IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH : E : NEW DELHI

BEFORE SHRI I. P. BANSAL, JUDICIAL MEMBER
AND
SHRI K. G. BANSAL, ACCOUNTANT MEMBER

ITA No.5377/Del/2011
Assessment Year: 2008- 2009

M/s Metal One Corporation, **3-23-1, Shiba,** **Taxation** **Minto-Ku Tokyo,** **JAPAN.**	**Vs.**	**Dy. Director of Income-tax,** **Circle-3(1), International** **New Delhi.**
(Appellant)		**(Respondent)**

Appellant by : Shri Mukesh Bhutani, Advocate
Respondent by : Shri Pradeep Kumar, CIT, D. R.

Date of hearing : 27/03/2012
Date of pronouncement : 11/05/2012

ORDER

PER K. G. BANSAL, ACCOUNTANT MEMBER

This appeal is directed against the order of assessment passed by the Dy. Director of Income-tax, Circle-3(1), International Taxation, New Delhi ("AO" in short), on 18/10/2011 u/s 144(3) read with section 144C of the I.T. Act, 1961, The assessee has taken up following grounds:

"1. That on the facts and in law the Assessing Officer [herein above referred as the "Assessing Officer"]/Dispute Resolution Panel [herein above

referred as the "DRP"] erred in holding that the assessee's Liaison Office (LO) in India was its Permanent Establishment (PE) in terms of Article 5 of the India-Japan Double Taxation Avoidance Agreement (DTAA).

1.1 That on facts and in law the AO/DRP erred in grossly violating the rules of natural justice and in not discharging the static burden of showing that the LO was a PE, without indicating any cogent, acceptable material on record.

1.2 That on facts and in law the AO/DRP erred in holding that:

(a) The LO of the Appellant was an "office" within the meaning of the term u/Art 5(2)(c) of the DTAA.
(b) The Appellant was maintaining the LO as a fixed "place of business".
(c) From the activities carried out by the LO it was apparent that the same were not solely restricted to the activities mentioned in Article 5(6) of the DTAA.
(d) The Appellant was using the premises of the LO to undertake core revenue generating activities.
(e) The business of the Appellant was partly carried on by the LO.

1.3 That on facts and in law while holding that the LO constitutes a PE the AO/DRP erred in:

(a) Mechanically relying upon the findings recorded by some other AO in cases pertaining to M/s Mitsubishi Corporation and M/s Mitsubishi India Pvt. Ltd.
(b) Holding that the LO was carrying out negotiations and conclusion of contracts for the assessee.
(c) Not appreciating that the LO was only carrying out activities which were preparatory or auxiliary in nature as stated in Article 5(6)(e) of the DTAA.

2. That without prejudice, on facts and in law the AO/DRP after holding that the LO constitutes a PE, further erred in attributing profits of the Appellant to such PE.

3. That without prejudice, on facts and in law while computing the total taxable income of the Appellant at Rs.32,63,29,903/- the AO/DRP erred in:

(a) Attributing profits on account of purchases made by the Appellant from Indian suppliers, for resale outside India amounting to Rs.10,502,539/-.
(b) Adopting a gross profit rate of 10% as against actual global gross profit rate of 2.5% earned by the Appellant.
(c) Holding that 50% of the gross profits were attributable to the activities of the PE in India.
(d) Disallowing in an arbitrary manner 50% of the actual expenses incurred by the LO.
(e) Not allowing a deduction on account of general administrative expenses incurred by the Head Office outside India.

4. That on the facts and in law the DRP erred in assuming the jurisdiction to enhance the assessed income proposed by the Assessing Officer in the draft assessment order.

5. That on the facts and in law the AO/DRP erred in levying interest under section 234B of the Act.

6. That on facts and in law the orders passed by the Assessing Officer/DRP are bad in law and void ab initio."

1.1 It is seen from the grounds that they contain facts as well as arguments and, therefore, they are not in accordance with ITAT Rules. However, in the course of hearing before us, the learned counsel for the assessee explained that the appeal primarily involves three questions:

(i) Whether the assessee has a Permanent Establishment ("PE" in short) in India?
(ii) If answer to aforesaid question is in affirmative, what is the amount which can be attributed as profit to the activities carried on by the PE ? and
(iii) Whether the assessee is liable to pay interest u/s 234B ?

