

**IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH 'C': NEW DELHI**

BEFORE Shri N.V. Vasudevan & Shri Deepak R. Shah

**ITA NOS. 1496 TO 1501/DEL OF 2007
Asstt. Years : 1997-98 to 2000-01, 2002-03 & 2003-04**

**M/s Rolls Royce Plc
C/o Luthra & Luthra, CAs,
16/9, Vasant Vihar, New Delhi Vs**

**Dy. Director of Income-tax
Circle 2(1), International Taxation,
New Delhi**

(Appellant)

(Respondent)

Appellant by : S/Shri Vikas Srivastava, Arvind Dubey & Jatin Dedwani

Respondent by : S/Shri Devender Shankar and Smt. Smita Jhingran

ORDER

Per: Deepak R. Shah, AM :

All these appeals by assessee are directed against the common order of learned CIT(A)-XXIX, New Delhi dated 27.2.2007.

2. The appellant Rolls Royce Private Ltd Company (RRPLC) is a company incorporated in United Kingdom ('UK') and is a tax resident of that country. The appellant is a non-resident foreign company for the purpose of its tax assessment in India. The appellant was not filing any return of income in India. It was found by the AO that the appellant was supplying aero-engines and spare parts of Indian Customers, mainly to M/s. Hindustan Aeronautics Limited (HAL), Indian Navy and Indian Air force. On examination of the facts and circumstances of the case, the AO was of the view that the appellant was having a business connection in India u/s 9 of the Act as well as permanent establishment under article 5 of the Double Taxation Avoidance Agreement (in short 'DTAA') between India and UK. The business connection and permanent establishment were found to be in existence in India in the form of a UK incorporated subsidiary company of the appellant in the name of M/s Rolls Royce India Limited (in short 'RRIL') which was having its offices in India. It was found by the AO that the marketing and sale of goods to Indian customers were carried out by the appellant through the said permanent establishment situated in India. As the appellant was found to have carried out its business activities through the permanent establishment situated in India, the AO was further of the view that the profits attributable to the permanent establishment was liable to tax in India in terms of article 7 of the DTAA. The AO, accordingly, invoked rule 10 of the Income-tax Rules, 1962 and attributed 100% of the profits arising

from sale of goods to Indian customers in India in the assessment years 1997-98 to 2000-01 and 75% of the profits in the asstt. years 2002-03 and 2003-04.

3. The appeal before learned CIT(A) were partially allowed for Asstt. Years 1997-98 to 2000-01 and the appeals for Asstt. Years 2002-03 and 2003-04 were dismissed. Learned CIT(A) held that (i) the issue of notice u/s 148 for framing assessment u/s 147 was valid; (ii) there is business connection in India and hence, income of the appellant non resident is chargeable to tax in India; (iii) the appellant has a permanent establishment (PE) in India within the meaning of Article 5(1), 5(2)(c), 5(2)(f) and 5(4) of the Double Taxation Avoidance Agreement between India and UK. Consequently, the income of appellant is taxable in India. It was held that out of the global profits, in respect of sales effected in India, profit can be attributed to such Indian sales which will be 75% of the profit attributable to such sales. Levy of interest u/s 234A and 234B were upheld and hence, these appeals.

4. For all these years notice u/s 148 were issued as, in the opinion of the AO, the appellant has a PE in India and income attributable to the PE is taxable in India. Since the assessee has not filed return of income, to that extent, the income chargeable to tax has escaped assessment. On the basis of such reasons opinion was formed and notice u/s 148 were issued for all the years. It is also to be noted that after the completion of assessment for Asstt. Years 1997-98 to 2000-01, survey operations were conducted u/s 133A on 9.1.2006 at the premises of RRIL to find out the exact nature of business activities carried out by RRIL and the appellant in India. Action u/s 147 was also initiated for Asstt. year 2001-02 and the assessment in which case was completed prior to conducting survey u/s 133 A. Though the income for Asstt. Year 2001-02 was computed on the ground that there is a business connection and there is PE in India when the matter was carried before the Tribunal, the Tribunal by its order in ITA No.282/Del/2005 dated 19.4.2005 upheld the validity of initiation of assessment proceedings u/s 147 but held that there is no PE in India. Learned CIT(A) held that the order of the Tribunal did not consider the documents and evidence gathered by the AO as a result of survey operation. The result of survey operation depicts the real picture of the business activities carried of by the appellant and RRIL in India which leaves no doubt to hold that there is not only business connection but also a PE in India as per Article 5 of Indo-UK DTAA and hence the income is to be brought to tax in India. It was also held that since no separate accounts are maintained for India operations, the global accounts are to be considered and applying Rule 10 of Income-tax Rules, 1962, the income is to be computed. Learned CIT(A) held that through Indian PE, significant and major parts of its core business activity relating to marketing and selling of its goods in India is carried out. Thus, as per Rule 10 of Income-tax Rules read with Article 7(4) of the Indo-UK DTAA, the profit attributable to PE shall be 75% of the total profits arising to the appellant from sales made to Indian customers.

5. Though several grounds are raised, the assessee challenges the order on following grounds, namely,

(1) The issue of notice u/s 148 for framing assessment u/s 147 is bad in law.

(2) There is no business connection in India within the meaning of Section 9(1)(i) of the Act read with Section 5(2) of the Act.

(3) Even if there is business connection within the meaning of Section 9(1)(1) of the Act, there is no permanent establishment under Article 5 of Indo-UK DTAA and hence, since treaty overrides the Act, no income can be brought to tax in India.

(4) Even if the income is taxable in India, the same cannot be as high as 75% of the profits attributable to the sales made in India.

(5) Interest u/s 234A and 234B is not chargeable.

6. At the time of hearing we have heard Shri Vikas Srivastava, learned counsel for the appellant and Shri Devendra Shankar, CIT for the revenue.

7. Learned counsel for assessee Shri Vikas Srivastava argued at length. He submitted that reasons for issuing notice u/s 148 for asstt year 1997-98 to 2000-01 reveal that the same is based on the finding in the assessment proceedings for 2001-02. The notice was issued on 29.3.2004 i.e. much prior to the date of survey carried out u/s 133A i.e. on 9.1.2006. The Tribunal in its order for Asstt. year 2001-02 has held that there is no PE in India. Thus, the very basis for formation of an opinion that income chargeable to tax has escaped assessment is non-existent one. Accordingly, the assessments are to be cancelled. Action u/s 147 cannot be justified on the basis of subsequent finding based on survey carried out u/s 133A. The validity of the reasons are to be examined on the basis of circumstances prevailing on the date of issue of notice and the reasons recorded therein. Reliance was placed on following decisions:

(a) Anil Kumar Satish Kumar Nahta vs IAC of Income-tax, 242 1TR 238;

(b) Calcutta Discount Co. Ltd. vs. ITO, 41 1TR 191

He further submitted that the opinion on the basis of which AO forms the belief that income has escaped assessment should be relevant and have a direct nexus or live link between the material coming to the notice of AO and formation of his belief. In absence of same, action u/s 147 are bad in law. For this proposition reliance was placed on following decisions:

- (a) ITO vs. Lakhmani Mewal Das, 103 ITR 437
- (b) John Lal (HUF) vs CIT, 88 ITR 439
- (c) Sheo Nath Singh vs AAC, 82 ITR 147 (SC)
- (d) S. Narayanappa vs CIT, 63 ITR 219 (SC)
- (e) Ganga Saran and Sons (P) Ltd. vs ITO, 130 ITR 1
- (f) Phool Chand Bajrang Lal Vs. ITO, 203 ITR 456.

