IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "F" NEW DELHI
BEFORE SHRI R.P. TOLANI AND SHRI J.S. REDDY

ITA Nos. 1443/Del/2012 &5243/Del/2011
Asstt. Yrs. 2006-07 & 2008-09

Convergys Customer Management Group Inc. 201, East Fourth Street, Cincinnati, Ohio 45202 USA C/0 Price Water Coopers House 11A, Vishnu Digamber Marg, Sucheta Bhawan, New Delhi-110002.	Vs.	Asstt. Director of Income-tax, Cir. 1(1), International Taxation New Delhi.

PAN: AACCC 8989 M

AND

ITA No. 1376/Del/2012
Asstt. Yr. 2006-07

Asstt. Director of Income-tax, Cir. 1(1), International Taxation New Delhi.	Vs.	Convergys Customer Management Group Inc. 201, East Fourth Street, Cincinnati, Ohio 45202 USA
(Appellant)		(Respondent)

Assessee by	:	S/Shri Pawan Kumar, Sachin Garg & Mudit Sharma CAs
Department by	:	Shri D.K. Gupta CIT (DR)

O R D E R

PER R.P. TOLANI, J.M::

This is a set of three appeals – cross appeals for A.Y. 2006-07 against the order of CIT(A) dated 24-1-2012; and assessee's appeal for A.Y. 2008-09 against the order of assessing officer passed with directions of DRP u/s

143(3) read with Sec. 144C dated 17-10-2011. Assessee and issues being same, all the three appeals are being disposed of by this common order.

2. Respective grounds raised by the assessee and the department are as under:

Assessee's appeal for A.Y. 2006-07 (1443/Del/2012):

> "1. That the Ld. CIT (Appeals) on the facts and in the circumstances of the case and in law, erred in confirming the order of the Ld. AO that the Appellant has a Permanent Establishment ('PE') in India under Article 5 of the DTAA between India and U.S.A.
>
> 1.1 That the Ld. CIT (Appeals), erred on facts and in law, in upholding that the Appellant has a Fixed Place PE in India in terms of Article 5(1) of the DTAA.
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> 1.2 That the Ld. CIT (Appeals), erred on facts and in law, in holding that the Appellant has a place of management in India under Article 5(2)(a) of the DTAA.
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> 1.3 That the Ld. CIT (Appeals), erred on facts and in law, in not appreciating that the Appellant was only procuring services from India and thus, falls within the exclusionary clause under Article 5(3) of the DTAA.
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> 2. That the Ld. CIT (Appeals) erred in facts and in law in ignoring that no profits can be attributed to the alleged PE both in terms of Article 7(4) of the DTAA and Explanation 1 to section 9(1) of the Act as the Appellant was merely procuring services from India.
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> 3. That the Ld. CIT (Appeals) having accepted the application of transfer pricing principles in determining the profits attributable to the alleged PE, and having regard to the functions, assets and risks already captured in the transfer pricing analysis of the Indian associated enterprise, erred in not appreciating that no further profits can be attributed to the alleged PE of the Appellant in India.

4. That the Ld. CIT (Appeals) erred on facts and in law, in upholding attribution of profits to the alleged PE of the Appellant to the extent of Rs. 43,10,86,460.

4.1 That without prejudice to the Appellant's contention that it does not have a PE in India and no further profits are attributable to the alleged PE, the profit attribution made by the Ld. CIT (Appeals) is highly excessive and without any basis.

4.2 That the Ld. CIT (Appeals) erred in not appreciating the Functions, Asset and Risk (FAR) profile of the Appellant, the alleged PE and the Indian Associated Enterprise, in relation to the India operations; thereby incorrectly computing the profit attribution to the alleged PE.

4.3 That for attributing profits to the alleged PE, the Ld. CIT (Appeals) ought to have considered only the revenue attributable to the alleged PE instead of considering the end-customer revenue of the Appellant.

4.4 That the Ld. CIT (Appeals) further, erred in facts and in law by invoking the provisions of section 44C of the Act with regard to cost incurred outside India and restricting the deduction for selling expenses to Rs.58,69,62,170 and executive and general administrative expenses to Rs.2,26,88,761.

4.5 That the Ld. CIT (Appeals) erred in facts and in law in not allowing deduction for other expenses incurred outside India such as research and development costs, depreciation, amortization etc for calculating the profits attributable to the alleged PE.

5. That the Ld. CIT (Appeals) has erred on facts and in law in upholding that the PeopleSoft license cost and maintenance charges amounting to Rs. 68,17,878 are taxable as "Royalty" under the provisions of section 9 (1)(vi) of the Act and Article 12 of the DTAA.

6. That the Ld. CIT (Appeals) erred on facts and in law in upholding levy of interest under sections 234B and 234D of the Act and withdrawal of interest under section 244A of the Act.

Revenue's appeal for A.Y. 2006-07 (1376/Del/2012):

"1. On the facts and in the circumstances of the case, the Ld. CIT (A) has erred in reducing the additions figure made by the AO on account of selling cost pertaining to Indian operations, profits earned by the assessee from Indian operations and attribution of total profit to the PE in India, by adopting the amount of revenue earned globally shown by the assessee, without appreciating the reasons and ignoring the findings of the AO.

2. On the facts and in the circumstances of the case, the Ld. CIT (A) has erred in holding that the assessee did not have a Dependent Agent Permanent Establishment in India through Convergys India Services Pvt. Ltd. (CIS), despite of having observed that the CIS did not have either economic independence or functional independence."

Assessee's appeal for A.Y. 2008-09 (5243/Del/2011):

1. That on the facts and in the circumstances of the case & in law, the order passed by the Ld. Assessing Officer under section 143(3) read with section 144(C) of the Act is bad in law and void ab-initio.

2. That on the facts and in circumstances of the case & in law, the Ld. LD. AO erred in assessing the returned income of appellant of Rs. 37,94,300 at Rs. 50,71,14,396.

3. That on the facts & circumstances of the case & in law, the Ld. DRP erred in confirming the draft order of the Ld. LD. AO and conclusions contained therein.

4. That the Ld. LD. AO erred on facts & in law, in alleging that the appellant has a Permanent Establishment ('PE') in India in terms of the provisions of the Article 5 of the Double

Taxation Avoidance Agreement between India and United States of America ('DTAA') without bringing any material on record.

4.1. That the Ld. LD. AO, erred on facts & in law, in holding that the Appellant has a Fixed Place PE in India in terms of Article 5(1) and 5(2) of the DTAA.

4.2. The Ld. LD. AO, erred on facts & in law, in not appreciating that the appellant was only procuring services from India and was accordingly covered under the exclusionary clause provided under Article 5(3) of the DTAA.

4.3. That the Ld. LD. AO, erred on facts & in law, in holding that the Appellant has Dependent Agent PE in terms of Article 5(4) and 5(5) of the DTAA.

4.4. That the Ld. LD. AO, erred on facts & in law, in holding that the Appellant has Service PE in terms of Article 5(2)(l) of the DTAA.

5. That the Ld. LD. AO erred on facts & in law, in attributing a sum of Rs. 45,51,71,917 as profits of the alleged PE of the appellant in India on conjectures and surmises.

5.1. That the Ld. LD. AO erred in law in making the impugned attribution/addition to the alleged PE without referring the matter to the Transfer Pricing Officer which is in complete contradiction to the Instruction No. 3 dated May 20, 2003 issued by the CBDT which was binding on the Ld. LD. AO.

5.2. That the Ld. LD. AO erred in law in making the impugned attribution/addition to the alleged PE without following the transfer pricing principles which is in complete inconsistency to the Circular No. 5 of 2004 dated September 28, 2004 issued by the CBDT which was binding on the Ld. LD. AO.

5.3. That the Ld. LD. AO having considered the PE Profit Attribution Analysis Memo which was filed without prejudice to the contention of the appellant that it does not have a PE in India and contained a functions, assets and risks (FAR) analysis of the alleged PE, erred in not accepting the Appellant's contention that based upon the same, nothing further was required to be attributed to the alleged PE.

5.4. That the Ld. LD. AO failed to appreciate that attribution of profits to the PE is a transfer pricing issue and grossly erred on facts and in law in disregarding established judicial pronouncements in India on the issue that once an arm's length price has been determined for the Indian associated enterprise [Convergys India Services Private Limited (CIS) in the present case] which subsumes the functions, assets and risk profile of the alleged PE, nothing further can be attributed to the PE.

5.5. Without prejudice to the ground that no PE exists, the profit attribution made by the Ld. LD. AO to the alleged PE is highly excessive and without any basis.

5.5.1. That for attributing profits to the alleged PE, the Ld. LD. AO ought to have considered only the revenue attributable to the alleged PE instead of considering the end-customer revenue of the appellant company.

5.5.2. That the Ld. LD. AO further, erred in facts & in law by invoking the provisions of section 40(a)(i) and section 44C of the Act with regard to cost incurred outside India thereby restricting the allocation of expenses to USD 831,643 as against the claim of allocated actual expenses of USD 33,824,353 incurred outside India.

6. That the Ld. LD. AO, erred on facts and in law, in making an addition of Rs. 4,81,48,179 paid on account of International Private Leased Circuit (IPLC) charges by stating that they are taxable as 'Equipment Royalty' in terms of Article 12(2) read with Article 12(3)(b) of the DTAA.

> 7. That the Ld. LD. AO erred on facts and in law in withdrawing interest under section 244A of the Act and levying interest under sections 234B of the Act.

3. Brief facts are: The assessee i.e. Convergys Customer Management Group Inc. ('CCMG') is a company incorporated in the United States of America and claims itself a tax resident of USA under Article 4 of the India – US Double Taxation Avoidance Agreement ('DTAA'). The Appellant provides IT enabled customer management services by utilizing its advanced information system capabilities, human resource management skills and industry experience.

3.1. The Appellant has a subsidiary in India by the name of Convergys India Services Pvt. Ltd. (hereinafter referred to as "CIS"). To service its customers, the Appellant claims to procure services from India on a principal to principal basis from CIS. The Appellant does not carry out any business operations in India. CIS provides IT enabled call centre/back office support services to the Appellant. It is claimed that substantial risk of procurement of services by the Appellant from CIS lies with the Appellant like, market risks, price risks, R&D risk, service liability risk towards its customers for quality and efficiency in delivery of services. Appellant claims that its customers are outside India, aforesaid risk resides outside India.

3.2. In its return for A.Y. 2006-07 the Appellant declared a total income of Rs. 4,00,06,350 comprising of Rs. 1,92,29,077 as interest on external commercial borrowings and an amount of Rs. 2,07,77,272 as fees for included services. The interest and service income was earned by the Appellant from CIS. The interest income was offered to tax @15% on gross basis in accordance with Article 11 of the DTAA and the service income was also offered to tax @15% on gross basis in terms of Article 12(4)(b) of the

DTAA. Certain reimbursements made by CIS in the nature of link charges, software payments etc. were not offered for taxation since it claimed that they were not subject to tax in India in accordance with the provisions of the DTAA.