1.2 Before proceeding further, it may be mentioned that the assessee – company had made an application for stay of demand. This application

was disposed of on 23/12/2011. The assessee was directed to pay a sum of Rs.4.00 crore upto 30/03/2012. On doing so the balance demand was stayed for a period of 180 days or the disposal of appeal, whichever event occurs earlier. A condition was also imposed that the assessee shall not seek any adjournment in hearing of the appeal except on account of unavoidable circumstances. This interim order comes to an end with passing of this order.

2. The facts mentioned in the assessment order are that the return declaring nil income was filed on 26/09/2008. Assessment proceedings were initiated by issuing notice u/s 143(2) on 07/08/2009. The assessee has maintained a liaison office ("LO" in short) with effect from 16/04/2003 with the approval of the Reserve Bank of India. In this year sales of Rs.699,51,34,489/- have been effected. The assessee was directed to file correspondence with the clients in India, copies of invoice, e-mail exchanged and profit & loss account of the Head Office ('HO' in short). The assessee furnished the details on a sample basis. It was informed that the LO was closed down in May, 2008 and, therefore, the information has to be obtained from HO in Japan. In the circumstances, it has tried to do the best it could do on the basis of old records. The legal argument of the assessee was that by its very nature, the LO cannot earn profits and, therefore, no tax is payable under Double Tax Agreement voidance Agreement between India and Japan. ("DTAA" in short)

2.1 The learned Assessing Officer examined the terms and conditions on which the assessee was permitted to open the LO by the Reserve Bank of India. He also considered that under the DTAA, if the office of the assessee in India is engaged purely in preparatory or auxiliary activities, its income is not liable to be taxed in India. However, such a situation is obtained only if the office in India is engaged only in preparatory or auxiliary activities. The assessee, as a matter of fact, is using the LO for undertaking revenue generation activities. In other words, it is not merely carrying on preparatory or auxiliary work, but is also undertaking core business activities. Having decided that business is being conducted from the LO, the Assessing Officer proceeded to compute profits attributable to it. The assessee had not furnished any India specific financial statement or profit & loss account, therefore, he invoked the provision contained in Rule 10(iii) of the I.T. Rules, 1962. The gross profit rate of 10% was applied to work out the profits and 50% of the profits were attributed to the LO. The income was computed at Rs.32,58,04,780/- as under:

Particulars	Rs.
Sales in India	6,99,51,34,490
Gross profit on sales @10% as discussed above	69,95,13,449
Profits attributed to India @50%(A)	34,97,56,724
Less:Expenses incurred by LO as discussed above(B)	2,39,51,948
Taxable Income (A-B)	32,58,04,776
Round off to	32,58,04,780

2.2 The assessee filed objections to the draft order, which were considered by the ld. Dispute Resolution Panel "(DRP" in short). After hearing the assessee, it has been mentioned that it is pertinent to look at

the description of activities of Mitsubishi Corporation Japan ("MCJ" in short). In the case of Mitsubishi Corporation India Private Limited for assessment year 2007-2008, in the draft order, the Assessing Officer has held that in the year 2003, MCJ created a separate entity in the form of Metal One Corporation, with a view to conduct metal business in the same manner in which MCJ had been conducting the business earlier. Based upon the detailed discussion, it was found that it did not make any difference if the trading was done through an entity based in Singapore or Thailand, as such offices function in similar manner in respect of entire group for locating potential buyers, negotiating and selling the goods in the market. The tax residence certificates are of no consequence in such a business model. Further, the Assessing Officer concluded that the assessee has been functioning in the same manner as MCJ had been functioning earlier. Accordingly the taxability has to be decided in the same manner.

3.1 The activities carried on by the assessee are that potential buyers are located in different countries, negotiations are carried on with a view to settle contractual terms and the sales are effected. The documents prove that the India office locates potential buyers, conducts negotiations with them and then sells the goods through the HO. These activities are core business activities. They are not in the nature of preparatory or auxiliary activities. Thus, the existence of PE has been upheld.

3.2 The Assessing Officer had considered only the sales effected in India. He had not taken into accounts the sales made from India. These sales have been computed at Rs.1,05,02,539/-. These have been taken into account to determine the total sales effected by the India office.

3.3 Coming to attribution of income, the finding of the Assessing Officer has been confirmed as it is mentioned that the assessee filed only sketchy details.

