IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : B : NEW DELHI

BEFORE SHRI R.S. SYAL, VICE PRESIDENT
AND
MS SUCHITRA KAMBLE, JUDICIAL MEMBER

ITA No.1623/Del/2015
Assessment Year : 2006-07

Daikin Industries Ltd., C/o BMR & Associates LLP, 22nd Floor, Building No.5, Tower A, DLF Cyber City, DLF Phase III, Gurgaon. PAN: AACCD2498N	Vs.	ACIT, Circle 1(2)(2), International taxation, New Delhi.
(Appellant)		(Respondent)

Assessee By : Shri Vishal Kalra, Advocate,
Shri Anuj Agarwal, CA,
Shri Gaurav Barchha, CA,
Rajnandini Shukla, Advocate

Department By : G.K. Dhal, CIT, DR

Date of Hearing : 24.05.2018
Date of Pronouncement : 28.05.2018

ORDER

PER R.S. SYAL, VP:

The assessee has assailed the final assessment order dated 21.01.2015 passed by the Assessing Officer (AO) u/s 144C read with sections 143(3)

and 254 of the Income-tax Act, 1961 (hereinafter also called 'the Act') in relation to the assessment year 2006-07. It is second round of proceedings before the Tribunal.

2. The first issue raised in this appeal is against treating M/s Daikin Air-conditioning India Pvt. Ltd. (DAIPL) as dependent agent Permanent Establishment (PE) of the assessee and the second one is against the attribution of income to the PE by the AO.

3. Succinctly, the factual matrix of the case is that the assessee is engaged in the development, manufacture, assembly and supply of air-conditioning and refrigeration equipments. It is incorporated in and is a tax resident of Japan. The assessee is having a wholly owned subsidiary in India by the name and style of DAIPL. Earlier, DAIPL was a joint venture company of the assessee and Shriram Group. In the immediately preceding year, the joint venture was terminated and the assessee acquired all the shares in it. During the course of the first round of assessment proceedings, for which assessment was completed on 26.12.2008, the Assessing Officer held DAIPL to be a dependent agent PE of the assessee in India and also

attributed some income to the PE. In such proceedings, the AO noticed that the assessee sold air-conditioners etc. worth Rs.55.15 crore to DAIPL. In addition, the assessee also claimed to have made direct sales worth Rs.45.40 crore to third parties in India. The AO obtained certain information from the assessee as well as DAIPL. On perusal of such information, it was observed that the price charged from direct sales to customers was higher than that charged from DAIPL. For example, in respect of model FT35BAVM, the assessee charged 72 US $ from DAIPL as against 97 US $ from direct sales to customers. It was further noticed that the assessee paid commission @ 10% to DAIPL for rendering marketing services in connection with direct sales made by it in India. Allowing adjustment for the payment of commission in the price charged, the Assessing Officer worked out the adjusted sale price to customers for the same model at 87.3 US $ as against the actual sale price of 97 US $. In this way, he noticed with respect to all the products sold that there was a difference to the extent of 79.85% in such adjusted price charged on sales to customers *vis-à-vis* DAIPL. A show cause notice was issued to the assessee requiring it to explain, with documentary evidence, the role played

by it and DAIPL in making direct sales to Indian parties, viz., in identifying customers, approaching, presentation, demonstration, price catalogue, negotiation of prices and finalization of prices with them. The assessee stated that the role of DAIPL in making such direct sales in India was limited to the marketing support services as set out in the Commission agreement (hereinafter also called `the Agreement') dated 22.12.2005. It put forth that the activities of identifying customers, negotiating and finalizing prices with customers in India etc. were exclusively done by it directly from Japan. However, it could not furnish any satisfactory documentary evidence to support its contention. Even *qua* the claim that it paid commission to DAIPL for rendering limited services, the assessee candidly admitted, vide its reply dated 20.11.2008, that it had not furnished any Form No.3CEB in respect of international transactions with DAIPL nor maintained any documents required to be maintained u/s 92D of the Act. On a perusal of Form No.3CEB filed by DAIPL for its own international transactions, the Assessing Officer found that DAIPL received total commission amounting to Rs.10,64,39,135/-. The Assessing Officer noticed from the Agreement that the functions of DAIPL were shown to

