

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO.(s). 2833 OF 2018  
(Arising out of SLP(C)No.25363 of 2014)

HONDA MOTOR CO.LTD, JAPAN,  
THROUGH ITS AUTHORISED REPRESENTATIVE

Appellant(s)

VERSUS

ASSTT.DIRECTOR OF INCOME-TAX, NOIDA & ORS.

Respondent(s)

WITH

CIVIL APPEAL NO.(s). 2834 OF 2018  
(Arising out of SLP(C) No. 26978/2014)

CIVIL APPEAL NO.(s). 2835 OF 2018  
(Arising out of SLP(C) No. 26841/2014)

CIVIL APPEAL NO.(s). 2836 OF 2018  
(Arising out of SLP(C) No. 26829/2014)

CIVIL APPEAL NO.(s). 2837 OF 2018  
(Arising out of SLP(C) No. 26826/2014)

CIVIL APPEAL NO.(s). 2838 OF 2018  
(Arising out of SLP(C) No. 26803/2014)

CIVIL APPEAL NO.(s). 2839 OF 2018  
(Arising out of SLP(C) No. 7526/2015)

CIVIL APPEAL NO.(s). 2840 OF 2018  
(Arising out of SLP(C) No. 8142/2015)

O R D E R

Leave granted.

We have heard learned counsel for the parties and perused the record.

In the judgment of this Court dated 24<sup>th</sup> October, 2017 in Assistant Director of Income Tax-I, New Delhi v. M/s. E-Funds IT Soluction Inc., Civil Appeal NO.6082 of 2015 and connected matters, it has been held that once arm's length principle has been satisfied, there can be no further profit attributable to a person

even if it has a permanent establishment in India.

Since the impugned notice for the reassessment is based only on the allegation that the appellant(s) has permanent establishment in India, the notice cannot be sustained once arm's length price procedure has been followed.

Accordingly, the impugned order(s) is set aside and the appeals are allowed.

Learned counsel for the Revenue states that he does not have complete instructions. If the Revenue disputes the above factual position, it will be at liberty to move this Court.

.....J.  
(ADARSH KUMAR GOEL)

.....J.  
(ROHINTON FALI NARIMAN)

.....J.  
(NAVIN SINHA)

New Delhi,  
March 14, 2018.

ITEM NO.14

COURT NO.11

SECTION XI

S U P R E M E C O U R T O F I N D I A  
R E C O R D O F P R O C E E D I N G S

Petition(s) for Special Leave to Appeal (C) No(s). 25363/2014

(Arising out of impugned final judgment and order dated 05-08-2014 in CMWP (TAX) No. 1363/2012 passed by the High Court Of Judicature At Allahabad)

HONDA MOTOR CO.LTD, JAPAN,  
THROUGH ITS AUTHORISED REPRESENTATIVE

Appellant(s)

VERSUS

ASSTT.DIRECTOR OF INCOME-TAX, NOIDA &amp; ORS.

Respondent(s)

WITH SLP(C) No. 7526/2015 (XI)  
SLP(C) No. 8142/2015 (XI)  
SLP(C) No. 26978/2014 (XI)  
SLP(C) No. 26841/2014 (XI)  
SLP(C) No. 26829/2014 (XI)  
SLP(C) No. 26826/2014 (XI)  
SLP(C) No. 26803/2014 (XI)

Date : 14-03-2018 These petitions were called on for hearing today.

CORAM :

HON'BLE MR. JUSTICE ADARSH KUMAR GOEL  
HON'BLE MR. JUSTICE ROHINTON FALI NARIMAN  
HON'BLE MR. JUSTICE NAVIN SINHA

For Petitioner(s) Mr. Parag Tripathi, Sr. Adv.  
Mr. Tarun Gulati, Adv.  
Mr. Kishore Kunal, Adv.  
Mr. Pranav Bansal, Adv.  
Mr. Prashant Tahiliani, Adv.  
Ms. Anshul Verma, Adv.  
Mr. Abhishek Boob, Adv.  
Mr. R. Chandrachud, AOR  
Mr. Shashi Mathews, Adv.

For Respondent(s) Mr. Y.P. Adhyaru, Sr. Adv.  
Mr. H.R. Rao, Sr. Adv.  
Mr. Arijit Prasad, Adv.  
Mr. T.M. Singh, Adv.  
Mr. Pravesh Thakur, Adv.  
Mrs. Anil Katiyar, AOR  
Mr. S.A. Haseeb, Adv.  
Mr. Arun Kumar Singh, Adv.  
Mr. Niranjana Singh, Adv.

UPON hearing the counsel the Court made the following  
O R D E R

Leave granted.

In terms of the signed order, the appeals are allowed.

Pending applications, if any, shall also stand disposed of.

(MAHABIR SINGH)  
COURT MASTER

(PARVEEN KUMARI PASRICHA)  
BRANCH OFFICER

(Signed order is placed on the file)

**Court No. - 33**

**Case :-** WRIT TAX No. - 1363 of 2012

**Petitioner :-** The Principal Officer, Honda Motor Co. Ltd.

**Respondent :-** Asstt. Director Of Income Tax, International Taxation & Ors.

**Counsel for Petitioner :-** Gaurav Mahajan, Amit Mahajan

**Counsel for Respondent :-** C.S.C., Income Tax, Ashok Kumar

**Hon'ble Tarun Agarwala, J.**

**Hon'ble Dinesh Gupta, J.**

Dismissed.

For orders, see order of date passed in Writ Tax No.1366 of 2012.