3.4 The charging of interest u/s 234A, 234B and 234C has been confirmed on the ground that it is for the Assessing Officer to decide this matter and that the DRP is required to issue directions only in respect of variation in income or loss.

4. Based upon these directions, the Assessing Officer passed the order on 18/10/2011, computing the total income at Rs.32,63,29,903/- as under:

Particulars		Rs.	
Sales in India (as mentioned in the draft order)			6,99,51,34,490
Add:			
Enhancement of sales by DRP-I (refer para 15.1)		1,05,02,539	
Total:		7,00,56,37,029	
Gross profit on sales @10% as discussed above			70,05,63,703
Profits attributed to India @50%	(A)		35,02,81,851
Less:Expenses incurred by LO as discussed above (refer para 17)	(B)	2,39,51,948	

Taxable Income (A-B)	32,63,29,903

4.1. Aggrieved with this order the assessee is in appeal before us.

5. The learned counsel furnished background facts of the case that the assessee company is a tax resident of Japan. It deals in steels and steel products. It had opened a LO in India with the approval of the Reserve Bank of India in terms of section 6(6) of the Foreign Exchange Management Act ('FEMA' in short). The LO was to act as only as a communication channel between constituents in India and HO in Japan. The approval is subject to filing of audited accounts before the Reserve Bank of India along with the activity report. This has been done every year. The LO has been closed down in the year 2008. The assessee was required to pay fringe benefit tax because of which return was filed in which income was shown at nil.

5.1 The Assessing Officer passed a draft order on 23/12/2010 holding that the LO is a PE, carrying on core business activities. A draft order was passed computing the income of about Rs.35.58 crores. The DRP not only upheld the finding of the Assessing Officer but also enhanced the income. The Assessing Officer passed final order on 18/10/2011.

5.2 In the course of assessment, the assessee was required to file copies of correspondences with client, invoice, e-mail and profit & loss account of the HO. The compliance was made on a sample basis. In

paragraph 9 of the assessment order, it is inter alia mentioned that it appears (emphasis supplied of the learned counsel) that the assessee's LO in India is in a sense not only undertaking preparatory and auxiliary work but also core revenue generating activities. It is argued that this is only a tentative conclusion as the word "appears" has been used. The conclusion is arrived on the basis that the assessee did not furnish sufficient evidence that it was carrying on only preparatory and auxiliary work. As a matter of law, this is not sufficient reason to hold that the assessee has set up a PE in India. The Assessing Officer has also made a mention of the LO of MCJ. Such a mention had been made in the order of the DRP. It is argued that the details in the case of MCJ were not furnished to the assessee and the assessee was not granted sufficient opportunity to distinguish facts or rebut the same.

5.3 The learned counsel took us through the evidence filed before the Assessing Officer in respect of e-mails exchanged between India office, its HO and customers. As mentioned earlier, these have been filed on a sample basis. We may note the gist of such correspondence in respect of two customers, i.e. Mahindra and Tractor Engineers Limited. In respect of first customer the e-mail was sent on 26/07/2007 by Shri J. B. Marolia from India office to the HO. The supplier of goods in this case was Nippon, Japan. The best offer for S48C and 38MnSiV6 categories of steel was sought. The HO quoted the price of US$860 per mt. ton in respect of 38MnSivS5+. The terms were LC at site and the offer was valid until end of

the year 2007. The offer price for S48C+ was declined as price gap was too big. Consequently the India office informed Mahindra about the price offered by the HO by way of e-mail on 30th August 2007. Mahindra replied to this e-mail on 31/08/2007 mentioning that the price is high and made a counter offer at US$810 per mt. ton. On receipt of this e-mail the India office sent an e-mail to the HO intimating the offer made by Mahindra. The India office also informed Mahindra that the HO will discuss the matter with the supplier in Japan. The requirement of Mahindra was also sought. Finally the HO wrote to the India office on 03/09/2007 that its representative will visit India on 12/09/2007 although none from the supplier side is available. In these circumstances advice was also sought regarding rescheduling of the visit so that representative of supplier in Japan may also be available to come to India.