3.3. AO by assessment order dated December 29, 2008 determined the taxable income at Rs. 294,46,73,964 against the declared income of Rs. 4,00,06,350. It was held by AO that the Appellant has various forms of Permanent Establishment('PE') in India as under:

(i) Fixed Place PE :

a. Fixed Place PE under paragraph 1 of Article 5 of the DTAA
b. An Office under paragraph 2(c) of Article 5 of the DTAA
c. A Factory under paragraph 2(d) of Article 5 of the DTAA

(ii) Service PE under paragraph 2(l) of Article 5 of the DTAA .

(iii) Dependent Agent PE (DAPE) under paragraph 4(a) and 4(c) read with paragraph 5 of Article 5 of the DTAA.

3.4. After coming to the conclusion that the Appellant has a PE in India, the Ld. AO has computed profits of Rs. 2,84,45,67,544 as attributable to the alleged PE in India by further estimating the revenue from Indian operations at Rs. 12,15,81,77,391 by allocating the global revenue in proportion of number of employees, as against the actual revenue of Rs. 6,19,73,70,750/-. Actual revenue figure has been accepted by the CIT(A) after giving a proper opportunity of hearing to the AO). Further, the AO also allocated expenses (excluding direct expenses) in proportion of number of employees. Assessee claims that if the methodology adopted by the AO is followed by taking the correct/ actual revenue as accepted by the Ld. CIT(A) i.e. of Rs. 6,19,73,70,750 as the starting point, it will result in a loss in the hands of the alleged PE.

3.5. Further the AO held the PeopleSoft license cost / maintenance charges are taxable as "Royalty" under the provisions section 9(1)(vi) of the Act and Article 12 of the DTAA.

3.6. AO also held the IPLC/link charges are taxable as "Equipment Royalty" in terms of clause (iva) of Explanation 2 to section 9(1)(vi) of the Act and Article 12(2) read with Article 12(3) (b) of the DTAA.

3.7. By above observations, the assessed income was computed by the AO as under:

S. No.	**Particulars**	**Amount (in Rs.)**
(i)	Returned Income (Taxable @ 15%)	4,00,06,350
(ii)	Profits attributable to alleged PE (Taxable @ 40% plus applicable surcharge and cess)	2,84,45,67,544
(iii)	People-soft charges (Taxable as Royalty @ 15%)	68,17,878
(iv)	IPLC Charges (Taxable as Equipment Royalty @ 10%)	5,32,82,192
	Total	**2,94,46,73,964**

3.8. Being aggrieved by the AO's order, the appellant filed a writ petition with the Hon'ble High Court of Delhi for stay of demand. The Hon'ble High Court disposed off the writ petition on May 20, 2011 directing the assessee to file an appeal with the CIT (A), accordingly, the appeal was filed with the CIT (A).

3.9. In the order passed by the CIT (A), partial relief has been allowed to the Appellant. The Ld. CIT (A) held as under:

(i) Permanent Establishment

a) The Ld. CIT (A) while confirming the order of the Ld. AO held that the Appellant has a Fixed Place PE in India under article 5(1) of the DTAA and a place of management under Article 5(2)(a) of the DTAA.

b) The Ld. CIT (A) accepted the contention of the Appellant and held that it does not have a Service PE in India in terms of Article 5(2)(l) of the DTAA as the services are in the nature of included services covered under Article 12 of the DTAA.

c) The Ld. CIT (A) accepted the contention of the Appellant and held that it does not have a Dependent Agent PE in India as none of the conditions mentioned in Article 5(4) are satisfied.

(ii) Profit attribution to PE - In connection with profit attribution to the PE, the Ld. CIT (A) recomputed and reduced the amount of profits attribution from Rs. 2,84,45,67,544 to Rs. 43,10,86,460.

(iii) People Soft charges - The Ld. CIT (A) affirmed the order of the Ld. AO and held that the PeopleSoft license cost and maintenance charges received by Appellant are in the nature of Royalty in terms of section 9(1)(vi) of the Act and Article 12 of the DTAA and hence taxable @15% on gross basis. CIT (A) relied on the judgement of Karnataka High Court in the case of Samsung Electronics Co. Ltd. 203 Taxman 477 in his order.

(iv) IPLC charges - The Ld. CIT (A) deleted the addition made by the Ld. AO and held that the payments for International Private Leased Circuits ('IPLC') charges do not constitute Royalty in terms of provisions of Article 12 of the DTAA as the third party service provider was merely using its own equipment itself while rendering the services to its customers including the Appellant and CIS and there is no transfer of right to use, either to the Appellant or CIS.

(v) Interest under section 234B - The Ld. CIT (A) has held that except for the payment with regard to PeopleSoft charges made by CIS, the income of CMG was not liable for withholding under section 195 of the Act and therefore CMG was liable to pay advance tax on its business income (i.e. profits attributed to PE) and consequentially liable to pay interest under section 234B of the Act.

3.10. Aggrieved with the order of the CIT (A), both assessee and revenue have preferred appeals before the ITAT. The revenue has not challenged the order of the CIT (A) holding that assessee has no Service PE. Thus, the revenue has accepted that CMG does not have a Service PE in India.

4. In this factual backdrop, ld. Counsel for the assessee Shri Pawan Kumar CA adverted to following issues:

A. Appellant does not have a Fixed Place PE in terms of Article 5(1) and Article 5(2) of the DTAA

Factual Submissions:

4.1. The Ld. AO in his order has alleged that the Appellant has a Fixed Place PE in India in terms of Article 5(1) and Article 5(2) of the DTAA on the basis of the following:

- Employees seconded by CMG to CIS and the visiting employees of CMG had a fixed place of business at their disposal in the form of the facilities and premises of CIS.
- Seconded employees of CMG to CIS were working on key positions such as Country Head and Managing Director of CIS.
- CMG has borne revenue expenses incurred for setting up of various call sites (pre-operative expenses), capital costs were borne by CIS itself.
- CMG has provided free of cost assets in India for use of CIS.
- CMG has provided free of cost access to gateways, communication lines etc outside India to CIS.
- CMG has provided free of cost software to CIS for its use.

4.2. The Ld. CIT (A) in his order has upheld that the assessee has a Fixed Place PE in India in terms of Article 5(1) of the DTAA by stating that the premises of CIS were at the disposal of CMG and the business of CMG was carried on from such place and following other observations:-

(i) CIS did not have either economic independence or functional independence in relation to functions carried on by it due to the following:

   a. entire pre-operative expenses for setting up the call centre sites for CIS were borne by the Appellant,

b. entire capital was provided to CIS in the form of share capital/loan by the Appellant to start its operation in India,
c. CMG exercised substantial control and influence in the functional matters as is evident from the frequent and extensive visits of Appellant's employees to India, secondment of Appellant's employees to the key position in CIS,
d. CIS did not bear any substantial risk in relation to the functions carried out by in India and,
e. Deployment of certain assets (hardware and software) without charging any cost.

(ii) Management of risk related to delivery of services was carried out in India by CMG through its employees visiting India on frequent basis or secondment of its employees on key positions in CIS.

(iii) The entrepreneurial services were performed in India by CMG through the frequent visits of its employees to provide supervision, direction and control over the operations of CIS and such employees had a fixed place of business at their disposal.

(iv) The Ld. CIT (A) has held that the appellant had a place of management in India under Article 5(2)(a) of the DTAA.

Legal Submission:

4.3. Article 5.1 of the DTAA defines that the term 'permanent establishment' to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on. Thus, the conditions so prescribed under Article 5(1) are as follows:

- There must be a place of business;
- The place of business must be fixed; and
- The business of the enterprise must be carried on through that place of business.

4.4. In view of these propositions, one of the basic conditions to be satisfied before a PE can come into existence is that the foreign enterprise must have a place of business in the other country. The concept of a place of business envisages the following:

- A facility such as a premise which is used for carrying on the business of the enterprise; and
- Such facility must be at the constant disposal of the enterprise.

In other words, the place of business (facility) must be at the foreign enterprise's 'disposal' before such enterprise could be said to create a PE situation.

4.5. The scope of above Article was examined by the coordinate bench in the case of SAIL vs. ACIT [2006] 301 ITR 235**,** wherein the Bench at Para 7 observed as under:

> *"We may also examine the provision contained in para 1 of article 5, which defines PE to mean a fixed place of business through which the business of an enterprise is wholly or partly carried on. On the basis of para 1 it can be inferred that fixed place of business should be that of the assessee. It may be owned, rented out to the assessee or the assessee might have obtained facility by way of license to carry out business from that fixed place. But, the assessee should have some kind of domain or control over the place for conduct of his business either or wholly or partly."*

4.6. Similarly, in the case of Ericsson Radio Systems A.B. vs DCIT 96 TTJ 1 [Del SB], ITAT Special Bench held as under:

> *"The OECD commentary on Double Taxation refers to a "fixed place" as a link between the place of business and a specific geographical point. It has to have a certain degree of permanency. It is emphasized that to constitute a "fixed place of business", the foreign enterprise must have at its disposal certain premises or a part thereof. Phillip Baker in his Commentary on Double Taxation Conventions and International Tax Law (3rd edition) states that the nature of the fixed place of business is very much that of a physical location, i.e. one must be able to point to a physical location at the disposal of the enterprise through which the business is carried on…"*

The above order of the Special Bench has been confirmed by the Hon'ble Delhi High Court.

4.7. Reference is also made to the decision of the Andhra Pradesh High Court in the case of CIT vs. Vishakahapatnam Port Trust 144 ITR 146, in which it was held that the PE postulates the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country into the soil of another country.

4.8. Further, the OECD Model Convention provides that in order to constitute a fixed place PE, there should be a distinct situs "in India in instant case" and that the word "fixed" refers to a distinct place with a certain degree of permanence. It further provides that the foreign enterprise should be able to walk into the place of its own right and not by permission.

4.9. Further, DTAA also recognizes that mere fact that a company of one Contracting State controls or controlled by a company which is a resident of the Other Contracting State, the relationship per se shall not by itself result in a PE of either company.

4.10. Reference in this regard is made to Paragraph 40 of the OECD Commentary which provides that it is generally accepted that the existence of a subsidiary company does not by itself, constitute that subsidiary company a permanent establishment of its parent company. The relevant extract is given below:

> *"40. It is generally accepted that the existence of a subsidiary company does not, of itself, constitute that subsidiary company a permanent establishment of its parent company. This follows from the principle that, for the purpose of taxation, such a subsidiary company constitutes an independent legal entity. Even the fact that the trade or business carried on by the subsidiary company is managed by the parent company does not constitute the subsidiary company a permanent establishment of the parent company."*

4.11. According to ld. Counsel, the unambiguous position which emerges from the perusal of foregoings is that the existence of a subsidiary does not, by itself, constitute that subsidiary company is a PE of its parent company. The PE can be constituted only if any space or premises belonging to the subsidiary or other entity is at the disposal of the parent company from where the parent company carries on its business.

4.12. Article 5(2) only lists down the examples which can prima-facie constitute a PE. Even the OECD Commentary provides that the list is only illustrative and the place of business will only constitute a PE only when the requirements of Article 5(1) are satisfied.