have been confined to forwarding the customers' request to DIL and forwarding DIL's quotations and contractual proposals to the customers in India. In the absence of the assessee submitting any cogent evidence of it being directly undertaking marketing activities in respect of sales in India, the AO held that such activities were, in fact, done by DAIPL simultaneous with making sales in respect of their own distribution activity. In the backdrop of such a position, DAIPL was held as a Dependent Agent Permanent Establishment of the assessee in terms of paragraphs 7(a) and 7(c) of Article 5 of the Double Taxation Avoidance Agreement between India and Japan (hereinafter also called `the DTAA'). Thereafter, the AO proceeded to compute profits attributable to PE at Rs.5,96,34,440/-. This amount was added to the total income of the assessee. In an appeal against the assessment order, the assessee contended before the Tribunal that necessary information could not be supplied to the AO as the person holding such details had fallen ill. The Tribunal set aside the assessment order and restored the matter to the AO for a fresh decision. It is an admitted position that such order of the Tribunal has attained finality. In the fresh consequential proceedings also, the assessee failed to satisfy the

AO on its line of reasoning, which led to the reiteration by the AO of the conclusions drawn in the first round of assessment. The assessee has again come up in appeal before the Tribunal.

4. We have heard both the sides and perused the relevant material on record. The impugned order on this score has been assailed on three counts, viz., DAIPL does not constitute dependent agent PE of the assessee in India; there can be no attribution of income when commission payment to DAIPL has been found at ALP; and without prejudice, no further attribution of profits is called for on merits also. We will espouse these contentions in seriatim for consideration and decision.

PERMANENT ESTABLISHMENT

5. The first question is whether DAIPL constituted a dependent agent PE of the assessee in India. The assessee, a Japanese entity, sold air-conditioners etc. to its subsidiary DAIPL worth Rs.55.15 crore and declared direct sales to third parties in India worth Rs.45.40 crore. The assessee paid 10% commission to DAIPL on its direct sales for the services enumerated in the Commission Agreement, while maintaining that all important

activities concerning the sales transactions, such as, negotiating and finalizing prices, payment terms, delivery schedule and other contractual terms with the customers, were settled by it in Japan. Clause 2 of the Agreement, referring to DIL as the assessee and DAIPL as the Indian subsidiary, sets out the nature of services rendered by the assessee and DAIPL respectively in completing the direct sales to customers in India, as under:-

> "PROVISION OF SERVICES
>
> DIL and DAIPL recognize that customers request DAIPL to procure the products from DIL. Pursuant to the request, DAIPL conveys the customers' request to DIL and DIL decides and finalizes the commercial terms and conditions with the customers. The respective roles and responsibilities of DIL and DAIPL are as under:
>
> 2.1 DIL
>
> 2.1.1 Based on the customer's request, to prepare a quotation for the customers;
>
> 2.1.2 Negotiate and finalize prices, payment terms, delivery schedule and other contractual terms with the customers.
>
> 2.2 DAIPL
>
> 2.2.1 To forward the customers' request for procuring products from DIL to DIL;
>
> 2.2.2 To forward DIL's quotation and contractual proposal to the customers."

6. Clause 3 of the Agreement provides that in consideration of the above services rendered by DAIPL, the assessee will pay commission at the rate

of 10% of the sales value. Since the assessee claimed the role of DAIPL as a mere communication channel, restricted to forwarding the customers' request for procuring products to it and forwarding its quotation and contractual proposal to the customers, the Assessing Officer sought details from the assessee as to who was identifying customers, approaching them, making presentations and demonstrations along with price catalogue and negotiation of prices and finalization of prices in respect of sales to third parties. The assessee submitted that it was: "trying its best to procure the relevant documents/details. Unfortunately, substantial records for the year under consideration are not traceable with the assessee." Certain sketchy details were submitted in relation to some of the customers by claiming: "that the person responsible for handling tax matters of the assessee has not been able to attend office for some time on account of ill health, which has also added to the difficulty in procuring and furnishing the required documents." To verify the assessee's claim that it was directly negotiating and finalizing prices, payment terms, delivery schedules and other contractual terms with the customers in India, the Assessing Officer required the assessee to furnish copies of e-mails/correspondence with its

customers in India. The assessee failed to furnish even such e-mails to buttress its claim. It was then stated that some of its employees visited India for having discussions with customers in India. However, the fact is that such visiting employees rendered only consultancy services etc., which were separately charged to DAIPL and the Assessing Officer has rightly concluded that the assessee cannot claim such personnel to be engaged in negotiating the prices.