5.4 In regard to Tractor Engineers Limited, a letter was received from it by the India office intimating that supplier's request for increase in price by 15% is a matter of concern, in the background of the fact that in February, 2007, it had reluctantly agreed to price increase of 6%. It was informed that quantity has been increased by more than 100%, therefore, the price should come down rather than increasing by 15%. This e-mail dated 20/07/2007 was replied to in which it was mentioned that the price hike is high and it needs clear explanation. Tokyo office has also been requested to negotiate the level of price hike which should be more moderate. This was followed by another e-mail informing about final revised offer from the

supplier in Japan in which the increase was US$65 which means that the price was US$890 per mt. ton. The customer responded mentioning that it will prefer increase of US$35 per mt. ton. Further increase can be considered subsequently depending on scrap price and other factors. This was followed by confirmation from the customer of the price and the quantity but LO informed that the required quantity may not be available. Subsequently the customer forwarded the revised requirement.

5.5 Page numbers 56 to 90 of the paper book contain direct correspondence between the HO and the customers and page numbers 96 to 111 contain e-mails exchanged regarding fixing of meeting between representatives of HO and the customers.

5.6 Coming to applicability of the DTAA, our attention has been drawn to paragraph number 6 of Article 5, which excludes from permanent establishment, the office which carry on activities of following nature:

> ***"(a) the use of facilities solely for the purpose of storage or display 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 or display;***
> ***(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 carrying on, for the enterprise, any other activity of a preparatory or auxiliary character."***

5.7 The case of the learned counsel is that the instant case is covered under clause (e), i.e., the maintenance of fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of preparatory or auxiliary character. It is his case that the term "preparatory or auxiliary character" should be interpreted in the light of the business of the assessee. In this case the assessee deals in iron and iron products. The activities of imparting information about requirement etc. of the constituents by India office to the HO or the customers about price, quantity, terms of supply etc. will constitute preparatory or auxiliary activities.

5.8 Our attention is drawn towards the dictionary meaning of the word "preparatory" to mean serving as a preparation, occupied in preparation. The word "auxiliary" means adding or supporting; subsidiary.

5.9 Our attention has also been drawn towards OECD commentary wherein it is mentioned that sub paragraph (e) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character, is deemed not to be a permanent establishment. It is recognized that such a place of business may contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realization of profits that it is difficult to allocate any profit to the fixed place of business in question. It is often difficult to distinguish between the activities which

have a preparatory or auxiliary character and those which do not have such character. The decisive test is whether or not the activities carried on form an essential and significant part of the activity of the enterprise as a whole. Therefore, each case will have to be examined on its own merits. The commentary also gives some examples. The servicing of patents and know-how is the purpose of an enterprise, therefore, a fixed place of business of such enterprise exercising such activity cannot get the benefit of this sub paragraph. A fixed place of business which has the function of managing an enterprise or managing a part of the enterprise or of a group of concern cannot be regarded as doing preparatory or auxiliary activity, because such a managerial activity exceeds this level.

5.10 The learned counsel relied on a number of decisions to support his case that the activity carried on by India office is only preparatory or auxiliary in nature. We may discuss these cases at this stage with a view to recapitulate the ratio decidendi thereof.

5.10.1 In the case of U.A.E. Exchange Centre Limited vs. U.O.I. and ANR 313 ITR 94, the authority for advance ruling had come to the conclusion that the activity carried on by the liaison office in India did not have an auxiliary character as the option of remitting of funds through the liaison office in India was exercised by the NRI remitter, which was nothing short of, as in the words of the parties, performing contract of remitting the amounts. It is mentioned that this view is clearly erroneous. We are living in a global

village where organizations and companies operate transnationally. There is an eagerness to bring to tax income of states by employing deeming fiction so that income which ordinarily does not accrue or arise within the taxing state is brought within its tax net. The expression "Permanent Establishment" has to be viewed in this context. Blacks Law Dictionary, 7th Edition at page No. 130 furnishes the meaning of the word "auxiliary" as "adding or supporting subsidiary". In this case the liaison office downloads the information, from main servers located in U.A.E. Based on this information, cheques or drafts drawn on drafts drawn on banks in India are prepared, which are sent via courier or dispatched to the beneficiaries in India, keeping in mind instructions of the NRI remitter. This activity is in aid or support of the main activity. The authority for advance ruling considered that the transaction would not be complete till this activity is carried on. This is a value judgment of the relevant sub paragraph, however, what is lost sight of is that by invoking this clause, an income will be taxed in India by way of deeming section which neither accrued nor arose in India.