4.13. It is submitted that the allegations made by the Ld. AO/Ld. CIT (A) that people who were on assignment with CIS were employees of the assessee and were looking after the business of CMG in India are based on surmises and conjectures. Reliance is placed on the judgment of ITAT, Mumbai in the case of DDIT (International Taxation) vs. Tekmark Global Solutions LLC (2010) 131 TTJ 173**,** wherein the ITAT observed as under:

> *8. ... The deputed persons are for all practical purposes employees of the Indian company. They carry out work allotted to them by the Indian company. Assessee has no control over the activities or the work to be performed by the deputed persons. Indian company has a right to remove the deputed persons from the services. What the assessee recovered was the actual salary payable to the deputed persons.... When the services rendered are independent of and not under the control of the assessee, the deputed persons cannot be considered as constituting a PE of the assessee in India. Hence there is no PE of the assessee in India. The actual salary of the deputed personnel reimbursed by the Indian company is only reimbursement of salary payable by the Indian company advanced by the assessee to the employees.*

4.14. The provision of assets and software free of cost by CMG to CIS cannot lead to the conclusion that CMG was carrying on business in India. The ITAT Delhi in the case of Western Union Financial Services Inc Vs. ADIT (101 TTJ 56 has analysed whether the software provided by the US tax resident to its Indian representative/agent can create a PE in India under the India-USDTAA. In this case, the assessee (a non-resident company) registered in USA was engaged in the business of rendering money transfer services. The business included transfer of monies across international borders. In this regard, the Liaison Office of the assessee in India provided the management software (VOYAGER) to the agents free of cost and trained their staff on the usage and versatility thereof. In this background, the ITAT held as under:

> *(c) Is the software "VOYAGER" the PE of the assessee?*
>
> *The department has made out a case that the software, which affords access to the agents to the assessee's mainframe computers in USA for the purpose of finding out the matching of the MTCN numbers, has been installed in the premises of the agents and hence taken together with the premises constitutes the PE. The premises of the agents are either owned or hired by them. There is no evidence to show that the assessee can as a matter of right enter and make use of the premises for the purpose of its business. The software is the property of the assessee and it has not parted with its copyright therein in favour of the agents. The agents have only been allowed the use of the software in order to gain access to the mainframe computers in the USA. Mere use of the software for the purpose from the premises of the agents cannot in our opinion lead to the decision that the premises-cum-software will be the PE of the assessee in India.*

4.15. This view finds support from the OECD Commentary also wherein it has been clarified that:

> *"If an enterprise of a State lets or leases facilities, ICS equipment, buildings or intangible property to an enterprise of the other State without maintaining for such letting or leasing activity a fixed place of business in the other State, the leased facility, ICS equipment, building or intangible property, as such, will not constitute a permanent establishment of the lessor provided the contract is limited to the mere leasing of the ICS equipment, etc."*

4.16. Reliance is also placed on the following in support of the contention that mere provision of the assets and software cannot create PE of the foreign enterprise in India:

- Airline Rotables [(2010) 131 TTJ 385] (ITAT, Mumbai)

- DDIT v. Nederlandsche Overzee Baggermaatschappiji BV. [2010-TII-78-ITAT-MUM-INTL] (ITAT, Mumbai)

4.17. In view of the above factual and legal submissions, Shri Pawan Kumar pleads that CMG could not be said to have a PE in terms of Article 5(1) & 5(2) of the DTAA.

B: Appellant was merely engaged in procuring services from India and would therefore fall within the exclusionary clause of Article 5(3) of the DTAA

4.18. The Ld CIT (A) failed to appreciate that the Company is merely engaged in procuring services from India and its activities are accordingly covered by clause (d) of paragraph 3 of Article 5 of DTAA which excludes "*the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the foreign enterprise*" from being regarded as PE.

4.19. It is further submitted that procurement of services is akin to purchasing goods or merchandise. In this regard, we draw your attention to the decision of the Supreme Court in the case of Commissioner of Income Tax vs. B. Suresh 313 ITR 149 (SC)**,** wherein the Apex Court observed that today the difference between "goods" and "services" is getting blurred with the globalisation and cross-border transactions. Accordingly, with technological advancement one has to change our thinking regarding concepts like goods, merchandise and articles.

4.20. In view of the above, notwithstanding the provisions of Article 5(1) and 5(2) of DTAA, even maintaining a fixed place of business in India merely for the purposes of purchasing/procuring services will not create a PE of CMG in India.

C: Appellant does not have any Dependent Agent PE in terms of Article 5(4) and 5(5) of the DTAA

Legal Submission :

4.21. Article 5(4) of the DTAA specifically precludes an agent of independent status from being considered as a PE. Article 5(5) provides that a person is considered to be an agent of independent agent when:

- He is an agent of independent status;
- He acts in the ordinary course of its business

However, such an agent would not be considered an agent of independent status:

- Where activities of the agent are devoted wholly or almost wholly on behalf of the principal; and
- The transaction between the agent and the principal are not made under arm's length price.

4.22. Thus, if an agent is of independent status, recourse to Para 4 is not available to the department as that para will apply only where the person carrying on business for the non-resident principal is one other than an agent of independent status referred to in Para 5. Further, the allegation that the activities of CIS are devoted "wholly or almost wholly" cannot be read without the condition of transaction being at Arm's Length.

4.23. Further, merely because an agent does not satisfy the test embodied in Paragraph 5, he does not per se become a deemed PE under Paragraph 4. In order to do so, the activities of such an agent should fall under at least one of the following three clauses, clauses (a) to (c), of Paragraph 4, as listed below:

(a) The dependent agent has and habitually exercises in India an authority to conclude contracts on behalf of the foreign enterprise; or

(b) The dependent agent has no such authority but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the foreign enterprise, and some additional activities conducted in India on behalf of the foreign enterprise have contributed to the sale of the goods or merchandise ; or

(c) The dependent agent habitually secures orders in India, wholly or almost wholly for the enterprise.

4.24. Reliance in this regard is placed on the AAR ruling in the case of TVM Ltd. 237 ITR 230**,** wherein it was held that merely because the agent is not independent would not automatically create an agency PE. The agent should be able to exercise the authority to conclude contracts.

4.25. In the present case, the above elements of authority to conclude contracts or secure orders do not exist in activities performed by CIS. It is CMG that is responsible for negotiating prices and entering into contracts with the end customers. The only assistance that CIS may provide CMG in this regard is intermittent inputs from an India perspective like USP, skill sets, and comparative advantage of choosing India as a base for outsourcing services etc. Even the Ld. AO has not brought any material on record to demonstrate that CIS had any authority whatsoever to conclude contracts or secure orders on behalf of the assessee. It is merely an allegation without any basis.

4.26. In the light of above, even assuming, CIS is an agent of CMG, it does not have any authority to conclude contracts or secure orders on behalf of CMG and hence CMG does not have a Dependent Agent PE in India.

5. Attribution of profits for Indian operations:

5.1. During the course of assessment proceedings, the details of aggregate customer revenue from the work subcontracted to CIS and estimated operating income of the appellant with respect to such revenue were submitted before the AO. The estimated operating income was computed by assessee considering the global operating income percentage of the customer care business came to 10.55%, this was explained in following tabular format:

Description	**Amount in USD million**
End-customer revenue with regard to contracts/ projects where services are procured from CIS **(A)**	138.9
Service fee paid to CIS (inclusive of mark-up of USD 13.8 million) **(B)**	112.5
Balance retained by CMG **(C = A - B)**	26.4
Expenses incurred in U.S. by CMG **(D)**	25.6
Profit retained by CMG for functions performed, assets utilised and risks borne in the US **(E = C - D)**	0.8

(Amount in USD million)

Description	**India**	**US**	**Consolidated**
Revenue (A)	112.5	26.4	138.9
Expenses (B)	98.7	25.6	124.3
Profit (C = A – B)	13.8	0.8	14.6

5.1.1. These details are submitted to AO/ TPO and are not adversely commented upon. TPO has adopted a totally realistic and unreasonable method.

5.2. The assessing officer rejected this information and adopted a head count basis for attributing profits of Rs. 2,84,45,67,544/- by allocating revenue and expenses (excluding direct expenses) in proportion of number of employees assuming that each employee delivers same value to the revenue earned by the appellant to the alleged PE of the appellant in India. This computation of profit attribution by the assessing officer in complete disregard of the provisions of law, arbitrary and without any basis and leads to following distorted results:

Description	
Number of employees during the year in CMG – based on the calendar year information reported in the annual report proportioned for Indian FY 2005-06 **(A)**	61,050
Number of employees during the year in CIS – approximate number taken based on internet report for 2004 and 2007 **(B)**	10,000
Total revenue of CMG for the year (as per annual report) **(USD)** **(C)**	1,66,36,00,000
Total revenue per employee **(USD) (D=C/A)**	27,250
Revenue generated by Indian employees **(USD) (B * D)**	27,24,97,952
Revenue generated by Indian employees **(INR) (E = B * D *44.6175)**	12,15,81,77,391
Cost of products and services taken to be total cost of CIS **(F)**	4,34,53,89,490
Allocation of other expenses (SG&A, R&D, Depreciation, Amortization) – global expenses proportioned in the ratio of employees **(G)**	3,01,52,06,032
Net profit due to Indian Operations **(H= E-(F+G))**	4,79,75,81,869
Ratio of costs of products & services to total cost considered to be attributable to India	72.77%
Profit attributable to Indian operations **(I = H * 72.77%)**	3,49,12,00,326
Profit before Tax of CIS **(J)**	64,66,32,792

Profit belonging to the PE **(I – J)**	2,84,45,67,534

5.3. The following table shows the computation of global expenses proportioned in the ratio of employees:

Particulars	**2006**	**2005**	**F.Y. 2005-06**
Selling, general and administrative expenses	335.8	308.2	315.1
Research and development costs	8.6	8.6	8.6
Depreciation	65.4	68.7	67.875
Amortization	4	10.7	9.025
Restructuring charges	6.5	13.8	11.975
Total expenses (Million USD)			412.575
Allocation of other expenses in (USD) (412.575 *10000/61050) (Rounded off)			67.579
Allocation of other expenses in (Rs.) (USD 67,579,000* Rs.44.6175)			3,01,52,06,032

-Computation of Ratio of costs of product and services to total cost

(Amount in USD million)

Particulars	**2006**	**2005**	**F.Y. 2005-06**
Costs of products and services	1,180.4	1,077.2	1,103
Selling, general and administrative expenses	335.8	308.2	315.1
Research and development costs	8.6	8.6	8.6
Depreciation	65.4	68.7	67.875
Amortization	4	10.7	9.025
Restructuring charges	6.5	13.8	11.975
Total Costs and expenses (Million USD)			1,515.575
Ratio of Costs of products and services to total cost (1,103/1515.575*100)			72.77%

5.4. The fundamental difference between the appellant and the AO's calculation lies at the starting point of the computation itself i.e. the revenue which was considered on the basis of head count instead of the amount submitted by the appellant i.e. USD 138.9 million representing the revenue from end customers with regard to contracts/projects wherein services were procured from CIS for AY 2006-07. If the methodology adopted by the AO is followed by taking the revenue of USD 138.9 million as the starting point, it will result in a loss in the hands of the alleged PE as explained through computation below:

Particulars	**Assessment order**	**Revised numbers**
Revenue generated by Indian employees **(USD)**	27,24,97,952	13,89,00,000
Revenue generated by Indian employees **(INR) (A)**	12,15,81,77,391	6,19,73,70,748
Cost of products and services taken to be total cost of CIS **(B)**	4,34,53,89,490	4,34,53,89,490
Allocation of other expenses (SG&A, R&D, Depreciation, Amortization) – global expenses proportioned in the ratio of revenue **(C)**	3,01,52,06,032	1,53,69,56,142
Net profit due to Indian Operations **(D= A-(B+C))**	4,79,75,81,869	31,50,25,116
Ratio of costs of products & services to total cost considered to be attributable to India	72.77%	72.77%
Profit / (Loss) attributable to Indian operations **(E = D * 72.77%)**	3,49,12,00,326	22,92,43,777
Profit before Tax of CIS **(F)**	64,66,32,792	64,66,32,792
Profit / (Loss) belonging to the PE **(E – F)**	2,84,45,67,534	(41,73,89,015)

5.5. In first appeal CIT(A) incorrectly held that Profit Split Method (PSM) appears to be the most suitable method to determine the arm's length profit attributable to CMG's PE in India. Without appreciating that the FAR profile of alleged PE of CMG in India has to be limited to 'additional FAR/Cost' if any deemed to be incurred for the purpose of carrying out the India operations of service delivery and which are not already captured in the FAR/Cost of CIT. It is pleaded that CMG or its employees do not perform any entrepreneurial service to manage risk related to service delivery in India. Further, neither CIS nor the alleged PE develops/ owns any intangibles. It is contended that merely for attribution towards free of cost assets and software by CMG, PSM is not the appropriate method for computing the attribution in the instant case for the alleged PE.