7. The assessee argued before the AO that whereas DAIPL was making sales to the individual customers in India, it was making direct sales only to institutional customers. This contention is also not correct. The AO has drawn a chart on page 10 of the assessment order in the first round, from which it is discernible that several sales to Indian customers are for an amount less than Rs.25,000/- and further there are many individuals, in contrast to institutions, in such a list.

8. There is hardly any need to accentuate that in a highly competitive industry of air-conditioning and refrigeration equipments, tremendous efforts are required to be made for effecting sales. The contention of the

assessee that customers in India were directly approaching it in Japan *de hors* any marketing efforts made by it, is not only vague but also devoid of merit. Our conclusion is further fortified by the fact that for selling the same products, in the capacity of a distributor, DAIPL has incurred huge Selling and distribution expenses to the tune of Rs.14.38 crore during the relevant year, which is evident from Schedule P to its Annual report, whose copy has been placed at page 68 of the paper book. We fail to comprehend as to how the assessee came in contact with customers in India and made sales to them directly, when DAIPL, situated in India, had to spend a huge amount of selling and distribution expenses for selling similar products in India.

9. The view projected by the assessee that DAIPL was acting only as a communication channel for its direct sales, does not instill confidence because no evidence has been brought on record to demonstrate as to how the customers in India were approaching the assessee in Japan to discuss and finalize their requirements and prices. It is not a case of an assessee dealing with a single customer to whom the entire sale of Rs.45.40 crore were made. On the other hand, the customers are scattered all over India

and the amount of sale price in many cases is even below Rs.25,000/-, which is overt from the statement drawn by the AO on pages 10 and 11 of the assessment order in the first round.

10. In the absence of the assessee furnishing any shred of credible evidence showing its direct involvement from Japan in making sales to customers in India and proving that the role of DAIPL was simply confined to a communication channel, the inescapable conclusion which follows is that the entire activity starting from identifying customers, approaching them, negotiating prices with them and finalization of products and prices were done by DAIPL in India not only for the products sold directly by them as distributor, but also for which the assessee is claiming to have made direct sales.

11. At this juncture, it is relevant to mention that the assessee argued before the Tribunal during the first round of proceedings that the Assessing Officer erred in holding that DAIPL constituted dependent agent PE of the assessee. The Tribunal, vide order dated 13.07.2012 in ITA No.3005/Del/2011, has recorded in para 11 of its order that the assessee

pleaded that complete information could not be provided to the AO as the person, who was in charge of the requisite details, had fallen ill. To meet the ends of justice and giving one opportunity to the assessee to substantiate its claim with relevant documentary evidence, the Tribunal set aside the assessment order and remitted the matter to the file of the AO for fresh determination of the issue. It is a matter of record that in the resulting instant round of proceedings also, the assessee, apart from reiterating its stand that DAIPL is economically independent and was remunerated for providing marketing support services and, hence, its activities could not constitute a PE of the assessee in India, failed to authenticate its claim with any fresh evidence except filing its own Transfer pricing study report and certain e-mails. Copies of such e-mails have been placed at pages 211 onwards of the paper book. Such e-mails were supplied in the extant round of proceedings to the AO with a covering letter dated 4.3.2014, whose copy is available at page 209 of the paper book. It has been categorically mentioned in this letter that the accompanying e-mails were exchanged between the assessee and DAIPL. Such a position needs to be viewed in backdrop of the AO's requirement of furnishing e-mails/correspondence

between the assessee and its customers in India with regard to the receipt of proposals, relating to price negotiation and other documents. Not even a single direct e-mail between the assessee and its customers in India has been provided, which reinforces the view that no activity resulting into direct sales in India was done by the assessee and such marketing activities were done by DAIPL alone.