7.1. Shri Srivastava further argued that for asstt. year 2002-03, the AO noted in the reasons recorded that in asstt. order for asstt. year 2001-02, it was found that the assessee has PE in India in the form of RRIL and the supplies are made to customers in India is attributable to it. The assessee has not filed return u/s 139 of the Act. As per Explanation 2 to Section 147, where no return of income has been furnished although his total income assessable is exceeding the maximum amount not chargeable to tax. On the basis of such reasons, the AO formed an opinion and issued notice u/s 148. Shri Vikas Srivastava submitted that effectively reasons recorded for all these years are similar to reasons recorded for four years. Since there was no material while issuing notice u/s 148 to form an opinion that income has escaped assessment particularly when the Tribunal by its order dated 19.4.2005 has held that there is no PE in India. Thus, the ground for re-Opening is non-existent and hence, assessment framed pursuant to incorrect assumption of jurisdiction should be annulled.

8. Learned counsel for assessee further submitted that for the first four years i.e. Asstt. Years 1997-98, 1998-99, 1999-2000 and 2000-01 the additions were made on the basis of the minutes of the meetings held with HAL. These minutes are the same minutes which were used by the AO in the AY 2001-02. In his remand report, he has also alleged that RRIL also constitutes other types of PE of the appellant in India. The Id. CIT(A) has considered the documents collected during the survey while passing his order. For the last two years i.e. AY 2002-03 and 2003-04 the additions were made on the basis of documents collected by the AO during the survey at the premises of HAL. The additions were made on the ground that RRIL constitutes the business connection/different nature of PE of the appellant in India. He accordingly submitted that since the addition for Asstt. Years 1997-98, 1998-99, 1999-2000 and 2000-01 are on the basis of minutes of the meeting held with HAL which were not held to be enough by ITAT in its order for Asstt. Year 2001-02 to hold any business connection/PE in India, the additions for these four years should be deleted in its entirety.

9. It is alleged that the appellant has a business connection in the form of persons of RRIL in India, conclusion for which arrived at on the basis of

erroneous interpretation of the minutes. The minutes establishes that no commitments were given, no decisions were taken, no negotiations were done at the meeting in which only the employees of RRIL were present, Such commitments/decisions/negotiations were undertaken only at such meeting in which the employees of appellant were present and were actually undertaken by them only. The employees of RRIL merely accompanied the employees of appellant at such meeting. Even the documents found during survey do not pertain to asstt. years 2002-03 and 2003-04. Thus, neither the minutes of the meeting nor the material found during survey establishes any business connection in India.

10. Shri Srivastava further submitted that even if it is held that there is business connection in India within the meaning of Section 9(1)(i) of the Act, as per DTAA between India and UK, if there is no PE of the appellant in India, no income can be attributed to the non resident which can be taxed in India. In the assessment order for first four years, the AO on the basis of minutes of the meeting held that RRIL is a dependent agent of appellant and to that extent, such dependent agent is to be considered as PE in India. It is to be noted that under Article 5(4) of Indo-UK Treaty, an agent of dependent status can be considered as PE only if (a) he habitually exercises any such authority to negotiate and enter into contracts for and on behalf of the enterprises; or (b) he habitually secure orders wholly or almost wholly for such enterprise. From the minutes of the meeting and other documents, it is clear that the employees of RRIL has no authority to negotiate and enter into contracts leave apart exercising such authority habitually. The activity of RRIL are merely of a preparatory or auxiliary character. He also submitted that there is no fixed place PE in India. Article 5(1) of the Treaty defines 'permanent establishment' as a fixed place of business through which the business of the enterprise is wholly or partly carried on. However, to apply this Article, the premises should belong to or must be at the disposal of the enterprise whose business is being carried on. In the present case, the premises belonged to RRIL and not the appellant and the premises are not utilized by the appellant. Thus, the premises of RRIL cannot constitute fixed place PE of the appellant. He also submitted that even under Article 5(2)(f), any premises used as sales outlet or for receiving or soliciting orders would be a PE of the non resident. However, the premises should belong to or must be at the disposal of enterprises whose business is being carried on and must be used by the enterprise itself as its sales outlet or for receiving or soliciting orders. Article 5(2)(f) cannot be interpreted to cover the cases where some entity is receiving or soliciting the order for the entity whose PE is said to be established. To constitute a PE, the premises must belong to the enterprise whose PE is sought to be established and no other entity. Even to constitute a PE, the premises must be used for receiving or soliciting the orders as distinguished from receiving documents for transmission to some other entity. This distinction should be understood and accepted as otherwise even the courier companies receiving order documents for transmission to overseas entities may be construed as PE of overseas companies. The role of RRIL is just

like a communication channel or a post office between the appellant and its customers in India. The RRIL does not receive or solicit orders on behalf of the appellant. Thus, under none of the Articles 5 or Sub Articles thereof of Indo-UK DTAA, there is any PE in India and hence, no income can be taxed in India.

11. Shri Srivastava submitted that without prejudice to the contention that there is no business connection/PE in India even if it is held otherwise, the agent in the form of RRIL is remunerated at an arm's length principle. RRIL has offered the same income in India and is taxed as such. Since the income earned by RRIL at an arm's length principle and the same having been taxed in India, no further income can be attributed to the alleged PE in India. This is made clear by CBDT in its Circular No.23 of 1969 dated 23.7.1969. In the said circular in Para 6 (c), it is opined as under

"(c) Where a non-resident's sales to Indian customers are secured through the services of an agent in India, the assessment in India of the income arising out of the transaction will be limited to the amount of profit which is attributable to the agent's services, provided that (i) the nonresident principal's business activities in India are wholly channelled through his agent, (ii) the contracts to sell are made outside India, and (iii) the sales are made on a principle-to-principal basis. In the assessment of the amount of profits, allowance will be made for the expenses incurred, including the agent's commission, in making the sales. If the agent's commission fully represents the value of the profit attributable to his service; it should prima facie extinguish the assessment."