**Order Date :-** 5.8.2014

Bhaskar

**(Dinesh Gupta, J.)      (Tarun Agarwala, J.)**

**Civil Misc. Writ Petition (Tax) No.1366 of 2012**

The Principal Officer, LG Electronics Inc. .... Petitioner

Vs.

Asstt. Director Of Income Tax,  
International Taxation & Ors. .... Respondents

**Connected with**

**Civil Misc. Writ Petition (Tax) Nos.**1365 of 2012, 1363 of 2012, 1364 of 2012, 1367 of 2012, 1373 of 2012, 60 of 2013, 61 of 2013, 62 of 2013, 63 of 2013, 64 of 2013, 65 of 2013, 66 of 2013, 67 of 2013, 68 of 2013, 69 of 2013, 70 of 2013, 71 of 2013, 72 of 2013, 73 of 2013, 75 of 2013, 76 of 2013, 77 of 2013, 78 of 2013, 79 of 2013, 80 of 2013, 81 of 2013, 82 of 2013, 83 of 2013, 84 of 2013, 85 of 2013, 86 of 2013, 87 of 2013, 88 of 2013, 89 of 2013, 90 of 2013, 91 of 2013, 92 of 2013, 93 of 2013, 94 of 2013, 95 of 2013, 96 of 2013, 98 of 2013, 99 of 2013, 100 of 2013, 101 of 2013, 102 of 2013.

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**Hon'ble Tarun Agarwala, J.**

**Hon'ble Dinesh Gupta, J.**

**(Per: Tarun Agarwala, J.)**

(Delivered on 5<sup>th</sup> August, 2014)

In this group of writ petitions, the petitioner's have challenged the validity and legality of the notice issued under Section 148 of the Income Tax Act, 1961 (*hereinafter referred to as the Act*). For facility, the facts

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of Writ Petition No.1366 of 2012 are being taken into consideration.

The petitioner is a Company incorporated under the laws of South Korea and is engaged in the business and manufacture of sale of refrigerators, washing machines, air conditioners and other household electronic appliances. The petitioner has a wholly owned subsidiary company in India known as LG Electronics India Private Limited (*hereinafter referred to as LGIL*) and has entered into several transactions relating to sale of raw materials finished goods and has received royalty income fees for technical services, etc. These transactions have been carried out between the two companies every year since its inception. For the assessment year 2004-05, the petitioner was in receipt of royalty income and fees for technical services of which the tax due was duly deducted and deposited. The petitioner, however did not file any return of income for the period under consideration since full tax as per the provision of Double Taxation Avoidance Agreement (DTAA) had been deducted by the Indian subsidiary on such payments.

On 24<sup>th</sup> June, 2010 a survey was carried out by the income tax department on the premises of the Indian subsidiary under Section 133A of the Act. In this survey statements of expatriate employees of the Indian subsidiary were recorded by the survey team. On the basis of the statement recorded, the Assistant Director of Income Tax (International Taxation), Noida formed a

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belief that the petitioners income was chargeable to tax in India and had escaped assessment and, accordingly, issued a notice dated 30<sup>th</sup> March, 2011 under Section 148 of the Act indicating that there was reasons to believe that the income of the petitioner had escaped assessment within the meaning of Section 147 of the Act.

In compliance of the said notice, the petitioner filed nil return of income under protest and, in terms of the procedure laid down by the Supreme Court in the ***GKN Driveshafts Vs. Income Tax Officer, 259 ITR 19*** applied for a copy of the reasons recorded, which was duly provided to the petitioner. Upon receipt of the reasons, the petitioner filed his objections objecting to the initiation of the reassessment proceedings contending that there was no material to form a belief that income chargeable to tax had escaped assessment. It was contended that the statements of the employees have been misconstrued to form an opinion that a permanent establishment (PE) of the petitioner was existing in India. The petitioner contended that the transactions in respect of which it is alleged that there has been an escapement of income had already been disclosed by the Indian subsidiary, which has been considered by the Transfer Pricing Officer (TPO) and found to be at arm's length basis.

The objection of the petitioner was duly considered and was disposed of by the Assistant Director of Income Tax, respondent no.1 by an order dated 2<sup>nd</sup> November,

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2012 contending that the survey clearly indicated that the petitioner had a permanent establishment in India and, consequently, the profits were required to be attributed to the permanent establishment in India in terms of the functions performed, risks assumed and assets deployed by the permanent establishment. The petitioner, being aggrieved by the initiation of the proceedings under Section 148 of the Act has consequently, filed the present writ petition.

We have heard Sri S. Ganesh, the learned Senior Counsel assisted by Sri Deepak Chopra, Sri Gaurav Mahajan and Sri Amit Mahajan, the learned counsels for the petitioner and Sri G.C. Srivastava along with Sri Ashok Kumar, the learned counsel for the Income Tax department.

Sri S. Ganesh, the learned Senior Counsel contended that the impugned notice has been issued in gross violation of the provisions of Section 147 of the Act and that the basic ingredients for assuming jurisdiction under Section 147/148 of the Act was not satisfied. The learned Senior Counsel submitted that the reasons to believe has been formed on the premise that certain income had escaped assessment which is based on certain transactions, which has already been accepted by the TPO as having met the arm's length price. The learned Senior Counsel submitted that the assumption of jurisdiction under Section 147 of the Act can be assumed when the Assessing Officer has reasons to believe that any income chargeable to tax had escaped

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assessment. The learned Senior Counsel submitted that in the facts of the given case, it is established that no income chargeable to tax had escaped assessment and that the respondents were unable to cross the very threshold for assuming such jurisdiction. It was submitted that there was no new material, which had come into possession of the respondents, which could reasonably led them to infer that income chargeable to tax had escaped assessment. The learned Senior Counsel submitted that the reasons recorded was only a suspicion on the basis of which reassessment proceedings could not be initiated and, consequently, there has been a complete non-application of mind.