12. Be that as it may, let us examine contents of the e-mails between the assessee and DAIPL. Page 212 is an e-mail originating from DAIPL to the assessee in Japan in which the Indian entity is referring to `price approval sheets already given for the following two projects'. Then it has been mentioned that certain amendments are required in case of the second project. It has been written that : `*Price of FXM 200 LVE in this case is 1259 USD each. Can it be reduced to 1240 USD*'. This e-mail has been replied by the assessee, on page 211 of the Paper book, mentioning that: `*We would like to remain previous price for FXM 200 LVE.* It's due to the difference of discount rate in our previous quotation. We gave you 5% discount only for the products on original quotation. This opposite pricing is occurring not only for this product but also for the other products. Please

understand it'. This communication demonstrates that it was DAIPL only which was negotiating and finalizing deals with Indian customers and then conveying it to the assessee. Not only that, DAIPL in this process, was also requesting for reduction in the price of products at the instance of the Indian customers, wherever requested by them. This belies the assessee's contention that the process of negotiation and finalization of prices was done by it. Page 215 of the paper book is another e-mail from DAIPL to the assessee, mentioning : `*I have sent 4 no. requests for approval of pricing on VRV projects* on 5th May, 2005. I hope you would have received them. *Please let me know as when can I get the approval sheets so that we can release the order*.' This e-mail reinstates that DAIPL was negotiating prices with customers in India and then sending such prices to the assessee for approval. On getting such prices approved, it was initiating the process of releasing the order. Page 224 of the paper book is an e-mail of customer to DAIPL mentioning : `The LC cl 9 is added as LC amended for confirmation. This means that you have to submit clean documents to Bank as per LC terms and same is required as LC realization is as per documents only. *If this is not acceptable then let us withdraw confirmation clause. Pl.*

convince your counterpart and make the shipment'. This e-mail explicitly proves that the entire deals were negotiated and finalized by Indian customers with DAIPL only. After finalization of deals, the assessee was asked to make the shipment of the products.

13. The foregoing discussion unambiguously proves, without any shadow of doubt that, in fact, DAIPL was negotiating and finalizing the contracts of sale claimed to have been made by the assessee from Japan. Albeit no authority apparently vested in DAIPL to finalize the contracts of direct sales in India, but the activities of negotiating and finalizing the contracts etc., constituting substance of any sale transaction, were indeed performed by DAIPL. Failure of the assessee to adduce any evidence showing its direct interface from Japan with customers in India and further the e-mails abundantly showing DAIPL negotiating and finalizing the prices, payment terms, delivery schedule and other contractual terms with the customers in India, leave no scope for doubt that such sales were, in fact, negotiated and finalized by DAIPL. The mere fact that the assessee was formally signing the contracts of sale does not, in any manner, alter the position.

14. At this stage, it is pertinent to mention that the AO held DAIPL as dependent agent PE of the assessee in terms of paras 7(a) and 7(c) of Article 5 of the DTAA. Such Article of the DTAA defines 'Permanent Establishment'. Relevant parts of Article 5, run as under:-

"ARTICLE 5

1 to 6……

7. Notwithstanding the provisions of paragraphs 1 and 2, where a person— other than an agent of an independent status to whom paragraph 8 applies— is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State, if

(a) he has and habitually exercises in that Contracting State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 6 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph;

(b) he has no such authority, but habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned Contracting State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control as that enterprise.

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

15. A cursory look at para 7, which starts with a *non-obstante* clause *qua* paras 1 and 2, shows that where a person, other than an agent of an independent status as discussed in para 8, is acting in India for an enterprise of Japan, the Japanese enterprise shall be deemed to have a PE in India if such person falls in any of the three clauses mentioned in para 7. It is not the case of the assessee that para 8 of Article 5 is activated and hence the character of independent agent is held to be impliedly lacking in so far as DAIPL is concerned *qua* the assessee. The AO held that sub-paras (a) and (c) of para 7 are attracted in this case. As per the essence of sub-para (a), DAIPL will become a dependent agent PE of the assessee, if it has and habitually exercises in India an authority to conclude contracts on behalf of the assessee, a Japanese enterprise. It is nobody's case that exception clause of sub-para (a) is attracted here. The facts stated hereinabove amply prove that DAIPL was habitually exercising authority in India to conclude contracts on behalf of the assessee, though such contracts were formally signed by the assessee in Japan. Sub-para (c) of para 7, which has also been invoked by the AO, is clearly magnetized inasmuch as DAIPL was securing orders in India `*almost wholly'* for the assessee. All the substantive parts of

the key activities in making sales were done by DAIPL from India. This shows that DAIPL constituted a dependent agent PE of the assessee in India.