Even the Transfer Pricing Officer has held that for the activities of RRIL cost plus 14.51% is the arm's length price. Thus, attribution of any further income is not justified.

12. Without prejudice to all the above submissions, it was submitted that even if any income is to be attributed to the operations in India, the same cannot be as high as 75% of the profit on the sales made in India. Reference was made to the decision in the case of Carborandum Co. vs CIT, 108 ITR 335. He also submitted that the core activity of the assessee is not in marketing the products in India. The core activity is manufacturing which is in UK. The contract of the nature executed in India does not require more than 10% of its total activities in India and hence, not more than 10% of the profit should be attributed to the Indian operations. Reliance was placed on the decision of Hon'ble Madras High Court in the case of Annamaiai Timber Trust and Co. vs CIT, 41 ITR 781. In the said case, it has been held that if an agent of a non resident negotiates and concludes contract in India on behalf of non resident, not more than 10% of the income can be attributed and taxed in India. He submitted that the AO has wrongly adopted the percentage of profit of the global accounts at 10.8%. In fact, the same is much lower. Thus, firstly the correct global profit should be arrived at and thereafter part of such profit only can be taxed to the extent of activities carried out in India. -

13. Learned DR Shri Shankar, CIT laid much reliance on the finding given by CIT(A). He submitted that the issuance of notice u/s 148 and consequent assessment framed u/s 147 is valid. The assessee never filed its return of income in India though it had substantial operations in India in the form of supplies to the Defence organization and to HAL for asstt. year 2001-02, though the Tribunal has held that there is no PE in India, the validity of notice issued u/s 148 was upheld. At the time when the notice was issued, the order of Tribunal was not rendered. Since the AO was of the opinion that income is chargeable to tax in India and in respect of which no return has been filed, it amounts to income escaping assessment which authorizes the AO to issue notice u/s 148. All the judgments relied by the counsel are in respect of those cases where the original returns were filed and even assessments were also framed originally. In the present case, the assessee never filed return of income which entitles the AO to form an opinion as to whether income chargeable to tax has been correctly offered or not. The Tribunal in assessee's own case on the basis of same set of facts having found that issue of notice u/s 148 is valid, no further case needs to be discussed.

14. Shri Shankar further submitted that though there is agreement between appellant and RRIL, according to which RRIL is to render certain services, the evidence found as a result of survey reveal that the activities undertaken by RRIL on behalf of assessee were much more than what were agreed to in the agreement. The activities of RRIL also includes marketing services, liaison services, market analysis, technical support, customer relationship/interface, strategic planning etc. on behalf of assessee. These facts would not have been noticed but for the survey conducted and the statement of MD of RRIL Mr. Tim Jones being recorded. Various documents found during survey were examined by the AO as well as learned CIT(A) in detail and the inescapable conclusion that could be drawn was that (i) the appellant has a fixed place of business in India in the form of premises of RRIL. Hence, under Article 5(1) of Indo UK DTAA, it has PE in India; (ii) Under Article 5(2)(f), premises used as a sales outlet or for receiving or soliciting orders will also be includible in the term 'permanent establishment'. Though at first instance, the premises are used by RRIL, RRIL recovers the entire cost for use of such premises from appellant. Such premises are also used for receiving and soliciting orders. Thus, even under Article 5(2)(f), the assessee has a PE in India; (iii) Under Article 5(4) of Indo UK DTAA, an agent if he is of a dependent status and if habitually, secure order for the enterprise such enterprise is said to have a PE in such state. The fact is admitted by the assessee that RRIL is a dependent agent of the appellant in India. This activities of RRIL in India are not merely of preparatory of auxiliary character and hence, the maintenance of fixed place PE is not to be excluded. The Statement of Mr. Tim Jones, MD, RRIL was recorded during the course of survey. On the basis of the statement, the issue emerges are.

(a) Personnel from Rolls Royce Plc frequently come to India and it is a continuous process.

- (b) The ultimate employer of Mr. Tim Jones is Rolls Royce Plc i.e. the assessee.
- (c) Rolls Royce (India) Ltd. does not undertake any activity in UK or any other country.
- (d) Mr. Tim Jones as MD has appointment letter in India.
- (e) These are employees in India Mr. Hardy and Palmes who are functionally accountable to a aerospace division of RR Plc.
- (f) These are some employees who come directly from Rolls Royce Plc like Mr. Mc Gummy.
- (g) RR International works as a Personnel Department for RR Plc overseas operations.

The above indicate that the India office is acting like a projection of RR Plc. in India. This has been confirmed by CIT(A) in para 17 of the order. The Indian office has been held to be 'customer facing business unit' of Rolls Royce Plc.). Shri Shankar also submitted that there are at least two person i.e. Mr. Prateek Dabral and Mr. Ajit Tosar apart from Mr. Tim Jones in India, who are employees of RRIL but who have authority to conclude contracts and sign documents on behalf of the appellant RRPlc. He went on to submit that even in cases where contracts are negotiated in India but are concluded in UK, a PE comes into existence. Shri Shankar submitted that though the documents were found which may not relate to all the years under appeal, the documents reveal what in substance is the activity carried on by the appellant in India. In the guise of liaison office in India, almost entire marketing activities are carried on in India. Thus, there is something more than that meets the eye. A document was found called 'Rolls Royce and Indian Air Force relationship' (RR-IAF relationship), another document was found titled 'RR-IAF relationship - key players'. This reveals various actions to be undertaken by appellant RRPLC through RRIL and who are the personnel designated for such action. It reveals that for identifying key players for relationship, mapping the key influence and decision makers and various other actions Mr. Tim Jones, MD of RRIL and Mr. Prateek Dabral of RRIL are assigned such job. Various other actions revealed that the relationship to be maintained with IAF and particularly with various key decision makers of IAF are to be handled by the employees of RRIL only. Even some of the personnel in Ministry of Defence like Defence Secretary, Joint Secretary and others are to be handled by Mr. Tim Jones, the MD of RRIL. These documents relate to all the years under appeal which gives an impression that but for the involvement of RRIL at each and every level i.e. from identifying the key players for relationship till negotiating and convincing IAF to convert letter of intent into orders, the employees of RRIL are involved at all stages. This fact came to light only after survey was conducted. Thus, it will be incorrect to hold that in respect of first four years there were no other documents to hold

the assessee as having any business connection or having PE in India. On the contrary, the Tribunal was misguided on earlier occasion by the assessee in saying that apart from the four minutes of the meeting there were no other documents to lead to conclusion for having any PE in India. These are continuous activities from year to year ever since an agreement was entered into by appellant with its 100% subsidiary RRIL in 1979. Thus, reliance cannot be placed on the decision of Tribunal to hold that there is no PE in India. Rather the said order can be treated as obtained by misrepresentation.