The learned Senior Counsel submitted that it is of crucial importance to note that the said transactions between the petitioner company and its subsidiary were referred to the Transfer Pricing Authority (TPO) under Section 92CA and that the TPO by his order dated 28<sup>th</sup> December, 2006 held that the prices at which the said transactions took place between the petitioner and its subsidiary in India were at arm's length prices and, therefore, no transfer pricing adjustment was required to be made under Chapter X of the Act. The learned Senior Counsel submitted that the order of the TPO was binding on the Assessing Officer under Section 92CA(4), which has not been considered by the authority while issuing the notice under Section 148 of the Act. The learned Senior Counsel submitted that the Assessing Officer had no jurisdiction or authority in law to raise any

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contention, which was contrary to or inconsistent with the order of TPO passed under Section 92CA.

The learned Senior Counsel further contended that the reasons recorded by the first respondent in issuing the impugned notice under Section 148 of the Act is, that the petitioner's Indian subsidiary LGIL is in fact a permanent establishment (PE) of the petitioner company and, consequently, the transactions between the petitioner and its permanent establishment gives rise to income attributable to the permanent establishment, which is assessable in the hands of the petitioner company in India. The learned Senior Counsel contended that the belief that the subsidiary company of the petitioner is in fact a permanent establishment is based on no evidence rather is based on surmises and conjectures. The learned Senior Counsel contended that even assuming without admitting that the petitioner had a permanent establishment in India, even then no income or profit could be determined or taxed in India in view of the order of the TPO.

The learned Senior Counsel contended that this reasoning of the Assessing Officer was contrary to the decision of the Supreme Court in ***DIT (International Taxation) Vs. Morgan Stanley and Co. Inc., 292 ITR 416*** wherein the Supreme Court held that where the Indian permanent establishment has received or paid arm's length prices for the transactions into by it with the foreign principal, then in law no further income assessable to tax in India could be attributable to the

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PE, which could be assessed in the hands of the foreign principal.

The learned Senior Counsel contended that the first respondent, while considering ***Morgan Stanley's case (supra)*** had committed a manifest error in holding that the prices at which the PE's transactions took place were not at arm's length without considering the order of the TPO. The learned Senior Counsel submitted that the Assessing Officer bypassing the order of the Supreme Court in ***Morgan Stanley's case (supra)*** has made a desperate attempt to justify the notice under Section 148 of the Act, which was wholly illegal and without any authority of law and contrary to the order of the TPO.

The learned Senior Counsel submitted that the petitioner had entered into various transactions with its Indian subsidiary with regard to the supply of raw materials, export of finished goods and capital goods, receipts of royalty income, receipts of fees on technical services, commissions, reimbursement, etc. These transactions have been noticed by the Assessing Officer from Form 3CEB filled by the Indian subsidiary disclosing related party transactions under the provisions of Chapter X of the Act. The Indian subsidiary has already deducted the tax at source and deposited the same with the government. Thus, there could not be any escapement of income. The reasons to believe recorded by the Assessing Officer that the income of the petitioner chargeable to tax had escaped assessment allegedly on account of these transactions relating to

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supply of raw materials, finished goods, commission and reimbursement was patently erroneous, inasmuch as these transactions between the petitioner and its Indian subsidiary has already been accepted by the TPO and such findings have attained finality. The learned Senior Counsel submitted that by resorting to reassessment proceedings the Assessing Officer was seeking to sit on the judgment and review the findings of the Transfer Pricing Officer, which could not be done.

The learned Senior Counsel submitted that the transactions relating to sale of raw materials, etc. between the petitioner and its subsidiary stood already disclosed by the Indian subsidiary and was accepted by the tax authorities and, consequently, the tax authorities having themselves accepted the same transactions in the subsidiary company's case were precluded from attributing any further income in the hands of the petitioner so as to allege that any income chargeable to tax had escaped assessment for the assessment year under consideration.

The learned Senior Counsel further submitted that the respondents have patently ignored the provisions of the DTAA between India and Korea, which is applicable in the instant case, as the petitioner is a tax resident of Korea and entitled to be governed by the provisions of such DTAA and the laws of Korea. The learned Senior Counsel submitted that the cardinal principle is that if a transaction has been submitted by one arm of the government then it was not open to the income tax

authorities to question the same.

On the other hand, Sri G.C. Srivastava, the learned counsel for the Income Tax department submitted that the Assessing Officer has reopened the assessment proceedings on the basis of the material uncovered in survey proceedings dated 24th June, 2010, which indicated that the petitioner has a permanent establishment (PE) in India for the purpose of the Income Tax Act. The learned counsel submitted that a survey under Section 133A of the Act was conducted on the premises of the Indian subsidiary in which the statements of various heads and expatriate employees were recorded and subsequent inquiries were carried out on the basis of which an opinion was formed that the petitioner was having a business connection as per Section 9(1)(i) of the Act and has a fixed place of business as per Article 5(1) of the DTAA. It was further submitted that this survey was carried out subsequent to the order of the TPO and that the survey findings are not part of the order of the TPO. The learned counsel submitted that the petitioner has also not filed returns for the assessment year in question raising the possibility that income had escaped assessment under the Act . The notice issued under Section 148 of the Act has only been issued on the basis of fresh materials uncovered in the course of the survey and, consequently, the Assessing Officer was within its jurisdiction and had the authority of law to issue the notice. The learned counsel submitted that the transfer pricing order does not prohibit

the Assessing Officer from initiating proceedings under Section 148 of the Act.