5.6. CIT(A) though after hearing detailed arguments and verification, accepted the revenue from end-customer with regard to contracts/projects wherein services were procured from CIS of USD 138.9 million as submitted by the appellant relying on the following:

(i) Customer-wise break-up of revenue earned from India operations along with a management certificate and also an affidavit from Director of the appellant.

(ii) Jurisdiction wise break-up of the global revenue.

(iii) Ledger extracts of top six customers.

(iv) Sample copy of contracts between appellant and its clients.

(v) Sample copy of invoices raised by the appellant on its clients.

(vi) Assessment order of assessment year 2008-09 wherein the revenue of USD 184.6 million was accepted by the assessing officer.

5.7. Shri Pawan Kumar ld. counsel for assessee pleads that once the revenue was accepted by the CIT(A) at USD 138.9 million the methodology adopted by the assessing officer about expenses, ought to have been followed. If this correct and reasonable method is adopted, it results in a loss in the hands of the alleged PE. However, the CIT(A) computed profits attributable to the alleged PE of the appellant in India by an unreasonable method, as under:

Particulars	Amount (Rs)
End – customer revenue from Indian operations (A)	6,19,73,70,750
Less: Amount paid to CIS (B)	4,98,68,34,000
Less: Selling cost allocated to Indian Operations (USD 13.155 million * Rs. 44.6175) (C) (estimated @ 50% of selling, general and administrative expenses)	58,69,62,170
Profits earned from India operations (D = A-B-C)	62,35,74,580
Profits attributable to CMG's PE in India (E = D*72.77%)	45,37,75,221
Less: 5% of above for Head Office expenses under section 44C of the Income Tax Act, 1961 (Act) (F = E*5%)	2,26,88,761
Profits taxable in India (E-F)	43,10,86,460

5.8. The above computation of profit attribution made by the CIT(A) is highly excessive as the starting point for computing the profits attributable to a PE should be the arm's length return/ remuneration of a PE based on the FAR profile of the PE whereas the CIT(A) has considered the end-customer revenue of the appellant. CIT(A) completely disregarded the transfer pricing analysis report for PE attribution conducted by an independent expert for the year under consideration and submitted during appeal.

5.9. Alternatively, it is submitted that the assessing officer has himself arrived at a percentage of 72.77% which according to him represents the proportion of functions performed in India. This has also been confirmed by the CIT(A). Hence, applying this percentage on revenue earned by the appellant with regard to contracts wherein services have been procured from CIS, one would arrive at the arm's length revenue of the alleged PE (i.e. USD 101.08 million = 72.77% of USD 139.9 million). The correction of this error would prove that no further attribution can be made as the amount of service fee paid by CMG to CIS (i.e. USD 112.5) is more than this amount. This can be explained as under:

Description	**Amount (USD in million)**	**Comments**
Revenue [A]	101.08	*[72.77% of USD 138.90 million i.e. total end-customer revenue]*
Less: Amount of service fee paid to CIS (including mark-up) [B]	112.50	Already offered to tax in India by CIS
Balance [C = A – B]	(11.42)	
Profit attributable to India	**No further attribution required**	

5.10. CIT(A) for arriving at the revenue of the alleged PE of the appellant has taken CMG revenue as the starting point. Hence, the Ld. CIT (A) should also have considered the expenses incurred outside India for arriving at the profit of the assessee with regard to the contracts wherein services have been procured from CIS. While computing the profit of CMG, there is no question of applying the provisions of the Act. The expenses incurred outside India have been incurred by CMG for its business outside India and not by the alleged PE. Hence, the Ld. CIT (A) erred in invoking the provisions of section 44C of the Act with regard to cost incurred outside

India and restricting the selling expenses to Rs. 58,69,62,170 and executive and general administrative expenses to Rs. 2,26,88,761 for attributing the profits to the alleged PE in India.

5.11. Ld CIT (A) should have allowed all the expenses incurred outside India such as Research and development expenditure, depreciation, amortization etc. while computing he profits of CMG. The Ld CIT (A) erred in allowing only 50% of the selling, general and administrative expenses and ignoring the other expenses incurred by CMG outside India for earning the revenue from end-customers.

5.12. The details and nature of expenses incurred by CMG outside India which are allocable to the contracts wherein services have been procured from CIS are submitted before the Ld. AO /Ld. DRP in the subsequent years i.e AY 2007-08 and AY 2008-09. Following the same methodology for the financial Year 2005-06, the detail of expenses aggregating to USD 25.69 million is enclosed as Annexure A with submissions. These expenses relate to the activities undertaken by CMG outside India such as sales and marketing, contract negotiation, customer relationship management, provision of necessary networking/telecom infrastructure, technology, project management, etc. By reducing the amount of such expenses aggregating to USD 25.69 million from the end-customer revenue of USD 138.9 million, the balance amount comes to USD 113.30 million. However, as CMG has already paid an amount of USD 112.50 million to CIS, profit of only USD 0.8 million is retained by CMG. Out of this USD 0.8 million, an amount of USD 0-46 million has been offered for taxation in India @ 15% on gross basis as 'Fees for Included Services' as defined under Article 12(4)(b) of the DTAA.

5.13. It is pleaded that this exercise amounts to double taxation of the same income as :

5.13.1. Post the transfer pricing regime the problems of attribution of profits are to be resolved in a manner consistent with international tax practice on the subject. Where the dealings are between two related corporate entities, one overseas and one domestic, then the transactions between them are subjected to the examination of "transfer pricing" in which it is ascertained by the department that appropriate income is attributed to the Indian entity for the Indian leg of operations and therefore the appropriate amount of tax is collected in India.

5.13.2. If the approach of the Ld. AO and Ld. CIT (A) is followed, then it would bring the following to tax in India:

a) part of the value of the transaction in the hands of the foreign company on the principle of attribution; and

b) the same income in the hands of the subsidiary company (CIS) by increasing the arms length value vis-a-vis the Indian company.

Thus the same income attributable to India may be taxed twice, once in the hands of the parent company on the principle of attribution and then in the hands of the subsidiary company on the arms length principle.

5.13.3. It is submitted that conceptually the department cannot apply transfer pricing principle which are designed to ensure that the entire income attributable to Indian operations is taxed in the hands of the Indian entity on the one hand and at the same time seek to tax a part of subsidiary's income in the hands of the parent company on principles of attribution. This runs contrary to established and recognized T.P. norms.

5.14. In this case, the Ld. TPO in the case of CIS (Indian subsidiary) has scrutinized and examined all the international transactions undertaken between CIS and Appellant and thereafter after confirmation by the DRP, an adjustment of Rs. 31,21,61,763 has been made under section 92CA in the assessment order by considering an arm's length mark-up of 22.61%. The matter is presently pending before the Hon'ble ITAT. For affecting the said transfer pricing adjustment, the Ld. TPO has determined this margin with reference to entrepreneurial companies in India assuming all normal business risks and has not allowed any adjustment/relief to CIS on account of the fact that majority of risks are borne by CMG. Thus as per the assessment order in the case of CIS, CIS should have earned a revenue of approx Rs. 5,29,89,96,030 instead of RS.4,98,68,34,267.

5.15. Therefore, on one hand the profits of Rs. 43,10,86,460 have been attributed to the alleged PE of the Appellant in India and on the other hand transfer pricing adjustment of Rs. 31,21,61,763 has been made in the hands of CIS. Thus the same income attributable to India would be taxed twice, once in the hands of the parent company on the principle of attribution and then in the hands of the subsidiary company on the arms length principle.

5.16. The above pleadings make it is absolutely clear that even if any adjustment has to be made, it can be made only to the assessable income of CIS.

PeopleSoft license cost and maintenance charges amounting to Rs. 68,17,878 taxable as "Royalty" under the provisions of section 9(1)(vi) of the Act and Article 12 of the DTAA

6. Ld counsel for the assessee made following submissions:

6.1. PeopleSoft License charges pertain to People Soft financial reporting package (PeopleSoft) costs which help in improving the visibility, tracking, and control with a single source of information that provides complete, real-time reporting and reconciliation of operational and financial data. PeopleSoft is a packaged enterprise application. Out of the total amount incurred by the Appellant, a proportion of the license cost and maintenance cost for PeopleSoft was allocated by CMG to CIS which was reimbursed by CIS to CMG.

6.2. The Ld. AO in his order has held that the consideration received for licensing of software was taxable as 'Royalty' in terms of section 9(1)(vi) of the Act and Article 12 of the DTAA and accordingly taxed it @ 15% on gross basis as per Article 12(2) of the DTAA without even bothering to mention as to which particular clause in the definition would get attracted in this case.

6.3. The Ld. CIT *(A)* relied on the decision of the Hon'ble Karnataka High Court in the case of Samsung Electronics Co. Ltd. 203 Taxman 477 and Sunray Computers Pvt. Ltd. 204 Taxman 1 wherein it has been held that there was a transfer of copyright and payment made for the import of software was in the nature of royalty in terms of the definition of royalty provided in the Act as well as the DTAA. The Ld. CIT (A) accordingly held that the amount received by the Appellant for providing the 'PeopleSoft' software was in the nature of Royalty and hence taxable.

6.4. Hon'ble Delhi High Court in the case of CIT vs. Industrial Engineering Projects (P) Ltd. (202 ITR 1014) has held that reimbursement of expenses can under no circumstances be regarded as revenue receipt.

6.5. Under the DTAA, a perusal of the definition under Article 12(3) of the DT AA shows that for a consideration to be treated as "Royalties", it should be towards use of or the right to use of any of the aforementioned rights. Payments for transaction where the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program should be dealt with as commercial income in accordance with Article 7 (Business Profits).

