आयकर अपीलीय अधिकरण, मुंबई न्यायपीठ 'एल', मुंबई ।

IN THE INCOME TAX APPELLATE TRIBUNAL MUMBAI BENCHES "L", MUMBAI

सर्वश्री आर.एस. स्याल, लेखा सदस्य **एवं** विवेक वर्मा, न्यायिक सदस्य, के समक्ष ।

Before Shri R.S.Syal, AM and Shri Vivek Varma, JM

ITA No.7227/Mum/2012 : Asst.Year 2009-2010

M/s.IHI Corporation Office No.605-606, Shristi Plaza Behind Amartara Plastics Off Saki Vihar Road, Andheri (East) Mumbai – 400 076. **PAN : AAACI8016M.**	**बनाम**/ Vs.	The Addl.Director of Income-tax (International Taxation) – 3 Mumbai.
(अपीलार्थी /Appellant)		(प्रत्यर्थी/Respondent)

अपीलार्थी **की ओर से** /**Appellant by : Shri M.P.Lohia**

प्रत्यर्थी **की ओर से** /**Respondent by : Shri Mahesh Kumar**

सुनवाई की तारीख / **Date of Hearing : 06.03.2013**		घोषणा की तारीख / **Date of Pronouncement : 13.03.2013**

आदेश / O R D E R

Per R.S.Syal (AM) :

This appeal by the assessee arises out of the order dated 10.10.2012 passed by the Assessing Officer u/s 143(3) read with section 144C(13) of the Income-tax Act, 1961 (hereinafter also called as `the Act') in relation to the assessment year 2009-2010.

2. First issue in this appeal is against taxability of a sum of ₹60,51,59,793 under the provisions of the Act, as well as India-Japan DTAA.

3. Briefly stated the facts of the case are that the assessee is a company incorporated in and tax resident of Japan engaged in

manufacturing of heavy machinery, providing technology oriented products and services to industrial, private and public sectors. The assessee was awarded three engineering, procurement, construction and commissioning contracts by Petronet LNG Limited in India. The contract consideration under these agreements is segregated into offshore portion and onshore portion. The onshore portion comprises of onshore supply of equipments and services in India and offshore portion also comprises of offshore supply of equipment and services from outside India. Insofar as the first two contracts are concerned, those were completed in the year ending 31.03.2006. The only contract which is relevant to the year under consideration is LNG storage tank at Kochi to be executed over 47 months, commencing from February 2008. For the execution of this contract the assessee set up a project office in India. In the return filed by the assessee it offered income received from onshore activities to tax in India with the claim of applicability of India-Japan Tax Treaty or the domestic law, whichever is beneficial to it. There is no dispute on this segment of the income. The assessee did not offer to tax income from offshore supply and offshore services by claiming that it did not accrue or arise in India. In support of its contention, the assessee relied on the judgment rendered by the Hon'ble Supreme Court in its own case viz., *Ishikawajima-Harima Heavy Industries Ltd. v. DIT [(2007) 288 ITR 408 (SC)]*. On being called upon to explain as to why the income from offshore supply and offshore services be not taxed in India, the assessee stated that all activities in connection with the offshore

supplies were undertaken outside India and since both the transfer of property in goods as well as the payment were carried on outside the Indian soil, the income from such transaction was not taxable. The Assessing Officer got convinced with the assessee's submissions in this regard and held that the income from offshore supply was not taxable. The entire controversy in this appeal revolves around the income from offshore services. The assessee claimed exemption of this income from tax by stating that its project office in India had no role to play in respect of offshore services rendered and hence income from offshore services was not taxable in India. It was also argued that since such services were rendered outside India, the same should not be charged to tax u/s 9(1)(vii). The Assessing Officer as well as the Dispute Resolution Penal (DRP) did not find any force in the assessee's contention *qua* the taxability of income from offshore services both under the domestic law and also the treaty. They opined that the judgment of the Hon'ble Supreme Court rendered in assessee's own case was rendered prior to retrospective amendment carried out to section 9(1)(vii) by means of substitution of *Explanation* below section 9(2) of the Act. As regards the assessee's contention about non-taxability of income from offshore services under the Double Taxation Avoidance Agreement between India and Japan (DTAA), the authorities held that the amount was liable to be considered as Fees for technical services under Article 12 of the DTAA. Resultantly, the gross sum of ₹60.51 crore received by the assessee towards offshore services was subjected to tax at

₹10.5575%. The assessee is aggrieved against the decision rendered by the Assessing Officer as regards the taxability of the amount of offshore services under the Act as well as the Treaty.