15. Since now it is established fact that under Article 5(1), 5(2)(f), 5(4)(a) and 5(4)(c) there is PE in India, as per Article 7(3) of the Indo-UK. DTAA, the income has to be taxed in India. Since no separate accounts of the assessee's India operation are being maintained, the AO has found that on the basis of global accounts, the profit rate is 10.8% on sales. Marketing is the primary activity for earning profit and but for such marketing being vigorously undertaken, the profit would not accrue. The profit accruing directly or indirectly due to operation in India are taxable even under Article 7 of DTAA. The word 'attributable' has wider meaning. In the contracts like Defence contracts or for supply of aero engine supplies in which the assessee is engaged, negotiation skill is of utmost importance. But for obtaining a contract which is the major activity, no profit would accrue. Hence, learned CIT(A) was justified in adopting 75% of the global profit as attributable to sales in India should be taxed in India. Reliance was placed on the decision of Tribunal in the case of Clifford Chance, United Kingdom vs DCIT, 82 ITD 106. The Special bench of the Tribunal in the case of Nokia, 95 ITD 269 has apportioned 20% of the global profits as accruing in India where the activities merely related to networking and other alter sales services etc. Shri Shankar also submitted that even if under the arm's length principle, the Transfer Pricing Officer has adopted 14.5% of the cost to RRIL as the income of RRIL, the issue before us is computing the income of appellant and not RRIL. Since there are many activities carried out by RRIL which is not part of its agreement and hence, it cannot be said that the entire profit accruing to the appellant is in the form of remuneration paid to RRIL. Under Section 92C(4) read with proviso thereto, there can still be double taxation of the income if the transaction is not at arm's length. Thus, even if income of RRIL is enhanced, to that extent, income of appellant RRPLC cannot be reduced. He accordingly pleaded that the order of learned CIT(A) maybe upheld.

16. We have heard the parties at length. In our opinion, following questions arise for consideration:

(1) Whether the AO was justified in issuing notice u/s 148 so as to frame an assessment u/s 147?

(2) Whether the assessee has any income chargeable to tax in India u/s 5(2) of the Act and whether the assessee has any business connection in India as per Section 9(1)(i) of the Act?

(3) If the answer to Question No.2 is in affirmative, whether, in terms of DTAA between India and UK, the appellant has any PE in India?

(4) If answer to Question Nos. 2 & 3 are in affirmative what is the extent of income earned in India and whether the same can be held as paid by the appellant to RRIL and no further income is attributable to the PE in India?

(5) If the answer to Question No.4 above is in negative, to what extent the income arises in India which can be charged to tax in India.

(6) Whether interest u/s 234A and 234B is chargeable?

17. As regards issue of notice u/s 148, it is seen from the reasons recorded in this behalf that the AO have a prima facie opinion which suggests that the appellant having established a subsidiary in India and through the activities of the subsidiary, it has business connection in India. Thus, the AO had prima facie material in his possession for forming an opinion that income chargeable to tax has escaped assessment. Prior to issue of notice, no return was filed. At the time of issue of notice, the information in possession of AO were the minutes of meeting between HAL and the assessee. At the time of issue of notice u/s 148, the AO is not expected to reach a final conclusion regarding the exact quantum of income that has escaped assessment or even a final conclusion regarding chargeability of such income to tax under the Act. A prima facie formation of an opinion would suffice. The fact that contracts were executed in India could reasonably lead to conclusion that income has accrued in India and was, therefore, chargeable to tax. All the case laws relied by learned counsel for assessee will not apply to the present set of facts. In those cases either some returns were filed or in some cases original assessments were completed. However, in the present case, in respect of activities being carried on in India, the return were not filed which lead the AO to believe that income has escaped assessment due to failure on the part of the assessee to file return of income. It is also to be noted that even though the Tribunal in its order for Asstt. Year 2001-02 has held that there is no PE in India, it has upheld the validity of proceedings being initiated u/s 147/148. Failure to file return within the time prescribed u/s 139 would also attract the provisions of Section 147. Hon'ble Supreme Court in the case of Raymond Woollen Mills Ltd., 236 ITR 34 held that for commencement of re-assessment proceedings, it has only to be seen that whether there was prima facie some material on the basis of which department could reopen the case. The sufficiency or correctness of the material is not a thing to be considered at this stage. We therefore, uphold the validity of issue of notice u/s 148 and consequent framing of assessment u/s 147 of the Act.

18. The next question before us is whether there is any business connection in India within the meaning of Section 9(1)(i) of the Act. The scope of total income is described in Section 5 of the Income-tax Act. As per Section 5(2), the total income of a person, who is a non resident to the extent which is received or deemed to be received in India, or accrue or arise or deemed to accrue or arise in India is taxable in India. As per Section 9(1)(i) of the Act, all income accruing or arising whether directly or indirectly through or from any business connection in India shall be deemed to accrue or arise in India. As per clause (a) of Explanation 1, in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be such part of the income as is reasonably attributable to the operations carried out in India. Thus, as per the conjoint reading of Section 5(2) and Section 9(1)(i) of the Act, only if the income is arising directly or indirectly through or from any business connection in India, can be taxed in India. The expression 'business connection' was earlier not defined in the Act. The Finance Act, 2003 w.e.f. 1st April, 2004 i.e. as applicable to Asstt. Year 2004-05 and onwards has inserted two new Explanations to clause (i) of Section 9(1) clarifying that expression 'business connection' will include a person acting on behalf of non resident and who engaged on certain activities. However, for the purpose of our present discussion, the amended provision has no relevance as the same are w.e.f. Asstt. Year 2004-05 onwards. Since these appeals are for the years prior thereto, we shall discuss only the un-amended provisions. The expression 'business connection' has a wide though uncertain meaning. It admits of no precise definition and the solution to the question must depend upon the particular facts of each case. Even the amended definition will not determine as to what constitute business connection as the same is not an exhaustive definition but is a definition which also include some of the activities be termed as business connection. We shall, therefore, revert to some of the judicial pronouncements in this regard. Hon'ble Supreme Court in the case of CIT vs. R.D. Agarwal & Co., 56 ITR 20 held thus:

"The expression business connection undoubtedly means something more than business. A business connection in Section 42 involves a relation between a business carried on by a non-resident which yields profits or gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. It predicated an element of continuity between the business of the non-resident and the activity in the taxable territories, a stray or isolated transaction is normally not to be regarded as a business connection. Business connection may take several forms. It may include carrying on a part of the main business or activity incidental to the main business of the non-resident through an agent or it may merely be a relation between the business of the non-resident and the activity in the taxable territories, which facilitates or assists the carrying on of that business. In each case, the question whether there is a business connection from or through which income, profits or gains arise or accrue to a non-resident must be determined upon the facts and circumstances of the case."