6.6. The Indian Courts (including the jurisdictional High Court have been consistent in their approach in holding that purchase of software would fall within the category of copyrighted article and not towards acquisition of any copyright in the software and hence the consideration should not qualify as Royalty. Reliance is placed on the decision rendered by the Delhi High Court in the case of Director of Income Tax v. Ericsson A.B. (ITA No. 504/2007). Reliance is also placed on the following judgments wherein it has been held that supply of computer software is sale of copyrighted article and not copyright:

- Special Bench of Delhi Tribunal in the case of Motorola Inc. v. Dy. CIT (96 TTJ 1)
- Infrasoft Limited vs. ACIT, Circle 2(2) (ITA No 847/Del/2008)

- Lucent Technologies International Inc. vs DCIT (120 TTJ 929) (Delhi)

- LotUS Development Asia Pacific Limited Corporation (ITA No. 564 to *566/Delj05)* (Delhi)

- Sonata Information Technology Ltd. vs DCIT (2006) (7 SOT 465) (Mum.)

- Sonata Software Ltd. vs. ITO (Int. Tax) (2006) (6 SOT 700) (Bang)

- Samsung Electronics Co. Ltd vs. ITO (TDS-1)(2005) (93 TTJ 65) (Bang)

- Hewlett - Packard (India) (P) Ltd. vs. ITO (2006) (5 SOT 660)(Bang)

- Metpath Software International Limited (ITA No 179) (Delhi)

- Velankani Mauritius Ltd. (2010-TII-64-ITAT-BANG-INTL)

- M/s Tata Communications Ltd (2010-TII-157-ITAT-MUM- INTL)

- DDIT vs. Reliance Industries Ltd (2010-TII-154-ITAT-MUM- INTL)

- Allianz SE vs. ADIT (TS-204-ITAT-2012-Pune)

- Solid Works Corporation (TS-76-ITAT-2012-Mumbai)

6.7. In the recent decisions of the Mumbai Tribunal in the case of Solid Works Corporation and the Pune Tribunal in the case of Allianz SE, the ITAT has followed the decision of the Hon'ble Delhi High Court in Ericsson A.B. instead of the Hon'ble Karnataka High Court in the case of Samsung Electronics Co. Ltd. stating that when two views are available on an issue one favourable to the assessee and the one against the assessee, the view which is favourable to the assessee and does not support levy of tax on the assessee should be preferred.

6.8. It is pointed out that even though the Finance Act, 2012 has made an amendment in section 9(1)(vi) of the Act and widened its scope, however, the same does not impact the provisions of DTAA in any manner.

6.9. In this regard, reliance is placed on the recent judgment of ITAT Mumbai, in the case of B4U International Holding (ITA No 3326/Mum/2006), wherein the Hon'ble Tribunal has observed that:

> *"Coming to the argument of the Ld Departmental Representative that the amendment to Finance Act 2012 changes the position, we find that there is no change in the DTAA between India and USA. Thus the amendment has no affect on our decision".*

6.10. Ld. Counsel contends that from above, it follows that:

(a) the payment made by CIS to CMG cannot be characterized as Royalty either under the Act or under the DTAA.

(b) Link charges amounting to Rs. 5,32,82,192 as 'Royalty' under Article 12(2) of the DTAA

(c) The link charges pertain to leased lines (under sea cables) that allow a dedicated capacity for a private, secure communication link from India to the US which enables CIS to communicate with the customer. The Appellant makes payment for such link charges to telecom service providers in the USA and cross charges the portion of the cost incurred by it in connection with the India half link to CIS, which is accordingly reimbursed by CIS to CMG.

6.11. The Ld AO in his order made an addition on account of link charges by stating that they were taxable as 'Equipment Royalty' in terms of Article 12(2) read with Article 12(3)(b) of the DTAA and accordingly taxed it @ 10% on gross basis.

6.12. CMG/CIS, who availed the services from the service providers, have neither intended to nor have obtained any right to use the underlying infrastructure maintained and used by the service providers for providing the services. The Indian judiciary has made it clear that it is important to see whether there was any intention to transfer the right to use or not. In the present set of facts, CMG/CIS do not have any control or possession over the equipment i.e. the network facilities are under the control of and maintained and operated by the service providers. CMG/CIS merely avail a service. Accordingly, the link charges do not qualify as 'Equipment Royalty' in terms of Article 12 of the DTAA and hence are not taxable in India. Reliance is placed on the following judgments:

- Bharat Sanchar Nigam Ltd. vs. Union of India (282 ITR 273) (SC)
- Dell International Services India Pvt. Ltd. (AAR No. 735 of 2006)
- Cable & Wireless Networks India Private Limited (AAR No. 786 of 2008) - *The Special Leave Petition filed against this ruling has been dismissed by the Supreme Court*
- Asia Satellite Telecommunications Co. Ltd. (332 ITR 340) (Delhi High Court)
- Yahoo India Pvt Ltd. Vs DCIT [ITA No. 506/Mum/2008]
- Standard Chartered Bank V s Dy. Director of Income Tax [ITA No. 3824/MUM/2006]

6.13. The Ld. CIT *(A)* in his order has accepted the contention of the Appellant that the third party service provider was merely using its own equipment itself while rendering the services to its customers including the Appellant and CIS and there is no transfer of the right to use, either to the

Appellant or CIS. The Appellant has merely procured services and provided the same to CIS and no part of the equipment was leased out to CIS. The Ld CIT (A) held that the payment for link charges do not constitute Royalty under the provisions of Article 12 of the DTAA.

6.14. The provisions of Equipment Royalty are also contained in Explanation 2(iva) of section 9(1)(vi) of the Income Tax Act, 1961 ('Act') which is similar to the provisions of Article 12(3)(b) of DTAA. Recently, there has been an amendment in section 9(1)(vi) of the Act which though dilutes the concept of control or possession in respect of any right, property or information and has widened its scope, however, the same does not impact the provisions of DTAA in any manner and has no effect on assessee's case.

6.15. It is further submitted that though Asia Satellite (supra) is a decision on the domestic law but also makes an observation regarding DTAA. In para 74 of the judgment, it is specifically mentioned that" Even when we look into the matter from the standpoint of Double Taxation Avoidance Agreement (DTAA), the case of the appellant gets a boost". This observation supports assessee's cse.

6.16. In the case of B4YoU holding (supra), the Mumbai ITAT has held that transponder hire charges are mere payment for rendering a service. In this regard, the Mumbai ITAT has relied on the judgment of Madras High Court in the case of Skycell Communications Ltd. (251 ITR 53).

6.17. In the facts and circumstances of the instant case, it is pleaded by ld. counsel that assessee's case is to be decided on the basis of the provisions of the DTAA and accordingly the link charges are not taxable as Equipment Royalty in view of Article 12 of DTAA. In addition, as already mentioned above, reimbursement of expenses can under no circumstances be regarded as revenue receipt. Accordingly, as payment for link charges pertains to reimbursement of expenses, it would also not be taxable under section 9(i)(vi) of the Act.

D. Levy of Interest under section 234B and 234D and withdrawal of interest under section 244A

7. The Ground no. 6 of the ITA No. 1443/DEL-2012 is as under:

> *"That the Ld. CI'T (Appeals) erred on facts and in law in upholding levy of interest under sections 234B and 234D of the Act and withdrawal of interest under section 244A of the Act".*

7.1. The Ld CIT (A) in his order has held that except for the payment with regard to PeopleSoft charges made by CIS, the income of CMG was not liable for withholding under section 195 of the Act and therefore CMG as liable to pay advance tax on its business income (i.e. profits attributed to PE) and consequentially liable to pay interest under section 234B of the Act.

7.2. The Ld. CIT (A)erred in upholding the levy of interest under section 234B of the Act without appreciating that the entire payment was tax deductible under section 195 of the Act. (though tax not deducted for reasons mentioned above).

7.3. Section 195 of the Act does not make any distinction between business income or royalty income for the purpose of tax withholding provided the income is taxable in India.

7.4. Section 209(1) (d) of the Act provides that "the Income tax calculated shall be reduced by the amount of income tax which is tax deductible at source ... " and when the entire income is tax deductible (assuming to be taxable) the Appellant cannot be held to have committed any default in paying advance tax.

7.5. Further, the issue of levy of interest under section 234B in such cases is already covered by the following decisions:

a) DIT vs. Jacabs Civil Inc. [ITA 491 of 2008] [Del.]

b) Motorola Inc. vs. DCIT 96 TTJ 1 Delhi Spl. Bench];

c) DIT vs. NGC Network Asia LLC 313 ITR 187 [Born.];

d. CIT vs Sedco Forex International Drilling Co. Ltd. 264 ITR 320 [Uttaranchal]

In view of the above position of law, the levy of interest under section 234B deserves to be quashed.

7.6. In the present case, no interest has been granted to the Appellant under section 244A of the Act as the Appellant has till date not received either the intimation under section 143(1) of the Act or the refund claimed by it in its tax return. Accordingly there is no question of withdrawing interest under section 244A or levying interest under section 234D of the Act.

8. Ld. CIT(DR) Shri D.K. Gupta supported the order of ld. AO /TPO as under:

8.1. On the issue of P.E. it is contended that assessee has a PE in India looking at interlinking and interlacing of CIS and CMG. This is further supported by the decision of the Hon'ble Delhi High Court in the assessee's case for A.Ys. 2002-03 & 2004-05 reported in 2012-TII-73-HC-DEL-INTL. The Hon'ble Court while upholding the validity of the notices issued u/s 148 of the Act has held that the facts of the case prima facie indicated that apart from the prima facie existence of a business connection there was also material to entertain the belief that Convergys India was a permanent establishment of the assessee. Orders of AO, CIT(A) and DRP are relied on.

8.2. Apropos attribution of profits to PE, assessing officer has given adequate, tenable and reasonable basis. The assessee was neither able to produce full details of revenue nor the expense could be fully verified by AO.

8.3. Apropos people soft license charges order of TPO is relied on.

8.4. Apropos IPLC/ Link charges it is pleaded that the decision of the Hon'ble Delhi High court relied by the ld. AR in the case of Asia Satellite is no longer applicable as subsequent to this decision section 9 of the I.,T Act ('Act') has been amended by the Finance Act, 2012 whereby Explanations 5 and 6 have been inserted with retrospective effect from 1-6-1976. The Hon'ble High Court had decided the issue against the department mainly on the ground:-

(a) The payments were made by non-resident to non-residents.

(b) The control of transponder/ equipment was in possession of the payee i.e. the satellite owner and not with the payer (telecasting company);

(c) No 'process' was involved.

8.4.1. After the insertion of Explanation 5 & 6 for the purposes of treating a payment as royalty within the meaning of section 9(1)(vi) of the Act it is not necessary that the 'control' should be with the payer. It has also been clarified that 'process' includes transmission by cable etc. Moreover, in the present case payments are from resident to non-resident. This being the position the Delhi High Court's decision is no more applicable. On the contrary the Special Bench decision of ITAT, Delhi in the case of New Skies Satellites (2009-TII-77-ITAT-DEL-SB-INTL) has now revived and hence is applicable. In the aforesaid decision after considering the meaning of 'process' and 'control' the ITAT has decided the issue in favour of the department. It is held that such payments are taxable as royalty both under the domestic law [section 9(1)(vi) and under article 12 of the DTAA.

