the goods or merchandise; or

(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's-length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a

> permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other."

The Definition of PE under Article 5 of the DTAA between India and Canada is also similar.

69. The AO, CIT(A) and ITAT have held that the office of Nortel India and Nortel LO constituted a fixed place of business of the Assessee. As pointed out earlier, we find no material on record that would even remotely suggest that Nortel LO had acted on behalf of the Assessee or Nortel Canada in negotiating and concluding agreements on their behalf. Thus, it is not possible to accept that the offices of Nortel LO could be considered as a fixed place of business of the Assessee. In so far as Nortel India is concerned, there is also no evidence that the offices of Nortel India were at the disposal of the Assessee or Nortel Canada. Even if it is accepted that Nortel India had acted on behalf of the Assessee or Nortel Canada, it does not necessarily follow that the offices of Nortel India constituted a fixed place business PE of the Assessee or Nortel Canada. Nortel India is an independent company and a separate taxable entity under the Act. There is no material on record which would indicate that its office was used as an office by the Assessee or Nortel Canada. Even if it is accepted that certain activities were carried on by Nortel India on

behalf of the Assessee or Nortel Canada, unless the conditions of paragraph 5 of Article 7 of the Indo-US DTAA is satisfied, it cannot be held that Nortel India constituted a fixed place of business of the Assessee or Nortel Canada.

70. The AO has further alleged that the offices of Nortel LO and Nortel India were used as a sales outlet. In our view, this finding is also unmerited as there is no material which would support this view. The facts on record only indicate that Nortel India negotiated contracts with Reliance. Even assuming that the contracts form a part of the single turnkey contract, which include supply of equipment - as held by the authorities below - the same cannot lead to the conclusion that Nortel India was acting as a sales outlet.

71. The AO's conclusion that there is an installation PE in India, is also without any merit. A bare perusal of the Services Contract clearly indicates that the tasks of installation, commissioning and testing was contracted to Nortel India and Nortel India performed such tasks on its own behalf and not on behalf of the Assessee or Nortel Canada. Undisputedly, Nortel India was also received the agreed consideration for performance of the Services Contract directly by Reliance.

72. The finding that Nortel India is a services PE of the Assessee is also erroneous. There is no material to hold that Nortel India performed services on behalf of the Assessee.

73. The AO has also held that Nortel India constituted Dependent Agent PE of the Assessee in India. The aforesaid conclusion was premised on the finding that Nortel India habitually concludes contracts on behalf of the Assessee and other Nortel Group Companies. In the present case, there is no material on record which would indicate that Nortel India habitually exercises authority to conclude contracts for the Assessee or Nortel Canada. In order to conclude that Nortel India constitutes a Dependent Agent PE, it would be necessary for the AO to notice at least a few instances where contracts had been concluded by Nortel India in India on behalf of other group entities. In absence of any such evidence, this view could not be sustained.

74. The CIT(A) as well as the ITAT has proceeded on the basis that the Assessee had employed the services of Nortel India for fulfilling its obligations of installation, commissioning, after sales service and warranty services. The ITAT also concurred with the view that since employees of group companies had visited India in connection with the project, the business of the Assessee was carried out by those employees

from the business premises of Nortel India and Nortel LO. In this regard, it is relevant to observe that a subsidiary company is an independent tax entity and its income is chargeable to tax in the state where it is resident. In the present case, the tax payable on activities carried out by Nortel India would have to be captured in the hands of Nortel India. Chapter X of the Act provides an exhaustive mechanism for determining the Arm's Length Price in case of related party transactions for ensuring that real income of an Indian Assessee is charged to tax under the Act. Thus, the income from installation, commissioning and testing activities as well as any function performed by expatriate employees of the group companies seconded to Nortel India would be subject to tax in the hands of Nortel India and the same cannot be considered as income of the Assessee.

75. Thus, the first three questions framed in ITA 671/2014, 672/2014, 669/2014 and 689/2014 are answered in the affirmative, that is, in favour of the Assessee and against the Revenue.

76. In view of our conclusion that the Assessee's income from supply of equipment was not chargeable to tax in India, the question relating to attribution of any part of such income to activities in India does not arise. In view of our conclusion that the Assessee does not have a PE in India,

the question of attribution of any income to the alleged PE also does not arise.

77. The controversy involved in ITA 666/2014, 667/2014 and 673/2014 does not relate to the issue whether the Assessee has a PE in India but concerns the question whether research and development expenses were liable to be taken into account while estimating the profits under Rule 10 of the Income Tax Rules, 1962. This issue also no longer survives in view of our conclusion that no part of the Assessee's income from supply of equipment is chargeable to tax under the Act.

78. The appeals are, accordingly, allowed and the impugned orders are set aside. However, the parties are left to bear their own costs.

VIBHU BAKHRU, J

S.MURALIDHAR, J

MAY 04, 2016
RK/MK/pkv