The learned counsel submitted that once it is established that there exist a permanent establishment of the petitioner in India, then any income of a non-resident, namely, the petitioner, has to be determined and profits need to be attributed and taxed in India as per the provision of Rule 10 of the Income Tax Rules.

Sri Srivastava submitted that under the DTAA, if the involvement of a permanent establishment in India is established, then the extent of income that can be taxed can be determined. Article 7 of the DTAA is similar to Section 9 of the Income Tax Act, which spells out the extent to which the income of a non-resident could be liable to tax in India. Section 9 has a direct territorial nexus and relief under a double taxation treaty having regard to the provisions contained in Section 90(2) would arise only in the event, a taxable income of the assessee arises in one contracting state on the basis of approval of income in other contracting state on the basis of residence. The learned counsel submitted that in attracting the tax statute, there has to be some activity through a permanent establishment and if income arises through a permanent activity, the principle of arm's length are required to be applied. The mandate of the provisions of Section 10 empowers the tax authorities to scrutinise all related transactions.

In support of their submissions, the learned counsel for the parties have placed reliance on several

decisions, which would be referred hereinafter at the appropriate place.

Income chargeable to tax that has escaped assessment has been provided under Section 147 of the Act. With effect from 1<sup>st</sup> April, 1989, Section 147 underwent an amendment to the effect that if the Assessing Officer had “reasons to believe” that any income chargeable to tax had escaped assessment, the Assessing Officer could assess or reassess such income. “Reasons to believe” has been a subject matter of interpretation by various Courts in various decisions. A Division Bench of this Court in ***Indra Prastha Chemicals Pvt. Ltd. and others Vs. Commissioner of Income Tax and another, 271 ITR 113***, after considering various decisions of Supreme Court and other High Court, culled out the following:-

*“Under Section 147 of the Act the proceedings for the assessment can be initiated only if the Assessing Officer has reason to believe that any income chargeable to tax has escaped assessment for any assessment year. The question whether the Assessing Officer had reasons to believe is not a question of limitation only but is a question of jurisdiction, a vital thing, which can always be investigated by the Court in an application under Article 226 of the Constitution as held in Daulatram Rawatmal v. ITO (1960) 38 JTR 301 (Cal), Jamna Lal Kabra v. ITO (1968) 69 ITR 461 (All), Calcutta Discount Co. Ltd. v. ITO (1961) 41 ITR 191 (SC), CM. Rajgharia v. ITO (1975) 98 ITR 486 (Pat) and Madhya Pradesh Industries Ltd. v. ITO (1965) 57 ITR 637*

(SC).

*The words "has reason to believe" are stronger than the words "is satisfied". The belief entertained by the Assessing Officer must not be arbitrary or irrational. It must be reasonable or, in other words, it must be based on reasons which are relevant and material as held by the apex Court in Ganga Saran and Sons (P) Ltd. v. ITO, (1981) 130 ITR 1.*

*The expression "reason to. believe" in Section 147 does not mean purely subjective satisfaction on the part of the Assessing Officer. The belief must be held in good faith; it cannot be merely a pretence. It is open to the Court to examine whether the reasons for the belief have a rational connection or a relevant bearing to the formation of the belief and are not extraneous or irrelevant to the purpose of the section. To this limited extent, the action of the Assessing Officer in starting proceedings under Section 147 is open to challenge in a Court of law as held in S. Narayanappa v. CIT (1967) 63 ITR 219 (SC). Kantamani Venkata Narayana and Sons v. Addl ITO (1967) 63 ITR 638 (SC), Madhya Pradesh Industries Ltd. v. ITO (1970) 77 ITR 268 (SC), Sowdagar Ahmed Khan v. ITO (1968) 70 ITR 79 (SC), ITO v. Lakhmani Mewal Das, (1976) 103 ITR 437 (SC), ITO v. Nawab Mir Barkat Ali Khan Bahadur, (1974) 97 ITR 239 (SC), CST v. Bhagwan Industries (P) Ltd., (1973) 31 STC 293 (SC) and State of Punjab v. Balbir Singh (1994) 3 SCC 299.*

*The formation of the required opinion and belief by the Assessing Officer is a condition precedent. Without such formation, he will not have jurisdiction to initiate proceedings under Section 147. The fulfilment*

*of this condition is not a mere formality but it is mandatory. The failure to fulfil that condition would vitiate the entire proceedings as held by the apex Court in the case of Johri Lal (HUF) v. CIT, (1973) 88 ITR 439 (SC) and Sheo Nath Singh v. AAC of I.T., (1971) 82 ITR 147 (SC). The reasons for the formation of the belief must have rational connection with or relevant bearing on the formation of belief. Rational connection postulates that there must be a direct nexus or live link between the material coming to the notice of the Assessing Officer and the formation of his belief that there has been escapement of income of the assessee from assessment in the particular year. It is not any and every material, howsoever vague and indefinite or distant, remote and farfetched, which would warrant the formation of the belief relating to escapement of income of the assessee from assessment, as held by the Hon'ble Supreme Court in the case of ITO v. Lakhmani Mewal Das (1976) 103 ITR 437. If there is no rational and intelligible nexus between the reasons and the belief, so that on such reasons, no one properly instructed on facts and law could reasonably entertain the belief, the conclusion would be inescapable that the Assessing Officer could not have reason to believe. In such a case, the notice issued by him would be liable to be struck down as invalid as held in the case of Ganga Saran and Sons P. Ltd. v. ITO (1981) 130 ITR 1 (SC).*