5.10.2 In the case of BKI/HAM V.O.F. vs. Addl. CIT (2001) 79 TTJ 480 (Del), the Tribunal referred to the dictionary meaning of the word "auxiliary" furnished in Webster's Dictionary to mean 'ancillary'. 'Ancillary' means subordinate or auxiliary. Therefore, 'auxiliary' means helping or aiding living support; subsidiary or additional supplementary power; a helper or aid; a confederate; an ally. The Tribunal found that the period of 6 months

was admittedly to be counted from arrival of first dredger on 16/12/93 on the basis of documents on record and the machinery and plant was completely demolished by 12/06/94. Thus, the period of 6 months was not completed. Therefore, no PE came to be existence in India.

5.10.3 In re 791 of 2008 in the case of K. T. Corporation, the authority mentioned that as per regulation 2(e) of FEMA 'liaison office' means a place of business to act a channel or communication between the principal place of business or HO by whatever name called and entity in India but which does not undertake any commercial, trading, industrial activity, directly or indirectly and maintains itself from remittances received from the abroad through normal banking channels. Schedule-II of that Act illustrates the liaison office as –(i) representing the parent company/group companies in India, (ii)promoting export/import from/to India, (iii) promoting technical/financial collaborations between parent/group companies and Indian companies, (iv) acting as communication channel between parent and Indian companies. From the facts made available, it has emerged that the liaison office in this case has not performed any core business activity but it has confined itself to preparatory and auxiliary activities. All that it has done is supplying information which is preparatory and auxiliary to formation of final contracts. The activities of preparing reports on Indian market scenario, mobile and broadband segment is in aid or support of the main activity and, therefore, rest in the area of preparatory and auxiliary activities.

5.11 In the case of Mitsui & Co. Ltd. vs. ACIT [2008] 114 TTJ 903 (Delhi), the question before the Tribunal was whether, the LO of the assessee constitutes PE in India? The assessee claimed exclusion under the aforesaid sub paragraph (e). The revenue and the assessee had differed on this issue in past and the Special Bench held in assessment years 1980-81 and 1981-82 that the LO was carrying out the work of supply of information and it was not carrying on any trading activity in India. The Reserve Bank of India while permitting the setting up of LOs in India does not allow the carrying out of trading, commercial or industrial activities. All the expenses are required to be met out of remittances from abroad through normal banking channel. Since no violation of RBI conditionalities was shown, it was held that the LO was engaged in the activity of supplying information and doing liaison work. This decision has been applied in the assessment year 1998-99. There is no material change in facts in regard to the facts of the year under appeal, it has been mentioned that there is no evidence to suggest that the LO is authorized to conclude contracts or transact business on behalf of the HO. The argument of the Revenue that signing of the contract is not the crux of the matter when entire work is done by the LO is not based on any material on record. Therefore, it has been held that the exclusionary sub paragraph is applicable to the facts of the case.

5.12 In the case of DCIT vs. Tokio Marine and Fire Insurance Co. Ltd. in I.T.A. No.4696/Del/05 for assessment year 2002-2003 dated 31st October, 2007, a copy of which has been placed on record, the Tribunal observed that the LO was approved by the RBI with the condition it would not render any consultancy or other services directly or indirectly with or without any consultation and it would not undertake any insurance business in India. No adverse finding has been brought on record. The material on record is that two expatriate employees of the LO signed as witness to the joint venture agreement. On the basis of this evidence alone it cannot be said that any business has been conducted as activity is preparatory and auxiliary in nature.

5.13 The facts in the case of Sojitz Corporation vs. ADIT [2008] 117 TTJ 792 (Cal) are that the assessee is a trading and export house of Japan, having presence in different countries including India. The assessee initially set up four branch offices in New Delhi, Calcutta, Mumbai and Chennai in the year 1957. Thereafter, new offices were established in Bangalore, Pune and Jamshedpur. In the year under consideration the assessee incurred expenses of about Rs. 18 crore on Indian operation. The finding of the Tribunal is that the case of the assessee falls within the aforesaid exclusionary sub paragraph (e). While coming to this conclusion support has been drawn from OECD commentary that the fixed place of business may contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realization of profits that

it is difficult to allocate any profit to the fixed place of business. Further, the office had been following guidelines applicable to a LO, i.e., it will not carry out any activity other than the activity for which approval had been given by the RBI. That such guidelines have been actually followed is evidenced by the certificate of auditor filed by the assessee before the RBI.