"A relation to be a business connection must be real and intimate, and through or from which income must accrue or arise whether directly or indirectly to the non-resident. But it must in all cases be remembered that by Section 42, income, profit or gain which accrues or arises to a nonresident outside the taxable territories is sought to be brought within the net of the income-tax law, and not income, profit or gain which accrues or arises or is deemed to accrue or arise within the taxable territories. Income received or deemed to be received, or accruing or arising or deemed to be accruing or arising within the taxable territories in the previous year is taxable by section 4(1)(a) and (c) of the Act, whether the person earning is a resident or non-resident. If the agent of a nonresident receives that income or is entitled to receive that income, it may be taxed in the hands of the agent by the machinery provision enacted in section 40(2). Income not taxable under section 4 of the Act of a non-resident becomes taxable u/s 42(1) if there subsists a connection between the activity in the taxable territories."

Hon'ble Bombay High Court in the case of Blue Star Engineering Co. vs CIT, 73 ITR 283 at page 291, after referring to the decision of R.D. Aggarwal and Co. (supra) held as under:

"It would thus be seen that in order to constitute a "business connection" as contemplated by Section 42, there must be an activity of the non-resident and contributing to the earning of profits by the non-resident in his business. The business connection must undoubtedly be a commercial connection but all commercial connections will not necessarily constitute business connection within the meaning of the concept unless the commercial connection is really and intimately connected with the business activity of the non-resident in the taxable territories and is contributory to the earning of profits in the said trading activity."

In light of the above provisions in the Income-tax Act and the judicial pronouncements, we shall examine the facts of the present case.

19. The appellant entered into an agreement with RRIL whereby RRIL was to render certain services to the appellant. The scope of services, inter alia, as included in Annexure to the agreement contained the following:

"The support services requested by Rolls-Royce International and performed by Rolls-Royce India can include but are not limited to:-

Organization of Events and Conferences:

Management of airshow logistics and attendance

Arranging visits to and from India (for example for Senior Rolls-Royce personnel visiting Indian Ministers)

Organization and management of training courses in India

Media Relations:

Sponsorship of local community events Liaising with the Indian media
Managing public relation activity Business Intelligence:

Monitoring personnel movements in important India business sectors and companies
Monitoring and informing relevant Indian parties of key personnel movements within Rolls-Royce

Compiling and publishing a daily summary of local press comment on Rolls-Royce, its competitors and relevant market sector activity

Liaising with and reporting to the Rolls-Royce International Affairs conference

Business Development:

Understanding and advising on the Indian business, political and economic climate.

Identifying and advising on potential market opportunities for Rolls-Royce

Identifying and advising on potential cost saving opportunities in India

Creating and sustaining a programme of High level relationship with Indian Government and business leaders.

Arranging discussions between Rolls-Royce and its current and potential customers and suppliers as requested by Rolls-Royce business units and Indian entities.

Administrative support:

Assisting with Visa applications

Assisting with arrangements for travel and accommodation

Facilitation of discussions with professional advisers

Assisting with in-country support of expatriate employees and their families based in India

Technical support:

Coordinating the provision of technically competent personnel to advise Rolls-Royce, its customers and its suppliers on technical issues relating to Rolls-Royce products."

Apart from the above, during the course of survey some papers were found. These papers were not available when the Tribunal decided the appeal of assessee for Asstt. year 2001-02. Annexure 4 which was found during survey outlined the detailed RRPL-IAF relationship as under:

"RR-IAF Relationship:

S.No.	Action	By
1.	Identify key players for relationship	TPFJ/CS/PD
2.	Map key influencer and decision maker	PD/TPFJ
3.	To break impasse, meet JS (Air) with an open mind	TPFJ
4.	Priorities the objectives	TPFJ/PD
5.	Working level meetings held with pilots, maintenance and logistics officers	PD
6.	Understand IAF's concern and translate them in a language which could be understood by DA	PD
7.	Understand IAF's concern and translate them in a language which could be understood by DA	PD
8.	Product support visits made to operational and maintenance basis	PD
9.	Organize visits from customers Business & Project	PHD/CS/PD
10.	Carry out review meetings with CAS, AOM, ACAS (Eng) and other seniors	TPFJ/PD
11.	Establish fortnightly meetings with IAP	PD
12.	Carry out half yearly review	TPFJ/PD
13.	Discuss LTA/LOT proposal	CS/PDH/PD
14.	Convince IAF to convert LTA/LOT to orders	CS/PDH/PD
15.	Review overdue debts situation with IAF	TPFJ/PD

RR-IAF Relationship - key Players

S.No.	Action	Designation	By
1.	Air Chief Marshal Krishnaswamy	CAS	TPFJ
2.	Air Marshal V A Pathak	COM	TPFJ/PD/CS/PDH
3.	Air Marashal Bhojwani	SASOWAC	TPFJ
4.	AVM Ambrish Kumar	ACAS(Eng B)	TPFJ/PD/CS/PDH
5.	AVM M.P. Sanyal	ACAS (Logistics)	TPFJ/PD/CS/PDH
6.	Air Commodore SHE Hussaini	Director (Pur)	CS/PDH/PD
7.	Air Commodore S. Gopakakrishna	Director (J&M)	CS/PD
8.	Sing Commandr S. Puntambekar	Director Eng B(T)	CS/PDH/PD
9.	Suadron Leader D. Shrivastava	A D Purchase	PD/Usha
10.	Squadron Leader O.P. Singh	A D Purchase	PD
11.	Squadron Leadr S. Balakumar	A D Eng J(T)	PD
12.	Squadron Leadr P.K. Awasthi	DD Eng B(T)	PD/Usha
13.	Group Captain V V K Bhalla	AOC Ambala	PD
14.	Air Commodore D C Kumaria	A O C Gorakhpur	PD
15.	Group Captain A B Maini	O C 4 B R D	PD/Bir Singh

MOD (MINISTRY OF DIFENCE) :

1.	Mr. Ajay Prasad	Defence Secretary	TPFJ
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2.	Mr. Arvind Joshi	JS(Air)	TPFJ
3.	Ms. Somi Tandon	Spl Sec Defence Procurement	TPFJ
4.	Mr. C.R Mahapatra	JS & AM (Air Systems)	TPFJ

OTHERS :