*Thus, it is well settled that the 'reason to believe' under Section 147 must be held in good faith and should have a rational connection and relevant bearing on the formation of the belief and should not be extraneous or irrelevant. Further, this Court in*

*proceedings under Article 226 of the Constitution of India can scrutinize the reasons recorded by the AO for initiating the proceedings under Sections 147/148 of the Act. The sufficiency of the material cannot be gone into but relevancy certainly be gone into.”*

**In *Hindustan Lever Ltd. Vs. R.B. Wadkar, Assistant Commissioner of Income Tax and others, 268 ITR 332*, the Bombay High Court held:**

*“ . The reasons recorded by the assessing officer nowhere state that there was failure on the part of the assessee to disclose fully and truly all material facts necessary for the assessment of that assessment year. It is needless to mention that the reasons are required to be read as they were recorded by the assessing officer. No substitution or deletion is permissible. No additions can be made to those reasons. No inference can be allowed to be drawn based on reasons not recorded. It is for the assessing officer to disclose and open his mind through reasons recorded by him. He has to speak through his reasons. It is for the assessing officer to reach to the conclusion as to whether there was failure on the part of the assessee to disclose fully and truly all material facts necessary for his assessment for the concerned assessment year. It is for the assessing officer to form his opinion. It is for him to put his opinion on record in black and white. The reasons recorded should be clear and unambiguous and should not suffer from any vagueness. The reasons recorded must disclose his mind. Reasons are the manifestation of mind of the assessing officer. The reasons recorded should be self-explanatory and should not keep the assessee guessing for the reasons. Reasons provide link*

*between conclusion and evidence. The reasons recorded must be based on evidence. The assessing officer, in the event of challenge to the reasons, must be able to justify the same based on material available on record. He must disclose in the reasons as to which fact or material was not disclosed by the assessee fully and truly necessary for assessment of that assessment year, so as to establish vital link between the reasons and evidence. That vital link is the safeguard against arbitrary reopening of the concluded assessment. The reasons recorded by the assessing officer cannot be supplemented by filing affidavit or making oral submission, otherwise, the reasons which were lacking in the material particulars would get supplemented, by the time the matter reaches to the Court, on the strength of affidavit or oral submissions advanced.”*

**In *Jamna Lal Kabra Vs. Income Tax Officer, 'B' Ward, Bareilly and others, 69 ITR 461***, a Division Bench of the Allahabad High Court held:

*“It is clear that the Income-tax Officer is bound to record the reasons for issuing a notice under section 148. The requirement is mandatory. Before the assessment can be had, the Income-tax Officer must issue a notice under section 148 and before that notice can be issued, he must record his reasons for doing so and must also upon those reasons obtain the satisfaction of the Board or the Commissioner. The recording of the reasons is, in my opinion, a pre-requisite to the assumption of jurisdiction by the Income-tax Officer for initiating the proceedings, for assessing or reassessing income which has escaped assessment. Those reasons are of particular significance when action is taken under clause (a) of*

*section 147 because they indicate the reasons which the Income-tax Officer has in mind for believing that income has escaped assessment for an assessment year by reason of one or the other default of the assessee specified in that clause. Sub-section (2) of section 148 requires the Income-tax Officer to record his reasons for issuing a notice under that section and it is necessarily envisaged that he will record all the reasons he has in mind. This consideration acquires importance when the question is raised as to what were the reasons on the basis of which the Income-tax Officer invoked the jurisdiction conferred under clause (a) of section 147. To justify action by reference to clause (a) of section 147 it is not open to the Income-tax Officer, in my opinion, to refer to reasons other than those recorded by him pursuant to sub-section (2) of section 148.....*

There is no quarrel with the aforesaid proposition. The reason to believe does not mean purely subjective satisfaction on the part of the Assessing Officer. It means that the belief must be held in good faith. Further, the formation of the opinion and belief is a condition precedent without which the Assessing Officer will not have jurisdiction to initiate proceedings for reassessment. The reasons for the formation of the belief must have a rational connection, which is germane to the issue and must have a direct nexus. Normally, there must be some fresh material, which would give rise to the formation of the belief that income had escaped assessment and, therefore, the fresh material, which comes to the notice of the Assessing Officer has

to have a direct nexus or a live link with the formation of the belief that there has been an escapement of income. The foundational requirement for reopening the assessment is, that there must be a reason to believe that income had escaped assessment. There has to be some tangible material on the basis of which a reason to belief can be formed that some income had escaped assessment.

It is settled law that the Assessing Officer having reasons to believe that there had been some omission or failure to disclose fully or truly all material facts necessary for the assessment must be based on some material facts which according to the Assessing Officer is based on some reasonable belief and which would have a material bearing on the question of under assessment. If there is no material for the formation of any belief or where the purported belief was nothing but a mere change of opinion, in that case, the Assessing Officer would have no jurisdiction to initiate proceedings u/s 147 and 148 of the Act. The Assessing Officer has the power to reopen the assessment where he has reasons to believe that income chargeable to tax has escaped assessment but such re-assessment cannot be initiated on a mere change of opinion to merely re-examine an issue on the basis of information or material which was already available to the Assessing Officer at the time of the completion of the original assessment. It is settled principle of law that “reason to believe” could never be an outcome of a change of opinion.

Consequently, before taking any action, the Assessing officer is required to substantiate his satisfaction in the reasons recorded by him.