5.14 In Re Gutal Trading Est. [2005] 278 ITR 642, the facts are that the applicant based in Dubai is owned by a non resident U.A.E. national and its local status is of "individual establishment" under the U.A.E. law. It is acting as agent of GVB, a group of foreign companies. It proposed to set up a communication channel in India, termed as LO by the RBI to perform – (a)hold seminars and conferences to cover information about general use by GVB in manufacturing reflective glass, (b) receive trade enquiries and pass on the same to Dubai or directly to GVB, (c) to transmit information from Dubai office or GVB to the customers, consumers and other organizations, (d) to collect feedback and pass on the same to Dubai office or to GVB. However, the LO in India was not to carry out negotiations by itself in respect of import or purchases of goods in any manner. The ruling is that so long as the LO does not enter into negotiations with customers in India for import or purchases of goods by the Indian customers from the principal company, GVB, it cannot be said that an intimate relationship exists between the trading activity of principal company and GVB on one hand and the activity of the liaison office LO in India on the other. The activity in India would not constitute a course of dealing or continuity of

relationship and, therefore, it cannot be said that it contributes directly or indirectly to the earning of income by the non resident person. Even under the treaty the resident assessee based in U.A.E will not be subjected to taxation in India unless he has a PE in India. This ground is admittedly covered in the ruling in case of Abdul Razak A. Meman [2005] 276 ITR 306.

5.15 In the case of DCIT vs. Sofema SA, I.T.A. No.3900/Del/2002 for assessment year 97-98 dated 05/05/2006, a copy of which has been placed before us, the facts are that the assessee has an office in India and it is a trader in defence equipments. It supplies goods to various companies and Government departments in India. The assessee maintains office at Delhi and Bangalore in which huge amounts have been spent. The finding of the Tribunal is that in absence of any evidence on record in respect of commercial activity having been undertaken by the assessee in India, its LO cannot be treated as a PE. In this connection reliance has been placed in the decision in the case of IAC vs. Mitsui & Co. Ltd. 39 ITD 59. This decision has been confirmed by Hon'ble Delhi High Court on 18/12/2006 with the remark that no substantial question of law arises. The Civil Appeal filed by the Revenue has also been dismissed by the Hon'ble Supreme Court. It has been mentioned that the finding has been given on the basis that there is no evidence or justification forthcoming from the Revenue to show that the assessee has a PE. On this account alone, the court does not wish to interfere in the matter.

5.16 In reply, the learned CIT, D.R. placed strong reliance on the assessment order. Our attention has been drawn towards the discussion in paragraph Nos. 4 and 5 of the impugned order. The assessee was required to file copies of correspondences with client, invoice, e-mail and profit & loss account of the Head Office. The details were file on a sample basis. The details were also sketchy. It was informed that the office was closed in May, 2008, and the information was to be received from Japan. Therefore, whatever best information is available, the same has been filed from the old records. It is argued that sketchy information was filed on a sample basis. Further, only selective information was filed, which best suited the assessee. Therefore, the information does not represent true and correct picture of activity undertaken by the office.

5.17 The fact of the matter is that the office has gone beyond the functions which were permitted to be undertaken by it by the RBI. In this connection, he referred to the observations made by the DRP in the case of MCJ in whose case it has been held that in the year 2003, it created a separate entity in the form of Metal One Corporation, which was assigned to deal with metal business in the same manner as the division of MCJ was doing earlier. Excerpts from the website of MCJ and Metal One Corporation have been furnished in the draft order that the assessee creates supply chains and value chains which link steel manufacturers and consumers and contributes to sustained development in metal industry. Therefore, it was held that there is no difference if the trading is done

through or with entity based in Singapore or Thailand. The office also functions in the similar manner for the entire group for locating and negotiating agreements with potential buyers and sellers in metal market. This clearly leads to an inference that the assessee is carrying on business in India and the activity of the India office is not confined to preparatory or auxiliary activities. It may be mentioned here that the argument of learned counsel for the assessee in respect of this part of the order is that the facts of the case of MCJ were not brought to the notice of the assessee and these observations have been based on some other assessment order of which the assessee is not aware. We may add that MCJ is an associated enterprise. Of course the question would remain as to whether the assessee knows or is required to know the activities of MCJ in India.