16. Reliance of the ld. AR on the judgment in the case of *Adobe Systems Inc. & Ors. Vs. ADIT & Ors (2016) 240 Taxman 353 (Del)* is misplaced. The Hon'ble High Court dealt with `Dependent Agent' issue in para 37 of the judgment and concluded that no Dependent Agent PE was constituted because: 'there is no allegation that Adobe India is authorized to conclude contracts on behalf of the assessee or has been habitually doing so.' *Per contra*, in the instant case, there is not only an allegation by the Assessing Officer that DAIPL was exercising an authority to conclude contracts and habitually securing orders in India, but, the same has also been sufficiently proved by the him, to which we accord our imprimatur. Thus it is held that the authorities below were justified in holding that DAIPL constituted dependent agent PE of the assessee in India. The assessee fails on this score.

NO ATTRIBUTIOIN WHEN A.L.P. HAS BEEN DETERMINED

17. The ld. AR argued that the international transaction of commission payment by the assessee to DAIPL was subjected to the transfer pricing analysis by the TPO, who found the same at arm's length price (ALP). Our attention was invited towards the TPO's order dated 26.10.2009 passed for the year under consideration in the hands of DAIPL in which the international transaction of 'Commission received on direct sales (Market Support Services' was accepted at ALP. It was submitted that in such circumstances, no further income could have been attributed to the operations carried on by the assessee in India. This argument was bolstered on the strength of the *ratio* laid down by the Hon'ble Supreme Court in *Director of Income-tax (IT) vs. Morgan Stanley & Co. Inc. (2007) 292 ITR 416 (SC)* holding that once the transfer pricing analysis is undertaken, there is no further need to attribute profits to PE which is an associated enterprise and has been remunerated on an arm's length basis taking into account all the risk taking functions of the multinational enterprise.

18. There can obviously be no dispute, in principle, on the applicability of the *ratio decidendi* laid down by the Hon'ble Apex Court in *Morgan Stanley (supra).* However, we find that the *ratio* propounded in this case is not applicable to the facts and circumstances of the instant case. Firstly, the assessee did not undertake its transfer pricing analysis, as has been recorded on page 4 of the assessment order in the first round wherein the assessee categorically admitted not to have maintained documents u/s 92D or furnished Form No.3CEB. In such circumstances, there can be no question of holding the transaction of payment of commission by the assessee to DAIPL at arm's length. The assessee cannot be allowed to approbate and reprobate. In the first instance, it neither reported any international transaction nor did any benchmarking and, now it is claiming that its international transaction of payment of commission is at ALP and hence no further attribution of profits to the PE be made. These are two irreconcilable situations.

19. In fact, it was DAIPL which reported the international transaction of receipt of commission from the assessee and the TPO accepted the same at ALP in that case only. Be that as it may, there is another significant aspect

of the matter. The assessee entered into agreement with DAIPL and paid commission only for rendering two services viz., 'to forward the customers' request of procuring products from DIL to DIL' and 'to forward DIL's quotation and contractual proposal to the customers.' The TPO did benchmarking of the transaction of receipt of commission by considering it at arm's length in respect of the above two declared functions. However, the fact of the matter is that DAIPL carried out a whole range of functions in selling the products of the assessee in India, which, apart from the two functions elaborated in the Agreement, also include negotiating and finalizing the price and concluding contracts with the customers in India. Since such other functions were neither borne out from the Agreement nor declared by DAIPL and further no consideration was awarded for them, there was no occasion for the TPO to determine the ALP of the transaction of receipt of commission as inclusive of such other functions as well. Had such other functions been declared, the entire FAR (Functions performed, assets utilized and risks undertaken) analysis would have undergone a complete change. This demonstrates that the benchmarking of the receipt of commission @ 10% in the hands of DAIPL was done only with

reference to two functions of forwarding customers' request to DIL and forwarding DIL's quotations to the customers. As such, the other functions performed by DAIPL in negotiating and finalizing contracts in India on behalf of the assessee remained excluded from the process of determination of the ALP by the TPO. Under such circumstances, the argument of the ld. AR becomes untenable.