In **Commissioner of Sales Tax, U.P. Vs. Bhagwan Industries (P) Ltd., Lucknow, AIR 1973 SC 370** a Full Bench of the Supreme Court held:-

*“..... Question in the circumstances arises as to what is, the import of the words "reason to believe", as used in the section. In our opinion, these words convey that there, must be some rational basis for the assessing authority to form the belief that the whole or any part of the turnover of a dealer has, for any reason, escaped assessment to tax for some year. If such a basis exists, the assessing authority can proceed in the manner laid down in the section. To put it differently, if there are, in fact, some reasonable grounds for the assessing authority to believe that the whole or any part of the turnover of a dealer has escaped assessment, it can take action under the section. Reasonable grounds necessarily postulate that they must be germane to the formation of the belief regarding escaped assessment. If the grounds are of an extraneous character, the same would not warrant initiation of proceedings under the above section. If, however, the grounds are relevant and have a nexus with the formation of belief regarding escaped assessment, the assessing authority would be clothed with jurisdiction to take action under the section. Whether the grounds are adequate or not is not a matter which would be gone into by the High Court or this Court, for the sufficiency of the grounds which induced the assessing authority to act is not a*

*justiciable issue. What can be challenged is the existence of the belief but not the sufficiency of reasons for the belief. At the same time, it is necessary to observe that the belief must be held in good faith and should not be a mere pretence.”*

At the stage of examining the validity of the notice issued under Section 148 of the Act and the reasons recorded by the Assessing Officer, the Court is only required to see whether there was any tangible material before the Assessing Officer to arrive at a belief that income had escaped assessment. The Court is not required whether the tangible material would conclusively prove the escapement of income as held by the Supreme Court in ***Assistant Commissioner of Income Tax Vs. Rajesh Jhaveri Stock Brokers P. Ltd., (2007) 291 ITR 500 (SC)***. A bonafide reason to believe is sufficient for the Assessing Officer to issue a notice under Section 148 of the Act as held by the Supreme Court in ***Raymond Woollen Mills Ltd. Vs. Income Tax Officer and others, 236 ITR 34***. Reasons to believe is on the basis of tangible material which must have a live link with the formation of belief.

The reasons given by the Assessing Officer for initiating action under Section 148 of the Act is, that the petitioner had entered into various transactions with its Indian subsidiary with regard to export of raw materials, export of finished goods, capital goods, receipts of royalty, receipts of fees for technical services, receipts of alleged commissions and receipts of reimbursement. The subsidiary company had deducted the tax as source

at payment made to it under the head royalty and fees for technical services. The petitioner had not paid any taxes on income earned by it from the supply of raw materials, finished goods, etc. The survey conducted under Section 133A of the Act revealed:

i) The Indian company, LGIL, is a 100% subsidiary company of the petitioner and it does not function as an independent corporate entity and is totally dependent on the petitioner.

ii) All the senior employees i.e. heads of all departments are Koreans. The hiring of these Korean expatriates is done by the petitioner.

iii) While working in India, the expatriates have a lien over their employment over the petitioner company and work on deputation in India clearly establishing a continuous connection between the subsidiary company and the petitioner, which is nothing but a business connection.

iv) The employees do not report only to the Indian management but also send reports to their principals in Korea.

v) The Korean expatriates visit Korea and other countries very frequently for business purposes and implement decisions taken thereof.

vi) The regional headquarters in Singapore monitors each and every function of the Indian company. It provides business consultancy and financial consultancy to the Indian company.

vii) The regional director visits India regularly and monitors the progress of the Indian company. It also looks after the interest of the petitioner and other affiliates in the region including India.

viii) The order of raw material and finished products is placed from India on a global portal provided by the petitioner which is accessed by the India company. This proves that there is a continuity of business and the office of LGIL is nothing but an extension of the petitioner company.

ix) The petitioner company has a menu card of products manufactured and launched by it. The Indian company can only import and launch those products as an independent business enterprise and cannot import or sell brands of any other company.

x) The Indian company does not own the brand. The brand promoted in India is LG brand which is owned by the petitioner. In India also the brand is registered by the petitioner.

xi) The Indian company cannot hire expatriates from anywhere else other than Korea. Every requirement of heads of various divisions is processed by the petitioner.

xii) Before the launch of a particular product, the employees of the petitioner company visit India and understand the market and do a comprehensive market survey which is a core business activity and not ancillary or auxiliary business activity.

xiii) Once the decision is taken to launch a particular

product in India is decided by the petitioner company, they provide the technology and details of parts to be used which are mainly supplied by the petitioner and its other affiliates.

xiv) The petitioner through its employees in India takes a decision as to what part can be localized or procured locally.

xv) Once the imported parts are decided by the petitioner, the quantity is decided by LGIL and order is placed through the portal without any price negotiation as price is strictly decided by the the petitioner.

xvi) The contract for sale is concluded in India once the orders are placed. No agreements are signed and no negotiation takes place. However, employees of the petitioner visit India to finalise the deal and in order to estimate th total sale to be made by them during a particular period.

xvii) As per the petitioner the sale is on C & F basis and therefore, the sale is concluded in India.

xviii) The MD of LGIL reports to the HQ at Singapore and Korea and is responsible to the petitioner.

xix) For the imports made by the Indian company, it has not done any analysis of comparative pricing or the price at which it can get the product from any other company.