8.4.2. The decision of ITAT, Mumbai in the case of B4U is distinguishable as in this case the main issue involved was whether disallowance can be made u/s 40(a)(i) on the payments made by the assessee to the Satellite owner. One of the grounds on which the issue was decided in favour of the assessee was that in view of the Delhi High Court's decision in the case of Asia Satellite (supra) such payment was not royalty. When the attention was drawn towards the above mentioned retrospective amendments in section 9 the ITAT in para 17 of the order merely stated that there was no change in the DTAA between India and the USA and hence amendments had no effect. It is submitted that there is no necessity for any change in the DTAA as the payments even before the amendments were royalty under article 12 of the DTAA. The Hon'ble Delhi High Court had decided the issue against the department under the domestic law. In fact, in the case before the High Court there as no DTAA with the concerned country (Hongkong) at the relevant time and the issue was being examined under the domestic law.

Now since the payment is taxable under the domestic law after the amendment, the same is liable to be taxed both under the domestic law as well as under the DTAA.

8.4.3. The term ‘process’ has not been defined in the DTAA. Thus in view of article 3(2) of the Treaty its meaning has to be seen under the domestic law. Sine after the retrospective amendment the term ‘process’ has now been defined in Explanation 6 to section 9(1)(iv) the same has to be considered while examining the payment as royalty under article 12 of the DTAA.

8.4.4. The assessee’s reliance on the Hon’ble Delhi High Court’s decision in the case of Nokia is misplaced as in the aforesaid case the issue involved was about the payment made for the use of software. The Hon’ble High Court decided the issue mainly on the ground that the software was embedded in hardware. It was also held that the payment was for a copyrighted article and hence was not covered in the definition of royalty under Article 12 of the DTAA. It was in this context it was observed that retrospective amendment in the Act by inserting Explanation 4 in sec. 9(1)(vi) would not change the position as there was no change in the Treaty. In the present case, as discussed above, there is no need for any change in the Treaty. Hence, in my humble view, the relied decision is of no help to the assessee.

8.4.5. Reliance is also placed on the AAR’s decision in the case of Dishnet Wireless Ltd., Chennai (2012/TII-47-ARA-INTL). In the aforesaid decision not only the AAR has considered the aspect of reimbursement of expenses but has also held that after the above amendments payments for such leased lines are in the nature of royalty both under the Income Tax Act and under Article 12 of the DTAA.

8.4.6. It is submitted that the IPLC changes are taxable as royalty both under the domestic law as well as under the DTAA.

8.5. Apropos interest u/s 234B & D and interest u/s 244A, assessing officer's order is relied.

9. We have heard the rival contentions and perused the material available on record and proceed to decide various issues/ grounds as under:

9.1. On the issue of PE, AO held that the assessee has a Fixed Place PE in India in terms of Article 5(1) and Article 5(2) of the DTAA on the basis of the following:

(i) Employees seconded by CMG to CIS and the visiting employees of CMG had a fixed place of business at their disposal in the form of the facilities and premises of CIS.
(ii) Seconded employees of CMG to CIS were working on key positions such as Country Head and Managing Director of CIS.
(iii) CMG has borne revenue expenses incurred for setting up of various call sites (pre-operative expenses), capital costs were borne by CIS itself.
(iv) CMG has provided free of cost assets in India for use of CIS.
(v) CMG has provided free of cost access to gateways, communication lines etc outside India to CIS.
(vi) CMG has provided free of cost software to CIS for its use.

9.2. AO was of the opinion that CIS was not an agent of Independent status within the meaning of Article 5(5) of the DTAA because the activities of CIS are wholly on behalf of the assessee and the transactions between CIS and the assessee are not made under arm's length conditions. The Ld. AO also alleged that the assessee has a PE under paragraph 4(a) and 4(c) of Article 5 of the DTAA as the sales team of CIS assists CMG in the sales and marketing efforts.

9.3. The Ld. CIT (A) in his order has upheld. that the assessee has a Fixed Place PE in India in terms of Article 5(1) of the DTAA by stating that the premises of CIS were at the disposal of CMG and the business of CMG was carried on from such place. The Ld. CIT (A) made the following assertions in this regard:

(v) CIS did not have either economic independence or functional independence in relation to functions carried on by it due to the following:

a. entire pre-operative expenses for setting up the call centre sites for CIS were borne by the Appellant,
b. entire capital was provided to CIS in the form of share capital/loan by the assessee to start its operation in India,
c. CMG exercised substantial control and influence in the functional matters as is evident from the frequent and extensive visits of assessee's employees to India, secondment of assessee's employees to the key position in CIS,
d. CIS did not bear any substantial risk in relation to the functions carried out by in India and,
e. Deployment of certain assets (hardware and software) without charging any cost.

(vi) Management of risk related to delivery of services was carried out in India by CMG through its employees visiting India on frequent basis or secondment of its employees on key positions in CIS.

(vii) The entrepreneurial services were performed in India by CMG through the frequent visits of its employees to provide supervision, direction and control over the operations of CIS and such employees had a fixed place of business at their disposal.

9.4. The Ld. CIT (A) has also held. that the assessee had a place of management in India under Article 5(2)(a) of the DTAA. With regard to the dependant agent PE, the Ld. CIT (A) has however held. that the assessee does not have a Dependent Agent PE in India as none on the conditions mention in Article 5(4) are met.

9.5. It was contended before us that the above finding given by the CIT(A) are not sustainable both on facts and in law. In this regard the ld. AR of the assessee submitted a point-wise reply to the allegations given by AO /CIT(A) holding that the assessee has a fixed place PE in India in terms of Article 5(1) and 5(2) of the DTAA, which is placed on record. Submissions as raised before assessing officer and CIT(A) are relied on.

9.6. Shri Pawan Kumar, counsel for the assessee has canvassed legal arguments relying on the case laws and the OECD Commentary that the assessee could. not be said to have a PE in terms of Article 5(1) and 5(2) of the DTAA. It is argued that assessee was merely engaged in procuring services from India and would. therefore fall within the exclusionary clause of Article 5(3) of the DTAA which excludes "the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the foreign enterprise" from being regarded as PE. It was further submitted that even if it is presumed that a business connection or a PE exists, even then procurement of services from the Indian subsidiary which is a 10A unit is akin to purchasing goods or merchandise. Therefore, Assessee is covered under clause (b) of Explanation 1 of sub-section (1) of section 9 of the Act read with article 7(4) of the DTAA. In this regard, the ld. AR of the assessee relied on the decision of the Hon'ble Supreme Court in the case of CIT vs. B. Suresh (313 ITR 149) (SC) wherein the Apex Court observed that today the difference between "goods" and "services" is getting blurred with the globalization and cross-border transactions. Accordingly, with technological advancement one has to change our thinking regarding concepts like goods, merchandise and articles.

9.7. The ld. CIT DR in reply submitted that the judgment of the Hon'ble Supreme Court in the case of B. Suresh (supra) was in connection with claiming of deduction under section 80HHC and the same cannot be applied in the present case. We are in agreement with the ld. CIT DR and reject the above contention of the assessee.

9.8. Looking at the entirety of facts and circumstances, we are of the view that the Ld. CIT (A)'s order on the proposition of PE deserves to be upheld. The employees of the assessee frequently visited the premises of CIS to provide supervision, direction and control over the operations of

CIS and such employees had a fixed place of business at their disposal. CIS was practically the projection of assessee's business in India and carried out its business under the control and guidance of the assessee and without assuming any significant risk in relation to such functions. Besides assessee has also provided certain hardware and software assets on free of cost basis to CIS. Thus, the findings of the CIT(A) that assessee has a fixed place PE in India under Article 5(1) of the DTAA is upheld.

10. Apropos the dependent agent PE in terms of Article 5(4) and 5(5) of the DTAA, after hearing the rival contentions, we do not find any infirmity in the order of the ld. CIT(A) and hold that CIS did not constitute a dependent agent PE of the assessee in India as the conditions provided in paragraph 4 of Article 5 of the DTAA are not satisfied. The grounds of appeal taken by the assessee and the department in connection with the PE are accordingly disposed off.

11. **Attribution of profits to the PE**

11.1. We now come to the issue of attribution of profits to the PE in India. In the assessment order for the assessment year 2006-07 the Ld. AO adopted a head count basis for attributing profits of Rs. 2,84,45,67,544 by allocating revenue and expenses (excluding direct expenses) in proportion of number of employees. The computation made by the Ld. AO is reproduced in para 5.2 above.

11.2. While coming to the above computation the AO estimated assessee's revenue at USD 272.49 million (INR 12,15,81,77,391) against the actual revenue of USD 138.9 million (INR 6,19,73,70,748). In appeal before the ld. CIT(A), the assessee submitted the relevant documentation as additional evidence in respect of the actual revenue from end customer with regard to contracts/projects wherein services were procured from CIS and for which opportunity was also given to the Ld AO. It is pertinent to mention that in the assessment of preceding and the subsequent years, the Ld. AO has accepted the end customer revenue based upon the methodology accepted by the ld. CIT(A) in assessment year 2006-07. Thus, AO himself accepted the actual revenue method in preceding and subsequent assessments.

11.3. It is not disputed that the details of aggregate customer revenue from the work subcontracted to CIS and estimated operating income of the assessee with respect to such revenue were submitted before the AO. The operating income was computed considering the global operating income percentage of the customer care business i.e. 10.55%. This percentage has been derived from the filings made by the assessee company with the Securities and Exchange Commission of USA. This has been explained in tabular format in the foregoing paragraphs.

11.4. The CIT (A) accepted the revenue from end-customer with regard to contracts/projects wherein services were procured from CIS of USD 138.9 million submitted by the assessee and reduced the attribution of profits to Rs. 43,10,86,460 to the PE of the assessee. In determining the profits, the ld. CIT (A) allowed deduction only for a part of the expenses. The computation of profits made by the CIT(A) is tabulated in para 5.7 above.

11.5. In the assessment order for the assessment year 2008-09, the AO accepted the end customer revenue submitted by the assessee and computed the profits attributable to the PE as under:

Description	Amount (USD)	Amount (Rs.)
Revenue from the Indian operations [A]	18,46,00,000	
Less: Amount of service fee paid to CIS (including mark-up) [B]	16,79,67,139	
Balance [C] = A – B	1,66,32,861	
Less: 5% of C in terms of section 44C of the Act [D]	8,31,643	
Balance [E = C – D]	1,58,01,218	
Profits attributable to India [72.89% of E]	1,15,17,508	45,51,71,917

11.6. The above attribution of profits to the PE of the assessee in India in the assessment year 2008-09 was confirmed by the DRP.

11.7. The fundamental difference between the computation submitted by the assessee for assessment year 2006-07 and as adopted by AO lies at the starting point of the computation itself i.e. the revenue which was considered on the basis of head count instead of the amount submitted by the Assessee i.e. USD 138.9 million representing the revenue from end customers with regard to contracts/projects wherein services were procured from CIS for FY 2005-06. If the methodology adopted by the AO is followed by taking the revenue of USD 138.9 million as the starting point, it will result in a loss in the hands of the alleged PE as explained in para 5.4.