20. Although the Hon'ble Supreme Court in *Morgan Stanley (supra)* has held that once a transfer pricing analysis is undertaken, there is no further need to attribute profits to a PE as, in such cases, nothing further would be left to be attributed, yet, their Lordships carved out an exception to the above general rule by lying down that : `*The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered.* Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each

case'. The extant case falls within the ambit of the exception spelt out by the Hon'ble Summit Court inasmuch as transfer pricing analysis in the hands of DAIPL captured only two functions, whereas it actually carried out several others functions as well, which have been itemized above. `*In such a situation, there would be a need to attribute profits to the PE for those functions/risks that have not been considered.'* In view of the foregoing discussion, we are convinced that this argument of the ld. AR is bereft of any force and is *ex consequenti* repelled.

ATTRIBUTION OF PROFITS

21. Now we turn to the determination of the quantum of income attributable to the PE. The Assessing Officer computed a sum of Rs.5,96,34,440/- as profit attributable to the PE as under:-

"Computation of Profits

	(Amount in Rs.)
Direct Sales to End Customers	454,011,720
Less: Commission 10%	45,401,172
Net Sale Value	408,610,548/-

As mentioned in Table 2 in Para 4 above, the sale price of the products to DAIPL is 79.85% of the sale price to customer less commission. Therefore,

had the same products were sold to DAIPL, the sale value would be Rs.326,275,522/-.

Therefore, the additional sale value earned by the assessee is computed at Rs.82,335,026/-. Out of this, expenses @5% of the sale price to customers to account for all the costs incurred by the assessee in direct sales, works out to Rs.22,700,586/-.

Therefore, the additional profit earned by the assessee on account of activities of the PE in India is worked out as under:

	(Amount in Rs.)
Additional Sale Value	8,23,35,026
Less: Expenses	22,700,586
Profits attributable to PE	5,96,34,440"

22. The assessee is aggrieved against such computation of profits attributable to PE. The ld. AR vehemently argued that this mechanism of computing profit attributable to PE is unknown to law. He stated that the Assessing Officer for the assessment year 2008-09, giving effect to the directions of the DRP, determined the amount of profits attributable to the PE in India by applying global net profit margin of 8.5% to the direct sales made to customers in India. His without prejudice argument was that for the year under consideration, global net profit margin of the assessee is 5% and the same should be applied, if at all, any further profits are to be attributed to the PE. This was opposed by the ld. DR, who stated that the

global profit rate of 5% is not backed by any evidence and hence the same cannot be accepted.

23. It is vivid that the AO computed profits attributable to PE by firstly reducing the amount of commission paid to DAIPL from the amount of direct sales to end-customers in India determining net sale value at Rs.40.86 crore; then applying the percentage of 79.58% as discussed in an earlier part of the order to the amount of net sales value for determining the sale value at Rs.32.62 crore if such products had been sold to DAIPL; and then allowing deduction for expenses at 5% of the sales value from the differential amount of Rs.8.23 crore (Rs.40.86 crore minus Rs.32.62 crore) for finally determining the amount of profit attributable to the PE at Rs.5,96,34,440/-. It is apparent that the mechanism followed by the AO in computing the amount of profits attributable to the PE is unique in nature and suffers from several infirmities. It is not understandable as to why the amount of commission was reduced straightway from the amount of direct sales and then what is the logic in applying 79.85% and then allowing expenses at the rate of 5%. Correct method in such circumstances is to first find out the amount of profit which would have been earned by the assessee

in India from direct sale to end customers and then reduce it with the amount which has already suffered taxation in the hands of its subsidiary, DAIPL, through the transaction of commission.