On the basis of the aforesaid, the Assessing Officer reasoned that the assessee's income from the above transaction was taxable in India as per Section 9(1)(i) of the Act. The Assessing Officer found that the employees

of the petitioner were using the office of the subsidiary company as a front for conducting their own business and, consequently, found that the office of the Indian company was functioning as a permanent establishment and was a fixed place of business available to the petitioner as per article 6(1) of the DTAA between India and Korea. The Assessing Officer, on the basis of the survey, drew the following conclusions, namely:

- i) There is a continuity of business between the Indian company and the non-resident.
- ii) The transaction of import is not an isolated transaction but a close business connection on a regular basis.
- iii) The non-resident is doing business in India through its employees who are heading various divisions in the Indian company and also through employees visiting India regularly.
- iv) There is a close business connection in terms of the dependence of the Indian company on the non-residents for all imports as it does not have the authority or choice to make imports from any other concerns other than LG affiliates.
- v) The whole transaction is so intermixed that supply of equipment cannot be segregated from the supply of technology and marketing of product. Each transaction is dependent on the other and has a close nexus with India.

vi) The products supplied including raw material and finished products are customized for India e.g. the sound system in television is customized for India as per the local needs. The Indian company is nothing but an extension of the Korean company. If we analyse the functioning of LG India it works as a branch of LG Korea.

vii) LG India and LG Korea work as partners in business.

viii) The transaction between both the parties are so inter linked that the Indian company cannot move an inch without the support and supplies of the non-resident.

ix) The function of the Indian company is marketing for the non-resident companies to build their brand and also manufacturing which is primarily assembly of products already launched by the non-residents.

x) The business arrangement between the two company is something like a partnership where roles are defined and divided but the ultimate decision is taken by the non-residents.

On the aforesaid basis, the Assessing Officer concluded that the assessee had business connection in India and was liable to be taxed under Section 9(1)(i) of the Act and income is taxable in India under Article 7 of the DTAA as the petitioner has a permanent establishment in India.

The Assessing Officer, in view of the facts, concluded that the petitioner has a fixed place of

business available to it in the office of its subsidiary company and is carrying on its business in India. This fixed place of business was available to the employees of the petitioner, who are either stationed permanently or visited India for business purposes. The Assessing Officer submitted that under normal circumstances, a subsidiary cannot be recorded as a permanent establishment if a subsidiary has its own independent business function. But in the instant case, the subsidiary company is also functioning as a permanent establishment and since the functions of the subsidiary company are not independent of the business of the parent company, namely, the petitioner, the Assessing Officer concluded that from the extracts of statements and documents impounded during the survey operation it was established that the petitioner not only had business connection but had a permanent establishment in India and since no returns were filed, its income had escaped assessment as per the provisions of Section 147 read with Section 148 of the Act. The Assessing Officer found that the total value of the transaction was Rs.2,41,14,53,972/- and if a profit of 25% was applied the income from the above transaction would come to Rs.60,28,63,493/-, which had escaped assessment.

At this juncture, it would be relevant to reproduce certain provisions of the DTAA.

*“The Government of the Republic of India, and the Government of the Republic of Korea desiring to conclude a Convention for the avoidance of double*

*taxation and the prevention of fiscal evasion with respect to taxes on income, have agreed as follows:*

*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” shall include especially –*

*(a) a place of management;*

*(b) a branch;*

*(c) an office;*

*(d) a factory;*

*(e) a workshop; and*

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

*3. The term “permanent establishment” likewise encompasses a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than nine months.*

*4. Notwithstanding the preceding provisions of this article, the term “permanent establishment” shall be deemed not to include –*

*(a) the use of facilities solely for the purpose of storage, display or 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 delivery;*

(27)

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

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

(e) *the maintenance of a fixed place of business solely for the purpose of advertising, the supply of information, scientific research or any other activity, if it has a preparatory or auxiliary character in the trade or business of the enterprise;*

(f) *the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e) of this paragraph, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.*

5. *Notwithstanding the provisions of paragraphs (1) and (2) if a person - other than an agent of independent status to whom paragraph (6) applies - is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise unless the activities of such person are limited to those mentioned in paragraph (4) which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment by virtue of that paragraph.*

6. *An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carried on business in that State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business.*

7. *The fact that a company which is a resident of a Contracting State contracts or is controlled by a company which is a resident of the other Contracting State, or which carried 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.*

*ARTICLE 7 – Business profits – 1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carried 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 that permanent establishment.*

2. *Subject to the provisions of paragraph (3), where an enterprise of a Contracting State carried 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 separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a*

*permanent establishment.*

*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 permanent establishment including executive and general administrative expenses so incurred whether in the State in which the permanent establishment is situated or elsewhere, which are allowed under the provisions of the domestic law of the Contracting State in which the permanent establishment is situated.*

*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 the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.*

*6. Where income or profits include items of income which are dealt with separately in other articles of this Convention, then the provisions of those articles shall not be affected by the provisions of this article.”*

Section 9 of the Income Tax Act is similar to Article 7 of the DTAA. Section 9 provides that income accruing directly or indirectly, through or from any business connection in India shall be deemed to be Income accruing or arising in India. Hence, where the person entitled to such income is a non-resident, it would be included in his total income. However, Article 7 of the

DTAA further stipulates that a permanent establishment must exist in India before income accrues and is taxable in India. Once a permanent establishment exists and business is being carried out through a permanent establishment then profits, being a necessary consequence, need to be attributed and taxed in India as per Rule 10 of the Income Tax Rules. The existence of a permanent establishment presupposes that business operations are being carried out for profit. Clause (1) of Article 7 provides that if an income arises in Korea, which shall be taxable in that country unless the enterprise carries on business in another contracting state i.e. in India through a permanent establishment situated therein.

From the aforesaid, we find that what is to be taxed is profits of the enterprise in India but only so much of it as is directly or indirectly attributable to that permanent establishment. For attracting the taxing statute there has to be some activity through a permanent establishment. If income arising through the activity of the permanent establishment is established in which case, the profits would be attributed and taxed in India. Article 5 of DTAA defines "Permanent Establishment". Section 92F(iii) of the Act also defines "Permanent Establishment". The Supreme Court in ***Morgan Stanley's case (supra)*** held that the definition of permanent establishment in DTAA is exhaustive whereas the definition under the Act is inclusive. Section 9 of the Act spells out the extent to which the income of non-resident, namely, the petitioner

would be liable to tax in India.