5.18 Our attention has also been drawn towards page No. 40 of the paper book, being a letter written by India office to Tractors Engineers Limited mentioning that he had talked to the HO to enquire as to what was going on. The writer agreed that the price hike of US$120 per mt. ton for this commodity is an extreme jump and needs more clear explanation behind it. He has also given some factual information about conflict going on in the supplier company, TOPY for securing allocation between domestic sales and export sales. In such conflict one criteria is sale price or profitability. The case of the learned CIT, D.R. is that this correspondence clearly shows that India office is engaged in negotiation of price, which is core business function. This letter was responded to and Tractors Engineers Limited

wrote that the offer of increase of US$80 per mt. ton is surprising and that it is willing to increase of US$35 per mt. ton as suggested by it and upto US$50 as suggested by you. This letter also shows that India office is engaged in price negotiations. Page 42 of the paper book also shows that such negotiations were carried on by India office as Tractor Engineers Limited mentioned in correspondence to India office that they would prefer to have increase of US$35 per mt. ton in view of the data furnished and that in next LTA further increase in price can be accepted.

5.19 It is argued that even sketchy information filed by the assessee shows that the India office was engaged in price negotiation which is key to making a contract of sales. Thus, it is argued that the AO was perfectly justified in computing business profit in respect of India office.

6. We have considered the facts of the case and the submissions made before us. The facts of the case are that the assessee maintains an office in India, which under FRMA is known as LO. The office is maintained under the approval of RBI to carry out only certain activities. The assessee is required to furnish annually audited accounts to the RBI which have to be certified by a Chartered Accountant. Activity report has also to be filed to the RBI. This office has been closed in the year 2008. In the course of assessment, the assessee was required to file the details in respect of correspondence with clients, invoices, e-mails and profit & loss account of Head Office. The assessee admittedly filed sketchy details on sample

basis. It was submitted that the office was carrying on preparatory or auxiliary work but not undertaking any core revenue generating activity. This submission has not been accepted by the Assessing Officer or the DRP. The DRP has drawn a correspondence between the activities of the assessee and MCJ. On the basis of draft order in the case of MCJ also, it has been held that the activities go beyond preparatory or auxiliary activities. It has been held that the office is participating in the process of negotiation of contracts and, therefore, the India office constitutes a PE under the DTAA. The profit attributable to this office has been computed at Rs.32,63,29,903/-. The question is – whether, the office of the assessee in India maintained in this year constitutes PE ?

6.1 Paragraph No. 1 of Article 5 defines (PE) to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on. This is a key paragraph of Article 5 and what has to be seen under this paragraph is whether there is a fixed place through which the business of the assessee is carried on wholly or partly. There is no dispute that India office is a fixed place. The dispute is whether the business of the assessee is being partly carried on through this office.

6.2 Para No. 2 includes a number of items within the meaning of the term "PE" such as a place of management, a branch, an office, a factory etc. Admittedly, the India office is an office. However, it may be stated that this paragraph does not stand alone but has to be read in conjunction with

paragraph No. 1. Therefore, it has to be seen whether business is partly carried on from this office. Paragraph No. 6 makes certain exclusions from the term "PE". These are facilities solely for the purpose of storage of goods, maintenance of stock of goods etc. solely for the purpose of storage or display etc. The sub paragraph on which assessee relies is (e), i.e., maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character. The case of the assessee is that India office is carrying on preparatory or auxiliary activity only, while the case of the Revenue is that this office is carrying on the key function of price negotiation leading to formation of contract.

6.3 In the first place, the learned counsel has relied on the OECD commentary, which frankly admits that it is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criteria is whether or not the activity is essential and significant part of the enterprise as a whole. India does not subscribe to the OECD model and, therefore, this commentary may have only a limited force. Nonetheless it may be capitulated that according to this commentary what is to be seen whether India office is carrying on essential and significant part of the activity in the scheme of the business of the assessee.

6.4 The learned counsel has relied on a number of cases decided by the Tribunal in which it has been held that if the assessee maintains a LO with the permission of the RBI and the RBI does not find any violation of any condition(s) imposed on its functioning, a presumption can be drawn that the office is carrying on preparatory or auxiliary activity. We have discussed these cases but we may again state the names of these cases for the sake of completeness. These are BKI/HAM, Mitsui & Co. Ltd., Tokio Marine & Fire Insurance Co. Ltd., Sojitz Corporation and Sofema SA. This is a rebuttable presumption, which the AO may rebut with suitable evidence.