24. The first step of finding out the amount of profit which would have been earned by the assesee from direct sale to end customers in India involves two sub-steps. First is determining the amount of total net profit earned by the assessee from direct sales to end-customers and the second is to work out that part of total profit as determined in the first sub-step, which relates to the operations carried out in India.

25. Towards the first sub-step, the assessee has put forth a sheet calculating 5% global net profit rate. Calculation of such profit rate is not authenticated by the accounts of the assessee for the India specific operations. It goes without saying that when data of global profit of an entity relating to India specific operations is not available or is not authentic, then, some estimation is required to be done. Rule 10 of the Income-tax Rules, 1962, deals with the determination of income in the case of non-residents. It provides that where the Assessing Officer is of the

opinion that the actual amount of income accruing or arising to any non-resident person cannot be definitely ascertained, the amount of such income for the purposes of assessment to income-tax shall be calculated 'at such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable'. Considering the entirety of the facts and circumstances of the instant case, we hold that the estimation of rate of net profit at 10% is reasonable. Our estimation of such net profit rate accords with the statutorily prescribed rate of 10% given in sections 44BB and 44BBB, being, the special provisions in case of a non-resident for computing profits and gains in connection with the business of exploration, etc., of mineral oils; and special provision for computing profits and gains of foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects. Accordingly, the amount of net profit relatable to the direct sale to customers in India, as per the first sub-step, would be 10% of the amount of sales of Rs.45,40,11,720/-, which comes to Rs.4,54,01,172/-.

26. Now we turn to the second sub-step, being, calculation of that part of the profit rate of 10%, which is attributable to the operations carried out in

India. The Delhi bench of the Tribunal in *Rolls Royce PLC vs. DDIT 2007-TII-32-ITAT-DEL-INTL* held 35% of global profit from sales in India as relatable to the marketing activities carried out in India. The said order of the Tribunal has been affirmed by the Hon'ble Delhi High Court in *Rolls Royce PLC vs. DIT(IT) (2011) 339 ITR 147 (Del)*. The Delhi Bench of the Tribunal in *ZTE Corporation vs. Addl. DIT (2016) 159 ITD 696 (Del)* has also attributed 35% of the profits attributable to marketing activities in India. The Delhi Bench of the Tribunal in *GE Energy Parts Inc. vs. Addtl. DIT (IT) (2017) 49 CCH 0021 DelTrib,* after considering the nature of activities carried out in India, estimated 26% of total profit in India as attributable to the operations carried out by the PE in India.

27. It goes without saying that there can be no hard and fast rule of determining the rate of profit attributable to marketing activities carried out in India. It is a fact based exercise, depending upon the role played by the PE in the overall generation of income. Such activities carried out by a PE in India resulting in generation of income, may vary from case to case. Attribution of income has to be in line with the extent of activities of PE in India. Considering the whole gamut of the facts and circumstances

prevailing in the instant case, we estimate 30% of the above total profit @ 10% of the sales, as attributable to the operations carried out by the PE in India. Accordingly, the amount of net profit attributable to the marketing activities carried out in India would be 30% of the amount of net profit relatable to sales in India at Rs.4,54,01,172/-, which comes to Rs.1,36,20,352/-.

28. Now, we come to the second step of finding out the amount of profit attributable to the PE which has already been taxed in the hands of DAIPL through the transaction of commission payment. Here it is apt to mention that it is the amount of net profit in the hands of DAIPL from the commission transaction which is to be reduced and not the gross amount. Such net profit is to be computed by reducing all the direct and indirect expenses incurred by DAIPL in earning commission income from the assessee, which include not only those incurred in respect of two activities as per the commission agreement, but also pertaining to all other activities which it actually carried on in making sales in India on behalf of the assessee, including seeking customers, negotiating prices and then finalizing the deals. The amount so deduced, when reduced from the net

profit earned by the assessee on total direct sales to the end-customers at Rs.1,36,20,352/-, would give the further amount chargeable to tax in the hands of the assessee as attributable to the operations carried out in India through its PE.