4. We have heard the rival submissions and perused the relevant material on record. As the assessee has assailed the taxability of the amount both under the domestic law as well as the DTAA, we would consider the position one by one under both the compartments.

(i) Position under the Act:

5.1. The assessee is admittedly a non-resident. Section 5(2) provides that the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which – (a) is received or is deemed to be received in India in such year by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during such year, subject to the provisions of this Act. Section 9 deals with the incomes deemed to accrue or arise in India. Section 9(1)(vii), which is relevant for our purpose, provides that income by way of fees for technical services payable by …..(b) a person who is a resident, except where the fees are payable in respect of services utilized in a business or profession carried on by such person outside India etc., shall be deemed to accrue or arise in India. Going by the mandate of this provision, if any person who is resident of India pays an income by way of fees for technical services to a non-resident, such income shall be deemed

to accrue or arise to such non-resident subject to the fulfillment of the other requisite conditions as stipulated. The Hon'ble Supreme Court has held in assessee's own case that offshore services rendered in connection with the turnkey project did not fall within the purview of section 9(1)(vii) as the entire services were rendered outside India though utilized in India. It further held that section 9(1)(vii) envisages the fulfillment of two conditions viz. the services which are the source of income must be utilized in India and such service must be rendered in India. As the services provided by the assessee were utilized in India but not rendered in India, the Hon'ble Supreme Court held that the amount would go out of the purview of section 9(1)(vii).

5.2. At this juncture, it would be relevant to note that the Finance Act, 2010 has substituted *Explanation* below section 9(2) with retrospective effect from 01.06.1976, which runs as under:-

> *"Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,—*
>
> *(i) the non-resident has a residence or place of business or business connection in India; or*
>
> *(ii) the non-resident has rendered services in India."*

5.3. By means of this *Explanation,* the income from fees for technical services shall be deemed to accrue or arise in India to a non-resident whether or not, *inter alia,* the non-resident has rendered services in India. The substitution of this *Explanation* has diluted the twin conditions formulated by the Hon'ble Supreme Court in the assessee's own case, being the rendering of services and utilization of such services in India as a pre-requisite for the attractability of section 9(1)(vii). With this substitution, the rendering of services even outside India would be a good case for bringing the income of non-resident from fees for technical services within the purview of section 9(1)(vii) if such services are utilized in India. Admittedly, there is no dispute on the fact that the instant payment received by the assessee is in the nature of fees for technical services and the services were rendered outside India. As such services were utilized in India, the rendition of such services outside India can now no more be claimed as a relevant criteria to push such income outside the ambit of section 9(1)(vii). In view of the amendment to the relevant provisions by means of the substitution of *Explanation* to section 9(2) governing the year under consideration also, we are of the considered opinion that the income from offshore services rendered outside India would fall within the domain of section 9(1)(vii) of the Act. This contention raised on behalf of the assessee is jettisoned.

(ii) Position under the DTAA

6.1. Now let us examine the position under the DTAA. Article 12 encompasses the income from Royalty and fees for technical services; and Article 7 discusses the Business profits. Para 1 of Article 12 provides that royalty and fees for technical services arising in a contracting State and paid to a resident of the other contracting State may be taxed in that other contracting State. Article 12(2) provides that the fees for technical services may also be taxed in the contracting State in which they arise. Para 4 of this Article defines the term "fees for technical services", which is not disputed. Para 5 of this Article is a centre of controversy between the assessee and the Revenue, which is reproduced as under:-

> *"Article 12(5)*
> *5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through a permanent establishment situated therein, or performs in that other Contracting State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of article 7 or article 14, as the case may be, shall apply."*

6.2. The learned Departmental Representative submitted that the case of the assessee cannot be considered under para 5 of Article 12

because the fees for offshore services cannot be considered as "effectively connected" with the permanent establishment. He submitted that the words used here are `effectively connected' and not casually `connected'. It was accentuated that unless the income directly results from the permanent establishment, it cannot be construed as effectively connected to it. His whole emphasis was on the direct link between the income and the permanent establishment as a *sine qua non* for the establishment of effective control. As the fees for technical services had no direct and live link with the permanent establishment in the present case, the ld. DR argued that it should not be held to be `effectively connected' with the permanent establishment so as to throw it in the scope of Article 7.