1.	Mr. Ramphal	CDA(AF)	PD
2.	Mr. Nitin Khandria	CDA(AF)	PD
3.	Mr Sadrao	Bank	PD/Usha
4.	Mr. Chopra	Bank	PD/Usha

It is to be noted that TPFJ i.e. Mr. Tim Jones is Managing Director of RRIL and PD is Mr. Prateek Dabral, General manager, Defence Division. A letter was issued by appellant through Mr. L.R. Morgan incharge of International business addressed to Prateek Dabral. In the said letter, it was emphasized that Indian Air Force should not send any request for quotation/extension to the appellant in UK directly. It was stated that all the request for quotation/extension and other correspondence should be issued through the office of RRIL only. Once RRIL scrutinize and analyze details of the correspondence received, only then the same is to be forwarded to the appellant. This is true for all sorts of correspondence received from the customers in India. This shows the extension of operation of appellant in India. The contention of appellant is that this material was found during survey carried out in 2006. The assessment for Asstt. year 1997-98, 1998- 99, 1999-2000 and 2000-01 were completed prior to survey being conducted. Thus, this material cannot be used in an assessment framed prior to conducting of survey. We are unable to agree to such a contention. The material existed for all the time to come and it is unfortunate that the assessee never disclosed its true relationship vis-a-vis RRIL. Only after the survey was conducted, the true face has come out. Once this material was found, the appellate proceedings were pending and were being considered by learned CIT(A) after calling for a remand report from the AO. The objection of assessee against the remand report were also considered. However, since the material relates to the entire business activity even for all the years under appeal there is no case that the same should be ignored only because the same were not found after the conclusion of assessment proceedings but before the conclusion of appellate proceedings. Prima facie these papers itself show the extent of work being handled by RRIL for appellant in India. RRIL is not only 100% subsidiary of the appellant but also maintains a permanent office in India to undertake all such activities. Thus, it can be concluded that the appellant has a business connection in India within the meaning of Section 9(1)(i) of the Act and under the Income-tax act, its income is chargeable to tax in India arising out of such business connections.

20. The next question for our consideration is even if there is business connection in India whether there is any PE in India within the meaning of Article 5(1), 5(2)(f) and 5(4) of the Indo UK DTAA. Whereas the appellant's case is that there is no PE in India and even if it is so, it is solely for the purpose of preparatory or auxiliary character and hence, under Article 5(3), it shall not be deemed to be considered as PE in India. For the sake of brevity, Article 5 of the Indo UK DTAA is extracted herein:

1 "Article 5:

PERMANENT ESTABLISHMENT:

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

2. The term "permanent establishment" shall include especially:

- (a) a place of management;
- (b) a branch;
- (c) an office
- (d) a factory;
- (e) a workshop;
- (f) premises used as a sales outlet or for receiving or soliciting orders;
- (g) a warehouse in relation to a person providing storage facilities for others;
- (h) a mine, an oil or gas well, quarry or other place of extraction of natural resources;
- (i) an installation or structure used for the exploration or exploitation of natural resources;
- (j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or

supervisory activity, being incidental to the sale of machinery or equipment; continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a contracting State by an enterprise through employees or other personnel, but only if:

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

(ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating to more than 3- days within any twelve-month period:

Provided that for the purposes of this paragraph an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with, or supplies plant and machinery on hire used or to be used in the prospecting for, or extraction or production of. mineral oils ion that State.

3. The term "permanent establishment" shall not be deemed to include:

(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 for collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade or business of the enterprise. However, this provision shall not be applicable where the enterprise maintains any other fixed place of business in the other Contracting State for any purpose or purposes other than the purposes specified in this paragraph;

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

4. A person acting in a Contracting State for or on behalf, of an enterprise of the other Contracting State other than an agent of an independent status to whom paragraph 5 of this article applies shall be deemed to be a permanent establishment of that enterprise in the first mentioned State if:

(a) he has, and habitually exercises in that State, an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or

(b) he habitually maintains in the first mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned 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.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. However, if the activities of such an agent are carried out wholly or almost wholly for the enterprise (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to same common control) he shall not be considered to be an agent of an independent status for the purposes of this paragraph.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

7. For the purposes of this article the term "control", in relation to a company means the ability to exercise control over the company's affairs by means of the direct or indirect holding of the greater part of the issued share capital or voting power in the company."

It is firstly to be noted that RRIL has a office in India at DLF Centre. New Delhi. RRIL is wholly owned subsidiary of appellant. The appellant is to reimburse RRIL all the cost incurred by RRIL in the provision of the support services including but not limited to the salaries and expenses of employees, the cost of operating office premises and any payment to sub contractors used. RRIL is to receive service fees at 5.1-6% of the reimbursed expenses. The employees of the appellant visits India frequently and the premises of RRIL are being occupied and used during such visits. This fact is confirmed by the counsel for appellant. In a way, the appellant maintains the premises but on the face of premises, it is being stated as occupied by RRIL However, the entire expenses for operation and maintenance of such office in India is being paid by appellant Paragraph. Paragraph I gives a general definition the term permanent establishment' which brings on its essential characterstics of a permanent establishment in the sense of the Convention i.e. a distinct 'situs', a 'fixed place of business'. The paragraph defines the term 'permanent establishment' as a fixed place of business, through which the business of an enterprise is wholly or partly carried on. This definition, therefore, contains the following conditions:

(i) the existence of a 'place of business', i.e. a facility such as premises or, in certain instances, machinery or equipment;

(ii) this place of business must be 'fixed' i.e. it must be established at a distinct place with a certain degree of permanence;

(iii) the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.

The term 'place of business' covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. A place of business may thus be constituted by a pitch in a market place. Again, the place of business may be situated in the business Facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereon owned by the other enterprise.

21. As noted above, the mere fact that an enterprise has a certain amount of space at its disposal which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is therefore, required. Thus, for instance, a permanent establishment could exist where an enterprise illegally occupied a certain location where it carried on its business. Article 5(1) does not refer that the premises should belong to the assessee but if it is able to use the same, it is an identified and distinct location and on which he exercise the control, it will be considered as a PE within the meaning of Article 5(1) of the treaty. In the present case, we have found that the premises though in the name of RRIL are being occupied for the business operation in India. The cost of maintenance of such premises are being paid for by the appellant. The premises are also available to all the employees of appellant in respect of any business operations in India. Accordingly, it can be said that the appellant has a PE in India within the meaning of Article 5(1) of the treaty.

22. It is to be examined as to whether under Article 5(3), the exclusion will apply to such PE or not. It is the case of appellant that the premises are used by RRIL for the supply of information which are activities solely of a preparatory or auxiliary character. For this purpose, once again reliance is placed on the finding of the Tribunal in appeal for Asstt Year 2001-02. We are unable to agree. When the matter was considered by the Tribunal various documents found during survey were not available before the Tribunal to give the finding. In the light of various documents found, it is for us to examine and come to a conclusion whether the activities of RRIL in India is merely of a preparatory or auxiliary character. It is often difficult to distinguish between activities which

have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity. A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level.

Relevant documents that were found during course of survey are following, over and above. Some of the above documents are extracted hereinabove.

(i) The mail sent by Mr. Ajit Thosar of RRIL to the appellant wherein Mr. Thosar states that the Navy has placed the order and our acceptance needs to be communicated with certain observations as Mr. Ajit Thosar considered relevant. He also draws the attention of the appellant as to the insertion of arbitration clause. He also insist for advance being paid. He also reports as to what should be delivery schedule etc.