In the light of the aforesaid and on a perusal of the reasons recorded by the Assessing Officer, it is evident that there is a rational and in a live nexus between the reasons recorded and the belief that income had escaped assessment. Once the Assessing Officer comes to a conclusion that the petitioner has a permanent establishment and is carrying out its business activities through this permanent establishment for the purpose of supply of raw materials and finished products and that the permanent establishment was available to the employees of the petitioner, who were either permanently stationed or came to India for business purposes, we are of the view that the Assessing Officer has given valid reasons to believe that income had escaped assessment. The Court finds that once a permanent establishment comes into existence, which presupposes that business operations are being carried out for the purpose of profit in which case the profits or the income needs to be attributed and taxed in India. Admittedly, no returns were filed by the petitioner. The Assessing Officer had tangible material to form a belief that income had escaped assessment and, consequently, rightly issued the notice under Section 148 of the Act. The decision cited by the learned counsel for the petitioner in the case of ***G.S. Engineering and Construction Corporation Vs. Deputy Director of Income Tax (International Taxation) and others, 357 ITR 335*** is not applicable in the facts of this case.

The contention that there was no fresh material before the Assessing Officer to come to a belief that income had escaped assessment is patently erroneous. The analysis made from the survey report and the documents so impounded has led the Assessing Officer to reasonably believe that income had escaped assessment on account of the fact that the petitioner was carrying on business operation in India through a permanent establishment. The contention that there was no application of mind is patently erroneous. The reasons to believe recorded by the Assessing Officer clearly shows that an in depth study and analysis was made and reasons were recorded in detail in arriving at a belief that income had escaped assessment.

The contention that as per the provisions of Chapter X of the Act, the Indian subsidiary, in terms of the provisions of Section 92E of the Act had disclosed all the transactions with the petitioner relating to purchase of raw materials, finished goods, commission and reimbursements and further, in terms of Section 92CA of the Act, the TPO of the Indian subsidiary had already examined the said transaction and by its order dated 20<sup>th</sup> December, 2006 found the same to be meeting the arm's length principle, consequently, the Assessing Officer was precluded from drawing any inference that any further income of the petitioner from the same transactions was chargeable to tax had escaped assessment is erroneous and cannot be accepted.

In ***Morgan Stanley's case (supra)***, the Supreme

Court held:

*“The object behind enactment of transfer pricing regulations is to prevent shifting of profits outside India. Under Article 7(2) not all profits of MSCo would be taxable in India but only those which have economic nexus with P.E. in India. A foreign enterprise is liable to be taxed in India on so much of its business profit as is attributable to the P.E. in India. The quantum of taxable income is to be determined in accordance with the provisions of the Income-tax Act. All provisions of the Income-tax Act are applicable, including provisions relating to depreciation, investment losses, deductible expenses, carry forward and set off losses etc.....”*

Once the Assessing Officer is satisfied that a permanent establishment of the petitioner exists in India and business is being conducted from this permanent establishment, the attribution of profits is a necessary consequence. The order of TPO will not come in the way for the reason that the TPO's order is in relation to the transactions between a subsidiary company and the petitioner. The situation becomes different when the subsidiary company also works as a permanent establishment of the petitioner. Once a permanent establishment is established, the petitioner becomes liable to be taxed in India on so much of its business profits as is attributable to the permanent establishment in India. The order of the TPO is in relation with the subsidiary company and not in relation with the permanent establishment of the petitioner. The transfer

pricing analysis is to be undertaken between the petitioner and its permanent establishment which has not taken place as yet. Once a transfer pricing analysis is done, the computation of income arising from international transaction has to be done keeping in mind the principle of arm's length price. Once this is done, there is no further need to attribute profits to a permanent establishment. However, where the transfer pricing analysis does not take into account all the risk taking functions of the enterprise and it does not adequately reflect the function performed and the risk assumed by the petitioner, the situation would be different and, in such a situation, there would be a need to attribute profits to the permanent establishment for those functions/risk that have not been considered. This is precisely what was considered in ***Morgan Stanley's case (supra)*** wherein the Supreme Court held:

*“As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the ruling is correct in principle provided that an associated enterprise (that also constitutes a P.E.) is reimbursed on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the P.E. The situation would be different if the transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a case, there would be need to attribute profits to the P.E. for those functions/risks that have not been considered. The entire exercise*

*ultimately is to ascertain whether the service charges payable or paid to the service provided (MSAS in this case) fully represent the value of the profit attributable to his service.”*

Further, we find that the survey was made much after the order of the TPO, which survey and documents so impounded revealed the existence of a permanent establishment of the petitioner and its business operations in India through its permanent establishment without disclosing its taxable income. We are of the opinion that the order of the TPO is not binding at the stage of issuance of notice and, in any case, it would be open to the petitioner to take a stand that the transactions with the subsidiary company and/or with the permanent establishment, being the same, no further tax could be levied. At the stage of examining the validity of the notice issued under Section 148 of the Act, the issue is limited only as to whether there existed any reasons for the Assessing Officer to believe that income had escaped assessment.

Consequently, for the reasons stated aforesaid, we do not find any infirmity in the issuance of the notice under Section 148 of the Act. All the writ petitions fails and are dismissed.

In the circumstances of the case, parties will bear their own cost.

**Date:**5.8.2014

Bhaskar

(Dinesh Gupta, J.) (Tarun Agarwala, J.)