6.5 Then, there is a decision of Hon'ble Delhi High Court in the case of UAE Exchange Centre Limited. Being the decision of the jurisdictional High Court, we find it purposeful to recapitulate the ratio of the case. It is mentioned that Blacks Law Dictionary furnishes the meaning of "auxiliary" as "aiding or supporting activity". The office in India downloads information which is contained in the main servers located in USA. Based upon this information cheques are drawn on banks in India. These checks are dispatched or couriered to the beneficiaries depending upon instructions of the NRI remitter. Such activity is in aid or support of main activity. It is further mentioned that the learned AR lost sight of the vital fact that income which otherwise neither arose nor accrued in India cannot be deemed to accrue or arise in India by looking merely an exclusionary clause (e). Once an activity is construed as being subsidiary or in aid or support of main activity, it would fall within the exclusionary clause. This

case has been followed by the AAR in the ruling in the case of K. T. Corporation, Korea, and it has been ruled that in view of the aforesaid decision the LO cannot be taken to be a PE unless its activities exceed the permitted activities or the department lays hand on any concrete material which impeaches the version of the assessee.

6.6 We may now consider the decision in the case of Sofema SA. The finding of the Tribunal is that in absence of any evidence on record with regard to commercial activity having been done by the assessee in India, the LO cannot be considered to be a PE. The Hon'ble High Court of Delhi dismissed the appeal of the Revenue by mentioning that no substantial question of law arises. However, the Hon'ble Supreme Court dealt with the case in greater detail and mentioned that there is concurrent finding that Sofema SA does not have a PE in India. This finding has been given on the basis that there is no evidence or justification forthcoming from the Revenue to show that the assessee has a PE in India. On this account alone, the Hon'ble court did not interfere in the matter. What follows from this decision is that there has to be evidence on record that the assessee has carried on some essential activities of business from the LO. The court found that no such evidence was coming from the side of the Revenue which means that such evidence has to be brought on record by the Assessing Officer. In this case the Assessing Officer has rued that only selective and sketchy information has been furnished by the assessee in the course of assessment. This is in fact correct, and it may be a cleaver

way of presenting facts. However, the AO has not taken any step to bring on record information that the activity was beyond the limit prescribed by the RBI. No doubt that the learned CIT(DR) referred to three pages in the paper book which, according to him, furnish a definite clue that India office was engaged in price negotiation. However, that is not correct as quotations were made on the basis of instructions from the Head Office. Some more information was added about internal dispute in the case of TOPY. But that does not form an essential part of the business of the sale of iron / iron material and iron product by the assessee in India.

6.7 On the basis of aforesaid discussion it can be concluded that the presumption which can validly be raised in this case that India office does not constitute a PE as no violation was noticed by the RBI. This presumption has not been rebutted by the Assessing Officer by bringing any positive material to show that any substantive business activity was carried on by the assessee in India.

6.8 Coming to similarity of activities of the assessee and MCJ, the draft order in the lead case is not available on record. There is no evidence that this order was shown to the assessee and it was given a chance to rebut the inference of similarity of functioning. It is also not mentioned as to what finally happened to that order. Therefore, we are of the view that these observations do not constitute any foundation for coming to any conclusion for or against the assessee. Therefore, we are of the view that

the India office does not constitute PE of the assessee in India. The result is that the assessee succeeds on ground No. 1.

6.9 Thus, it is held that although the assessee has a fixed place of business in India, there is no evidence on record that any substantive business activity has been carried on from this place. Therefore, the decision of Hon'ble Supreme Court in the case of Sofema SA (supra) is applicable. Further, since no income accrues or arises to the assessee in India, no income can be deemed to accrue or arise to the assessee in India by invoking exclusionary sub-paragraph (e), as held in the case of UAE Exchange Centre Ltd. (Supra).

7. The income earned by the assessee is the business income. For bringing to tax business income in India, one of the essential conditions is that the assessee has a PE in India. Since it has been held that the assessee does not have a PE in India, it is not necessary for us to decide other grounds on merit.

8. In the result, the appeal is allowed as discussed above.

Sd/-	**sd/-**
(I. P. BANSAL)	**(K. G. BANSAL)**
Judicial Member	**Accountant Member**

Dated:…11.5.2012……..
***Singh**
3004

Copy of order forwarded to:

1. Appellant
2. Respondent

3. CIT(A)
4. CIT
5. DR