11.8. The revenue as accepted by the CIT (A) at USD 138.9 million and if the methodology as adopted by the AO is followed it would result in a loss in the hands of the alleged PE.

11.9. In view of the CBDT Circular No. 5 of 2004 as well as the judgment of the Supreme Court in Morgan Stanley (292 ITR 416), the Bombay High Court in Set Satellite (Singapore) Pte Ltd. (307 ITR 205), jurisdictional High Court in Rolls Royce Singapore Pvt. Ltd. (202 Taxman 45) (Del.), Director of Income Tax vs. BBC Worldwide Ltd. (203 Taxman 554) (Del.) and the OECD Guidelines, this issue is to be examined. An overall attribution of Profits to the Permanent Establishment is a transfer pricing issue and no further profits can be attributed to a PE once an arm's length price has been determined for the Indian associated enterprise, which subsumes the functions, assets and risk profile of the alleged PE. In this case 81% revenue has been transferred to the India Subsidiary in the assessment year 2006-07. For the assessment year 2008-09 this percentage comes to 90%.

11.10. AO in his order for assessment year 2006-07 has attributed a weight age of 72.77% to the delivery part which is the work done in India. Even if the attribution to the alleged PE is made by applying said weight age on end-customer revenue, no further attribution will be required in the hands of the alleged PE.

11.11. Assessee in compliance with the CBDT Circular No. 5 of 2004, placed on record submitted the Transfer Pricing Analysis report for Profit Attribution before the CIT(A), who forwarded the copy of the report and also proper opportunity of hearing to AO.

11.12. Ld. CIT(A) has accepted that to the extent of functions, assets and risks are already captured in the transfer pricing analysis of CIS, no further profits can be attributed to such functions, assets and risks in the hands of assessee's PE, but held that further profit was required to be attributed on account of the following:

(i) Certain assets were deployed by the Assessee in India;

(ii) entrepreneurial services to manage risk related to the service delivery were performed in India by the Assessee.

11.13. In our considered view the observations of the CIT(A) that further attribution is required to be made on account of the entrepreneurial services to manage risk related to the service delivery performed in India by CMG is completely without any basis and no attribution on these facts is required to be made on these issues. The risk is outside India with CMG since the Indian Company (CIS) is remunerated at Cost+14% irrespective of failure of service delivery. Even otherwise, no attributions can be made on account of risks in terms of paragraph 5 of Article 7 of the DTAA. The assessee submitted that the contention of the Ld. CIT (A) that the entrepreneurial services to manage risk related to service delivery were performed in India by the assessee through the employees of CMG visiting India on frequent basis or secondment of employees of CMG on key positions in CIS is factually incorrect. The Ld. CIT (A) himself in his order at para 8.7 has held. that the technical and consultancy services rendered by employees of CMG were in the nature of included/technical services. The employees/representatives of CMG visited India for short duration and for providing training under the Technical services Agreement. Further, the seconded personnel were employees of CIS working under its control and supervision and not the employees of CMG. It cannot be said that they were performing any entrepreneurial services to manage risk in India.

11.14. The AO/ CIT (A) for arriving at the revenue of the alleged PE of the assessee has taken the revenue of the assessee company (CMG as a multi-national enterprise) as the starting point. Hence, the LD. AO/ld. CIT(A) ought to have considered the expenses incurred outside India for arriving at the profit of the assessee company with regard to the contracts wherein services have been procured from CIS. The above expenses have been incurred for carrying on the business of the assessee company outside India and are not related to the PE of the assessee in India. While computing the profit of CMG as a multi-national enterprise, there is no question of applying the provisions of the Act. The expenses incurred outside India have been incurred by CMG for its business outside India and not by the alleged PE. Hence, the AO/ CIT(A) erred in invoking the provisions of section 44C of the Act in attributing the income of the assessee company without allowing the cost incurred to earn the revenue outside India thereby attributing the entire receipts. The AO erred in not allowing the deduction of the cost allocated to earn the Indian revenues by interalia, invoking the provisions of section 40(a)(i) and 44C of the Act without appreciating the provisions of Article 7(3) of the DTAA. What is stipulated and stated in paragraph 3 of Article 7 is that the expenses incurred by the assessee for the purposes of the business of the PE can be claimed as a deduction but only in accordance with and subject to limitation prescribed in the Act. Second part of paragraph 3 to Article 7 protects and states that the assessee is entitled to claim deduction both in India as well as administrative and general expenses whether they are incurred in India in which PE is alleged or outside India. In nutshell for the purpose of computing the taxable profits attributable to the alleged PE, even the executive and general expenses are allowable. The action of the lower authority order in invoking section 40(a)(i) in respect of all expenses incurred by CMG as a multi-national enterprise is not in accordance with Para 3 of Article 7 of the DTAA.

11.15. The submissions of both parties for assessment year 2008-09 are broadly same as the facts of assessment year 2008-09 are similar to assessment year 2006-07.

11.16. It will be desirable to reproduce Article 7 of the DTAA for arriving at the methodology for attributing profits to the PE of the assessee in India.

> *"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 attributable to (a) that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold. through that permanent establishment ; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.*
>
> *2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be*

expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm's length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other *rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.*

11.17. In view of the above facts, circumstances, case law, CBDT circulars and various articles of India-USA DTAA, following conclusions are arrived at:

A. The Ld. CIT (A) accepted the revenue from end-customer with regard to contracts/projects wherein services were procured from CIS of USD 138.9 million submitted by the assessee for assessment year 2006-07. The end customer revenue has been accepted by the AO is the assessment of all the other years on the same basis.

B. The methodology adopted by the AO and the ld. CIT(A) cannot be accepted as they have considered revenue of the assessee company (CMG as a multi-national enterprise) as the starting point for arriving at the profits attributable to the PE of assessee in India. The revenue of the assessee company cannot be considered as the revenue of the PE by any stretch of imagination. Furthermore the expenses incurred outside India are linked with the business activities of the assessee undertaken outside India for the functions performed outside India and are not linked to the PE of the assessee in India.

C. The attribution of profits to the PE should be made by the transfer pricing principles supported by the CBDT Circular No. 5 of 2004 as well as the judgment of the Supreme Court in Morgan Stanley (292 ITR 416). As per the Supreme Court in the case of Morgan Stanley, it has been held. as under:

> *"The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would. be left to be attributed to the PE. 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. Lastly, it may be added that taxing corporates on the basis of the concept of economic nexus is an important feature of attributable profits (profits attributable to the PE)."*

The application of transfer pricing principles is also supported by the decisions of the Bombay High Court in Set Satellite (Singapore) Pte Ltd. (307 ITR 205), jurisdictional High Court in Rolls Royce Singapore Pvt. Ltd. (202 Taxman 45) (Del.), Director of Income Tax vs. BBC Worldwide Ltd. (203 Taxman 554) (Del.)

D. The ld. CIT (A) has held. that further profit was required to be attributed on account of Assets provided by the assessee to CIS and management of risk by the assessee in India. In our view no attribution of profits can be made on account of management of risk as risk resides outside India. Even otherwise the charge for the employees seconded to CIS and employees visiting India to provide the technical services is subsumed in the transfer pricing analysis of CIS. Therefore, attribution can only be made on account of free of cost assets and software's provided by the assessee to CIS.

E. The assessee has submitted that it does not prepare India specific accounts, therefore the attribution of profits on the basis as disclosed in the transfer pricing study for assets and software cannot be accepted. Further, in the facts and circumstances of the case Profit Split method is not the correct method for attribution of profits to the PE of the assessee in India.

F. In our considered opinion, the correct approach to arrive at the profits attributable to the PE should. be as under:

Step 1: Compute Global operating Income percentage of the customer care business as per annual report/10K of the company.

Step 2: This percentage should. be applied to the end-customer revenue with regard to contracts/projects where services were procured from CIS. The amount arrived at is the Operating Income from Indian operations.

Step 3: The operating income from India operations is to be reduced by the profit before tax of CIS. This residual is now attributable between US and India

Step 4: The profit attributable to the PE should be estimated on residual profits as determined under Step 3 above. The attribution of India profit shall be worked out as under, mentioned after the table:

11.18. In the computation based on the above approach for the assessment year 2006-07, the profits attributable to India comes as under:

Particulars	**Amount (in USD)**
Total Revenue of CMG as per the Annual Report (A)	1,663,600,000
Operating Income of CMG as per the Annual Report (B)	175,500,000
Operating Income as a percentage of revenue earned (C = B/A)	10.55%
End-customer revenue from Indian operations (D)	138,900,000
Operating Income from Indian operations (E = C * D)	14,653,950
Operating Income of CIS (Profit before tax of CIS) (F)	13,800,000
Profit retained by CMG in the US (G = E – F) Placitum 'X'	853,950

11.19. As per this working, the worldwide profit earned by CMG for A.Y. 2006-07 comes to USD 853950. This by and large tallies with the submission of the assessee dated 26-12-2010 to the assessing officer in which it has been submitted that the approximate operating profits of CMG in USD come to 0.8 million. Now the important question that arises is as to how much of the profits shall be attributable to CMG's Indian PE over and above the profits declared by its subsidiary CIS.

11.20. Apropos TPO's estimation, we are of the view that the same is not justified as it involves a very unrealistic method of counting the worldwide number of employees and dividing it with CMG's global revenue without considering the relevant aspects. The finer and material aspects about the status, capacity of the employees are over looked and result become very vague and distorted. Therefore, the method adopted by assessing officer cannot be relied on as most appropriate method.

11.21. Apropos CIT(A)'s estimate about attribution, though he accepted the proposition that there cannot be notional addition to India revenue, however, CIT(A)'s method also does not become a rational inasmuch as the various expenditures incurred by CMG i.e. research & development, depreciation, amortization etc. have not been considered and 50% of selling, general and administrative expenses have been ignored along with other expenses incurred by CMG outside India for earning the revenue from end customers. In our considered view, this approach is also not viable and appropriate.

11.22. As the methods for calculating the attribution profit as adopted by TPO and CIT(A) are not reliable. Ld. Counsel has further demonstrated that if both the methods are harmoniously applied, this leads to a situation where no further attribution to the assessee's income can be made. Thus a harmonious intermixed rationalization of TPO and CIT(A) method results into no further attribution of profits to Indian PE.

11.23. In this backdrop we are reminded of two case laws decided by Hon'ble Supreme Court which have dealt with attribution of the profits to the Indian PEs:

(i) Anglo French Textile Company Ltd. vs CIT 23 ITR 101 (SC), in which 10% attribution ha been held to be reasonable.

(ii) Hukum Chand Mills Ltd. Vs. CIT 103 ITR 548 (SC), in which 15% attribution has been held to be reasonable.

11.24. These cases decided by the Apex Court though are old, but they still hold the field as they have not been tinkered with. In our considered view, the adoption of higher figure of 15% as held by Hon'ble Supreme Court in the Hukum Chand Mills Ltd. (supra), for attribution of assessee's Indian PE operations will meet the ends of justice. Thus, the attribution of Indian PE income should be made at 15% of profit retained by CMG in the US.