(ii) A letter issued by Ms Usha of RRIL reports about receiving the order and also request for early delivery. She also draws attention to some contract clauses which should be taken care of or otherwise the contract is final. The correspondence shows how RRIL plays its part in the sale of products in India. The activities are not merely preparatory or auxiliary in character but the primary responsibility rests on RRIL to analyze and scrutinize the proposal and orders received and if not found in accordance with the broad terms, to seek clarification from the customer.

(iii) Even the letter from appellant through Mr. L.M. Morgan addressed to Shri Prateek Dabral insist that the request for quotation/extension should not be issued directly to the appellant in UK but should be routed through the office of RRIL so that only those correspondence which are confirming to the standards laid down are forwarded. This negates the contention that the activities of RRIL are solely of a preparatory or auxiliary character or like a conduit or postman.

(iv) The employees of RRIL are functionally responsible to the appellant. Such positions are identified by appellant. This is evident from responsibility chart issued to the GM (Defence) which says as under:

"General Manager - Defence Business:

The position of General Manager - Defence Business has been identified by Defence (Aerospace) and Rolls-Royce India Ltd in order to have a senior manager at Rolls-Royce India Ltd., Delhi with the responsibility of managing Defence (Aerospace) liaison activities with the Government of India (Ministry of Defence i.e. Indian Army, Navy Aviation and Air Force). He will report locally to the MD Rolls-Royce India Ltd and functionally will be responsible to the Rolls Royce Defence (Aerospace) Customer Executive for the following):

- To manage and coordinate all communications associated with MOD.
- To develop and maintain personnel contact with appropriate service. Industrial/seniors/organizations and maintain upto date organization charts.
- To advise relevant market and competitor intelligence in an agreed and regular format.
- To advise and support RRDA participation in Air Shows. Exhibitions, Seminars, Conferences, Media/RR events and hospitality opportunities.
- To provide Customer satisfaction Reports to meet RRDA requirements and when necessary, assist in preparing and delivering recovery plans.
- Promptly inform of incidents or events affecting RRDA products, services or personnel and recommend damage limitation action to protect the company's liabilities and reputation.
- To assist MOD to identify their future requirements including spares and maintenance support.
- To solicit RFQ's/ Purchase orders for required parts at lead time.
- To monitor RFQ's issued by MOD including Rolls-Royce acknowledgement date, quotation date and firm order date.
- To provide advice and feed back on commercial proposals issues to MOD and progress the proposals in conjunction with the relevant commercial department.

- To expedite orders and order amendments from MOD,
- To advise RRDA on parts delivery data requirements on current purchase orders/contracts, expedite on behalf of MOD and keep them apprised of the status of deliveries.
- To manage and expedite invoice and payments.
- To manage the activities of other Rolls-Royce support personnel associated with RRDA,s products within the Indian Army, Naval Aviation and Air Force.
- To manage the in-country Service Representative dealing with Indian Air Force, Indian Navy and Indian Army."

The responsibility specifically includes to solicit request for quotation/purchase order. If the job is only to supply information or of preparatory or auxiliary character, such functions will not be performed by RRIL. Even the other activities which are to be undertaken by RRIL are not solely of the preparatory or auxiliary character but in a way like a marketing office to receive orders and even to promote the activities which converts the request for quotation into orders.

(v) The MD of RRIL Mr. Tim Jones had issued a certificate under Foreign Corrupt Practices Act which certifies that in respect of agreement with Air Force, there is no permission to offer, promise or give any pecuniary or other advantage directly or indirectly. But for the authority from appellant such certificate could not have been issued. Surely such activities could not be considered as preparatory or auxiliary in nature. There are various meeting wherein Mr. Tim Jones and Mr Prateek Dabral, who are employees of RRIL are present. Though it may be a case that the employees of appellant may also be present however, their participation in the meeting and making suggestions cannot be held to be only preparatory or auxiliary nature of work. In the meeting at HAL on 25.10.04, the only person present on behalf of the appellant was Mr. Prateek Dabral, GM, Defence Division. The points being discussed were repair scheme for engine division, supply of Master Vanes and various other matters where the actions were to be taken at the end of appellant. A decision was taken at the meeting which could not have been possible but for the authority of the person remaining present at the meeting and to agree to the agenda of the meeting.

(vi) A letter was written by Mr. Prateek Dabral to HAL suggesting turbine casing repair scheme, recommending to accept the offer of the repair scheme, advising to go for specialist for the exhaust duct repair scheme and also suggesting that such an exhaust duct which is available with the appellant can be supplied.

This letter do suggest that the work is something more than merely preparatory or auxiliary nature, and also for advising and seeking orders for the appellant.

(vii) Correspondence was found whereby Mr. Prateek Dabral signed certificate of origin of the goods manufactured by appellant and also sending the warranty statement for an on behalf of the appellant. This document shows that employees of RRIL in India have authority to sign documents on behalf of appellant and give certificate on their behalf. Such documents are binding on the appellant. Numerous of such documents are found.

(viii) The correspondence from RRIL to the appellant are in the form of request to the appellant to confirm acceptance for extension of time for considering the quotation. Another correspondence suggests discrepancy in invoice issued by appellant. The discrepancy could not have been noticed but for the fact that record is maintained by RRIL in respect of various contracts undertaken by the appellant for supply in India and the supply and invoices are matching with the terms of contract. All such activities cannot be merely held as solely of preparatory or auxiliary character but are in the form of marketing the product manufactured by appellant in India. Therefore, the exclusion granted under Article 5(3) is not available to the appellant.

23. It is also seen that the appellant has a dependent agent in India in the form of RRIL. The fact that RRIL is totally dependent upon the appellant is not denied. However, the contention of the appellant is that even though RRIL is a dependent agent and such agency is to be deemed as a PE, so long as such dependent agent has no authority to negotiate and enter into contracts, under Article 5(4), there is no PE in India. It is to be noted that Article 5(4) has three clauses, namely, a, b & c. Thus, even if one has to hold that the dependent agent has no authority to negotiate and enter into contracts for and on behalf of "appellant, still as per clause (e) of sub Article (4), it is found that RRIL habitually secures orders in India for the appellant. It is a set practice that no customers in India are directly to send orders to the appellant in UK. Such orders are required to be routed only through RRIL. This fact is evident from the letter of Mr. L.M. Morgan to Mr. Prateek Dabral and Ms Usha. In the said letter, it is made clear that even request for quotation/extension could not be communicated directly to the appellant but are to be routed through the office of RRIL. This is applicable even to the orders. The fact is not denied that the orders are firstly received by RRIL from the customers in India and only then communicated to the appellant. Thus, as per Para 4(c) of Article 5, the dependent agent habitually secures orders wholly for the enterprise itself and hence, is deemed to be a permanent establishment of the appellant. The contention of appellant that the role of RRIL is merely of a post office is, therefore, unacceptable in view of the facts of the case as evidenced by various documents and correspondence found during the course of survey. It can, therefore, be summarized that in the light of the facts as well as document

mentioned above, RRIL's presence in India is a permanent establishment of appellant because:

(a) It is a fixed place of business at the disposal of the Rolls Royce Plc and its group companies in India through which their business are carried on.