6.3. Per contra, the learned AR stated that the offshore services were rendered because of the composite "contract", whose remaining parts are effectively connected with the permanent establishment in India. It was submitted that if the effective connection of the fees for technical services and the permanent establishment is established, then the income goes back to Article 7 instead of staying in Article 12. The learned AR argued that the Hon'ble Supreme Court has held that the income from offshore services falls under Article 7. It was also submitted that the nature of contracts before the Hon'ble Supreme Court was admittedly similar to that under consideration, which fact has not been controverted by the Assessing Officer as well. Once income from offshore services comes within the scope of

Article 7, the same cannot be taxed because of clause 6 of Protocol as per which the profits of the enterprise can be taxed in the other State only so much of them as are appropriate to the part played by the permanent establishment in these transactions. Since the permanent establishment did not play any role in rendering such offshore services, the learned AR contended such income from offshore services would escape taxation as has been held by the Hon'ble Supreme Court and further the Hon'ble jurisdictional High Court in the assessee's own cases.

6.4. Having heard the rival submissions and perused the relevant material on record, the first question which arises for our consideration is as to whether the issue of income from offshore services as per the DTAA has been decided or not by the Hon'ble Supreme Court? The learned Departmental Representative vehemently argued that there is no decision by the Hon'ble Supreme Court on this aspect. He put forth that even if some reference was to be found to such issue in the judgment, it would not mean the decision of the Hon'ble Supreme Court because of there being no discussion of the issue in the body of the judgment as to whether the fees for technical services was `effectively connected' with the permanent establishment.

6.5. In order to answer this question, we find it useful to reproduce the judgment of the Hon'ble Supreme Court on this issue, whose relevant part is as under:-

> "Re : Offshore services :
>
> (1) Sufficient territorial nexus between the rendition of services and territorial limits of India is necessary to make the income taxable.
>
> (2) The entire contract would not be attributable to the operations in India viz. the place of execution of the contract, assuming the offshore elements form an integral part of the contract.
>
> (3) Section 9(1)(vii) of the Act read with the Memo cannot be given a wide meaning so as to hold that the amendment was only to include the income of non-resident taxpayers received by them outside India from Indian concerns for services rendered outside India.
>
> (4) The test of residence, as applied in international law also, is that of the taxpayer and not that of the recipient of such services.
>
> (5) For section 9(1)(vii) to be applicable, it is necessary that the services not only be utilized within India, but also be rendered in India or have such a "live link" with India that the entire income from fees as envisaged in article 12 of the DTAA becomes taxable in India.
>
> (6) The terms "effectively connected" and "attributable to" are to be construed differently even if the offshore services and the permanent establishment were connected.

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

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

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

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

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

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

6.6. From the above judgment it is discernible that the Hon'ble Supreme Court has rendered a positive decision on this aspect by holding in para (8) above that Article 7 of the DTAA is applicable in this case insofar as the income from offshore services is concerned. It

has further been held that since the entire services were rendered outside India having nothing to do with the permanent establishment, there can be no taxability of this amount in India. Further in para (12) it has been held that the offshore services are inextricably linked to the supply of goods, so it must be considered in the same manner. In view of the enunciation of law by the Hon'ble Supreme court in assessee's own case, it becomes vivid that the income from identical services rendered by the assessee in respect of the contract under consideration cannot be characterized differently as argued on behalf of the Revenue. It is further relevant to note that the Tribunal in assessee's own case for the assessment year 2003-2004 considered similar issue. Following the above judgment of the Hon'ble Supreme Court, it was held that the income from offshore services cannot be taxed in terms of section 9(1)(vii) of the Act. The Revenue assailed this order before the Hon'ble jurisdictional High Court by contending that *Explanation* added by the Finance Act, 2010 with retrospective effect from 1st June, 1976 has changed the position. The Hon'ble jurisdictional High Court vide its judgment in ITA No.239 of 2011 dated 6th November, 2012 upheld the Tribunal order by noting that the Apex Court in the assessee's own case has held that apart from non-applicability of section 9(1) in the present case, Article 7 of the DTAA is also applicable and hence the income arising on account of offshore services would not be taxable.