29. It has been noticed above that the assessee paid commission to DAIPL amounting to Rs.4,54,01,172/- at the rate of 10% on the amount of direct sales to end customers. It is the income component from such receipt of Rs.4.54 crore taxed in the hands of DAIPL, which will be reduced from Rs.1,36,20,352/-. To illustrate, if income of DAIPL from such commission is, say, 9% of the commission receipt, at Rs.40.86 lac, then additional income attributable to the PE in India as chargeable to tax in the hands of the assessee would be Rs.95.34 lac (Rs.136.20 lac minus Rs.40.86 lac). If such commission income of DAIPL is, say, 8% of gross commission receipts, at Rs.36.32 lac, then additional income attributable to the PE in India as chargeable to tax in the hands of the assessee would be Rs.99.88 lac (Rs.136.20 lac minus Rs.36.32 lac) so on and so forth. Since necessary details of income offered by DAIPL from the receipt of commission at Rs.4.54 crore are not readily available on record, it is not possible at our

end to work out the exact amount of further income chargeable to tax in the hands of the assessee as attributable to the PE in India. We, therefore, set aside the impugned order and remit the matter to the file of the AO to determine the amount attributable to the PE in India in the manner indicated above. Needless to say, the assessee will be allowed an opportunity of hearing in deciding the issue.

30. The assessee is seeking credit of TDS and taxes paid after original assessment through ground no. 4. The Assessing Officer is directed to verify the assessee's contention and allow necessary credit available as per law.

31. The last ground of the assessee's appeal is against charging of interest u/s 234B of the Act.

32. We have heard both the sides on the issue and perused the relevant material on record. Liability to pay interest u/s 234B of the Act is triggered, *inter alia,* when an assessee who is liable to pay advance tax has failed to pay it. Relevant provision for computation of advance tax is contained in section 209 of the Act. Clause (d) of sub-section (1) of section 209 provides

that the amount of advance tax payable by an assessee in the financial year shall be the amount of income-tax on the assessed income as reduced by : `the amount of income-tax which would be *deductible* … at source during the said financial year under any provision of this Act'. In other words, if a particular income is liable for deduction of tax at source, but not actually subjected to such deduction by the payer, there will be no liability of the recipient to pay advance tax and consequently interest u/s 234B of the Act. It is seen that the assessee is a non-resident. Its entire income is liable for deduction of tax at source under the provisions of the Act. Notwithstanding the fact that tax was not actually deducted at source in a proper manner, we hold that there will be no liability on the assessee to pay interest u/s 234B of the Act. Our view is fortified by the judgment of the Hon'ble Bombay High Court in *D.I (International Taxation) vs. NGC Network Asia Ltd. (2009) 222 CTR 86 (Bom),* in which it has been held that when a duty is cast on the payer to deduct tax at source, on failure of the payer to do so, no interest can be imposed on the payee assessee under section 234B of the Act. Similar view has been taken in *CIT & Anr. vs. Sedco Forex International Drilling Co. Ltd. & Ors. (2003) 264 ITR 320 (Uttaranchal).*

33. At this stage, it is relevant to note that the Finance Act, 2012, has inserted a proviso to section 209(1) of the Act w.e.f. 1.4.2012, which provides that : `for computing liability for advance tax, income-tax calculated under clause (a) or clause (b) or clause (c) shall not, in each case, be reduced by the aforesaid amount of income-tax which would be deductible or collectible at source during the said financial year under any provision of this Act from any income, if the person responsible for deducting tax has paid or credited such income without deduction of tax or it has been received or debited by the person responsible for collecting tax without collection of such tax'. With insertion of the above proviso, the liability to pay advance tax and the consequential interest u/s 234B will not be eclipsed merely if income is liable for deduction of tax at source. Unless the payer actually deducts tax at source, the liability to pay advance tax and interest u/s 234B will continue in the hands of the payee. Since the assessment year under consideration is 2006-07 and the proviso is applicable from the A.Y. 2012-13, we hold that the assessee is not hit by such proviso and as such is not liable to pay interest u/s 234B of the Act.

34. In the result, the appeal of the assessee is partly allowed.

The order pronounced in the open court on 28.05.2018.

Sd/-	Sd/-
[SUCHITRA KAMBLE] JUDICIAL MEMBER	[R.S. SYAL] VICE PRESIDENT

Dated, 28th May, 2018.

dk

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT (A)
5. DR, ITAT

AR, ITAT, NEW DELHI.