(b) The activity of this fixed place is not a preparatory or auxiliary, but is a core activity of marketing, negotiating, selling of the product. This is a virtual extension/projection of its customer facing business unit, who has the responsibility to sell the products belonging to the group.

(c) RRIL acts almost like a sales office of RR plc and its group companies,

(d) RRIL and its employees work wholly and exclusively for the Rolls Royce Plc and the Group.

(e) RRIL and its employees are soliciting and receiving orders wholly and exclusively on behalf of the Rolls Royce Group.

(f) Employees of Rolls Royce Group are also present in various locations in India and they report to the Director of RRIL in India.

(G) The personnel functioning from the premises of RRIL are in fact employees of Rolls Royce Plc. This has been admitted by the MD Mr. Tim Jones, GM, and can be discerned from statement of Mr. Ajit Thosar and documents like terms of employment of GMs.

Thus, the appellant can be said to have a PE in India within the meaning of Article 5(1), 5(2) and 5(4) of the Indo UK DTAA. Since we have found that the appellant has a business connection in India as well as PE in India, the income arising from its operation in India are chargeable to tax in India.

24. As per Section 9 (1)(i) of the Act, income accruing or arising whether directly or indirectly through or from any business connection in India shall be deemed to accrue or arise in India. As per clause (a) of Explanation 1, in a case of a business of which all the operations are not carried out in India, the income of the business deemed to accrue shall be only such part as is reasonably attributable to the operations carried out in India. Article 7 of the Indo UK DTAA provides a mechanism as to how the business profits of the permanent establishment is to be computed. Paras 1 to 4 of Article 7 of Indo UK treaty are extracted herein:

"Article 7

BUSINESS PROFITS:

1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State, but only so much of them as is directly or indirectly attributable to that permanent establishment.

2. Where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, the profits which that permanent establishment might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment shall be treated for the purposes of paragraph 1 of this Article as being the profits directly attributable to that permanent establishment.

3. Where a permanent establishment takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, notwithstanding that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the permanent establishment shall be treated for the purpose of paragraph 1 of this Article as being the profits directly attributable to that permanent establishment.

4. In so far as it has been customary in a Contracting State according to its law to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraphs 1 and 2 of this Article shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be necessary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles laid down in this Article."

24.1 Under para 1 of Article 7, all the profits accruing directly or indirectly attributable to the PE are taxable in a State in which such PE is situated. The profits are to be computed as if the PE is a distinct and separate enterprise and dealing wholly independently with the enterprise of which it is a PE. Such

profits are treated as directly attributable to the PE and are brought to tax. Under Para 3 of Article 7, where a PE takes an active part in negotiating, concluding or fulfilling contracts, notwithstanding that other part of the enterprise have also participated in those transactions, the proportion of the profit arising out of those contracts shall be treated as profit indirectly attributable to the PE and will be taxable in such contracting State where the PE is situated. Thus, the direct as well as indirect income attributable to the PE is chargeable to tax. Hence, for the purpose of our present discussion, it will be immaterial as to whether in negotiating the contracts, representatives of the appellant were also present. Profit in respect of all such contracts will be taxable in India as indirectly attributable to the PE in India. In such a situation, the total profits of the enterprise has to be apportioned on the basis of various factors affecting accrual of income. The first of that approach requires the identification of activities carried on through the PE. This should be done through a functional and factual analysis. Under the first step, the economically significant activities and responsibilities undertaken through the PE will be identified. This analysis should to the extent relevant consider the activities and responsibilities undertaken through the PE in the context of activities and responsibilities undertaken by the enterprise as a whole. Under the second step, the remuneration of any such dealing will be determined by applying, by analogy the principles developed for the application of the arm's length principle between associated enterprises, by reference to the functions performed, assets used and risk assumed by the enterprise through the PE and through the rest of the enterprise. As per Para 4 of Article 7, when the profits are to be attributed to the PE, it can be according to the law of the State where the PE is established. The assessee has not maintained separate books of accounts for the activities carried out in India. However, it is seen that the manufacturing of the goods dealt or traded in India are not manufactured in India. The manufacturing operation is carried on outside India. Manufacturing is one of the important and integral part of the total activities which contributes to the earning of income. The extent of assets used are irrelevant as in the present case, the activity comprises of manufacturing and marketing. The marketing is in India. Therefore, the profit accruing directly or indirectly in respect of the marketing activities in India shall be taxable in India Under the Income-tax Act read with Rule 10 of income-tax Rules, 1962. in a case in which the AO is of the opinion that actual amount of the income accruing or arising directly or indirectly through or from any business connection in India cannot be definitely ascertained, for the purpose of assessment the same may be calculated at such percentage of the turnover so accruing or arising as may be considered reasonable, or in such other manner as the AO may deem suitable. Hon'ble Supreme Court in the case of CIT vs. Ahmed Bhai Umar Bhai & Co., 18 ITR 472 held that where the manufacture and sale of the goods were not carried out in the same State, the profit of a part of business i.e. relating to manufacture of goods accrued at a place where manufacturing activities are carried out and hence, not assessable in the other State where only trading activities are carried on. We shall, therefore, allocate 50% of the profits towards

manufacturing activity which cannot be taxed in India as no such manufacturing activity is carried out in India. In respect of other activities apart from marketing of goods in India, the assessee has also carried out research and development activity outside India. In a product in which the assessee deals in Research and Development activities are as important as manufacture. R&D activities are on an ongoing basis which results into development of newer products. We, therefore, allocate 15% of the profits to such R&D activities. Balance of the profit can be attributable to the marketing activities which are in India. Though contracts are signed outside India yet the negotiations and other discussions are in India and hence, all other profits can be said to accrue or arise into directly or indirectly through the operations of PE in India. We, therefore, direct the AO to adopt 35% of the profit as against 75% of the global profits in respect of sales effected in India as chargeable to tax in India.

25. Charging of interest u/s 234A and 234B are consequential in nature. The same are compensatory as well as are mandatory in nature. The same may be charged as per law.

26. In the result, all the appeals are partly allowed.

Pronounced in the Open Court on 26 October, 2007.

(N.V. Vasudevan)
Judicial Member

(Deepak R. Shah)
Accountant Member

Copy to:

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