6.7. In view of the foregoing discussion it is abundantly manifest that the Hon'ble Supreme court as well as the Hon'ble jurisdictional High Court have held in unequivocal terms in the assessee's own case for the earlier years that the income on account of offshore services is not chargeable to tax as per Article 7 of the DTAA.

7. Section 90(2) of the Act provides that where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee. The Hon'ble Supreme Court in *CIT VS. P.V.A.L. Kulandagan Chettiar (2004) 267 ITR 654 (SC)* has held that the provisions of sections 4 and 5 are subject to the contrary provision, if any, in DTA. The crux of the matter is that the provision of the Act or of the DTA, whichever is more beneficial to the assessee, shall apply.

8. We, therefore, overturn the impugned order on this issue by holding that the income from offshore services, *albeit* chargeable u/s 9(1)(vii) but exempt under the DTAA, cannot be charged to tax in the light of section 90(2) as discussed above. The impugned order is, therefore, set aside to this extent.

9. In view of our above decision, ground no.4 raised by the assessee as regards the rate of taxation, has become infructuous and is accordingly dismissed.

10. Next issue is about short granting of tax deducted at source to the tune of ₹68,74,511. The Assessing Officer is directed to examine this aspect of the matter and thereafter, decide it as per law after allowing a reasonable opportunity of being heard to the assessee.

11. Next ground is about the levy of interest u/s 234B and 234C of the Act.

12. Having heard the rival submissions and perused the relevant material on record we find that the issue of charging of interest u/s 234B in the present case is no more *res integra* in view of the judgment of the Hon'ble jurisdictional High Court in the case of *Director of Income-tax (International Taxation) v. NGC Network Asia LLC [(2009) 313 ITR 187 (Bom.)]* in which it has been held that when the duty is cast on the payer to deduct tax at source, on failure of the payer to do so, no interest can be charged from the payee assessee u/s 234B. The same view has been reiterated in *DIT (IT) v. Krupp UDHE GmbH[(2010) 38 DTR (Bom.) 251]*. As the assessee before us is a non-resident, naturally any amount payable to it which is chargeable to tax under the Act, is otherwise liable for deduction of tax at source. In that view of the matter and respectfully following

the above precedents, we hold that no interest can be charged u/ss 234B and 234C of the Act. This ground is allowed.

13. Last ground about the initiation of penalty proceedings u/s 271(1)(c) is premature and accordingly dismissed.

14. In the result, the appeal is partly allowed.

Order pronounced on this 13th day of March, 2013.
आदेश की घोषणा दिनांकः को की गई ।

Sd/-
(Vivek Varma)
न्यायिक सदस्य / JUDICIAL MEMBER

Sd/-
(R.S.Syal)
लेखा सदस्य / ACCOUNTANT MEMBER

मुंबई Mumbai; दिनांक Dated : 13th March, 2013.
Devdas*

आदेश की प्रतिलिपि अग्रेषित/Copy of the Order forwarded to :

1. अपीलार्थी / The Appellant
2. प्रत्यर्थी / The Respondent.
3. आयकर आयुक्त(अपील) / The DRP-I, Mumbai.
4. आयकर आयुक्त / CIT
5. विभागीय प्रतिनिधि, आयकर अपीलीय अधिकरण, मुंबई / DR, ITAT, Mumbai
6. गार्ड फाईल / Guard file.

आदेशानुसार/ BY ORDER,

सत्यापित प्रति //True Copy//

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आयकर अपीलीय अधिकरण, मुंबई / **ITAT, Mumbai**