11.25. In other words 15% of the placitum 'X' (result of G=E-F) in the chart at para 11.18, as mentioned above as a reasonable attribution of profit of India PE, will meet the ends of justice. Thus, assessing officer will work out the profits attributable to Indian PE on this method for A.Y. 2006-07.

11.26. Following same profit attribution for assessment year 2008-09 should be done also by this methodology. The grounds of appeal of the assessee and the department in respect of profit attribution for A.Y. 2006-07 and 2008-09 are accordingly disposed off.

12. Apropos issue of taxability of PeopleSoft license cost and maintenance charges which is in the nature of reimbursement of payments for software financial reporting packages amounting to Rs. 68,17,878 taxable as "Royalty" under the provisions of section 9(1)(vi) of the Act and Article 12 of the DTAA. This issue is in assessment year 2006-07 only. Assessee demonstrated that these charges pertain to PeopleSoft financial reporting package (PeopleSoft) costs which help in improving the visibility, tracking, and control with a single source of information that provides complete, real-time reporting and reconciliation of operational and financial data. PeopleSoft is a packaged enterprise application. Out of the total amount incurred by the assessee, a proportion of the license cost and maintenance cost for PeopleSoft was allocated by CMG to CIS which was reimbursed by CIS to CMG. AO in order for assessment year 2006-07 held that the consideration received for licensing of software was taxable as 'Royalty' in terms of section 9(1)(vi) of the Act and Article 12 of the DTAA and accordingly taxed it @15% on gross basis as per Article 12(2) of the DTAA.

12.1. The Ld. CIT (A) relied on the decision of the Hon'ble Karnataka High Court in the case of Samsung Electronics Co. Ltd. 203 Taxman 477 and Sunray Computers Pvt. Ltd. 204 Taxman 1 wherein it has been held. that there was a transfer of copyright and payment made for the import of software was in the nature of royalty in terms of the definition of royalty provided in the Act as well as the DTAA and accordingly held. that the amount received by the assessee for providing the 'PeopleSoft' software was in the nature of Royalty and hence taxable.

12.2. Assessee contended that the nature of payment for PeopleSoft charges pertains to reimbursement of expenses, it would. not be taxable under section 9(i)(vi) of the Act. Reliance is placed on the decision of the Hon'ble Delhi High Court in the case of Expeditors International India (P) Ltd. (209 Taxman 18) on reimbursement of common expenses incurred by the parent company.

12.3. A perusal of the definition under Article 12(3) of the DTAA shows that any payment in order to be treated as "Royalties", should. be towards use of or the right to use of any of the aforementioned rights. Payments for transaction where the rights acquired in relation to the copyright are limited to those necessary to enable the user to operate the program are to be dealt with as commercial income in accordance with Article 7 i.e. Business Profits.

12.4. Assessee placed reliance on the decision of Hon'ble Delhi High Court in the case of Director of Income Tax v. Ericsson A.B. (ITA No. 504/2007) to contend that the jurisdictional High Court has held that purchase of software would. fall within the category of copyrighted article and not towards acquisition of any copyright in the software and hence the consideration should. not qualify as Royalty. Further reliance is placed on the following judgments, holding that supply of computer software is sale of copyrighted article and not copyright:

- Special Bench of Delhi Tribunal in the case of Motorola Inc. v. Dy. CIT (96 TTJ 1)

- Infrasoft Limited vs. ACIT, Circle 2(2) (ITA No 847 Delhi 2008) (Delhi)
- Lucent Technologies International Inc. vs DCIT (120 TTJ 929) (Delhi)
- LotUS Development Asia Pacific Limited Corporation (ITA No. 564 to 566/Del/05) (Delhi)
- Sonata Information Technology Ltd. vs DCIT (2006) (7 SOT 465) (Mum.)
- Sonata Software Ltd. vs. ITO (Int. Tax) (2006) (6 SOT 700)(Bang)
- Samsung Electronics Co. Ltd vs. ITO (TDS-1)(2005) (93 TTJ 65) (Bang)
- Hewlett – Packard (India) (P) Ltd vs. ITO (2006) (5 SOT 660)(Bang)
- Metpath Software International Limited (ITA No 179) (Delhi)
- Velankani Mauritius Ltd. (2010-TII-64-ITAT-BANG-INTL)
- M/s Tata Communications Ltd (2010-TII-157-ITAT-MUM-INTL)
- DDIT vs. Reliance Industries Ltd (2010-TII-154-ITAT-MUM-INTL)
- Allianz SE vs. ADIT (TS-204-ITAT-2012-Pune)
- Solid Works Corporation (TS-76-ITAT-2012-Mumbai)

12.5. In the recent decisions of the Mumbai Tribunal in the case of Solid Works Corporation and the Pune Tribunal in the case of Allianz SE, the ITAT have followed the decision of the Hon’ble Delhi High Court in Ericsson A.B. instead of the Hon’ble Karnataka High Court in the case of

Samsung Electronics Co. Ltd. stating that when two views are available on an issue one which is favourable to the assessee should be preferred.

12.6. Adverting to the issue of amendments brought in by Finance Act, 2012, we are of the view that even though the Finance Act, 2012 has made an amendment in section 9(1)(vi) of the Act and widened its scope, however, the same does not impact the provisions of DTAA in any manner. In this regard, reliance placed on the recent judgment of ITAT Mumbai, in the case of B4U International Holding (ITA No 3326/Mum/2006) and the Delhi High Court in the case of Nokia Networks OY (ITA No 512 of 2007) is well placed. The Delhi High Court has held as under:

> "……… *However, the above argument misses the vital point namely the assessee has opted to be governed by the treaty and the language of the said treaty differs from the amended Section 9 of the Act. It is categorically held. in CIT v. Siemens Aktiongesellschaft, 310 ITR 320 (Bom) that the amendments cannot be read into the treaty. On the wording of the treaty, we have already held. in Ericsson (supra) that a copyrighted article does not fall within the purview of Royalty. Therefore, we decide question of law No. 1 & 2 in favour of the assessee and against the Revenue.*"

12.7. After hearing both the parties and perusing the record and in view of the judgment of jurisdiction High Court, we hold that the purchase of software would fall within the category of copyrighted article and not towards acquisition of any copyright in the software and hence the consideration should. not qualify as Royalty. Even otherwise, the payment is in the nature of reimbursement of expenses and accordingly not taxable in the hands of the assessee. This ground is allowed to the assessee.

13. Adverting to the issue of taxability of link charges as 'Equipment Royalty' in terms of Article 12(2) read with Article 12(3)(b) of the DTAA. This issue is common to both assessment year 2006-07 and 2008-09. In this regard, the ld. AR of the assessee submitted that the link charges pertain to leased lines (under sea cables) that allow a dedicated capacity for a private, secure communication link from India to the US which enables CIS to communicate with the customers. The assessee makes payment for such link charges to telecom service providers in the USA and cross charges the portion of the cost incurred by it in connection with the India half link to CIS, which is accordingly reimbursed by CIS to CMG. Ld. counsel also referred to the invoice of raised by the assessee on CIS on Page 349 of paper book volume I and the basis of cross charged at page 828 of paper book volume III and placed reliance on the decision of the Hon'ble Delhi High Court in the case of Expeditors International India (P) Ltd. (209 Taxman 18) on reimbursement of common expenses incurred by the parent company.

13.1. AO made an addition on account of link charges by stating that they were taxable as 'Equipment Royalty' in terms of Article 12(2) read with Article 12(3)(b) of the DTAA and accordingly taxed it @ 10% on gross basis. CMG/CIS, who availed the services from the service providers, have neither intended to nor have obtained any right to use the underlying infrastructure maintained and used by the service providers for providing the services. It is important to see whether there was any intention to transfer the right to use or not. In the present set of facts, CMG/CIS do not have any control or possession over the equipment i.e. the network facilities are under the control of and maintained and operated by the service providers. CMG/CIS merely avail a service. Accordingly, we hold that the link charges do not qualify as 'Equipment Royalty' in terms of Article 12 of the DTAA and hence are not taxable in India. Useful can be drawn from the following judgments:

- Bharat Sanchar Nigam Ltd. vs. Union of India (282 ITR 273) (SC)
- Dell International Services India Pvt. Ltd. (AAR No. 735 of 2006)
- Cable & Wireless Networks India Private Limited (AAR No. 786 of 2008) – *(The Special Leave Petition filed against this ruling has been dismissed by the Supreme Court)*
- Asia Satellite Telecommunications Co. Ltd. (332 ITR 340) (Delhi High Court)
- Yahoo India Pvt Ltd. Vs DCIT [ITA No. 506/Mum/2008]
- Standard Chartered Bank Vs Dy. Director of Income Tax [ITA No. 3824/MUM/2006]

13.2. CIT (A) in his order has accepted the contention of the assessee that the third party service provider was merely using its own equipment itself while rendering the services to its customers including the assessee and CIS and there is no transfer of the right to use, either to the assessee or CIS. The assessee has merely procured services and provided the same to CIS and no part of the equipment was leased out to CIS. The Ld. CIT (A) held that the payment for link charges do not constitute Royalty under the provisions of Article 12 of the DTAA.

13.3. The provisions of Equipment Royalty are also contained in Explanation 2(iva) of section 9(1)(vi) of the Income Tax Act, 1961 ('Act') which is similar to the provisions of Article 12(3)(b) of DTAA.

13.4. Besides, though Asia Satellite case is a decision on the domestic law but also makes an observation regarding DTAA. In para 74 of the judgment, it is specifically mentioned that " Even when we look into the matter from the standpoint of Double Taxation Avoidance Agreement (DTAA), the case of the assessee gets a boost". This observation supports the case of assessee.

13.5. In view of the foregoing observations we hold that there is no transfer of the right to use, either to the assessee or to CIS. The assessee has merely procured a service and provided the same to CIS, no part of equipment was leased out to CIS. Even otherwise, the payment is in the nature of reimbursement of expenses and accordingly not taxable in the hands of the assessee. Therefore, it is held. that the said payments do not constitute Royalty under the provisions of Article 12 of the tax treaty and the ground is allowed in favour of assessee.

14. Coming to the assessee's ground about levy of interest under section 234B, it is pleaded that the taxable income of the assessee was liable to TDS, as the assessees are non-residents, therefore there was no liability to pay advance tax as per the provisions of sec. 209(1) of the I.T. Act and interest u/s 234B should. not be levied.

14.1. We have considered rival submissions and record. The charging of interest is automatic under the Act if the assessee has defaulted in payment of advance tax. The income of the assessee was not liable for withholding tax under section 195 of the Act. In this case we have no option but to hold. that the assessee is liable to interest u/s 234B, as the income being assessed now cannot be held. to be income liable to TDS under Indian provisions. The same is being assessed in the hands of PEs who had not filed their return on the ground that this income was not attributed to Indian Business Connection. Provisions of section 234B are mechanical in nature. In view of the above this ground of appeal of the assessee is dismissed.

15. In the result, assessee's appeals for A.Y. 2006-07 and 2008-09 are partly allowed and that of revenue for A.Y. 2006-07 is dismissed.
Order pronounced in open court on 10-05-2013.

Sd/-
(J.S. REDDY)
ACCOUNTANT MEMBER

Sd/-
(R.P. TOLANI)
JUDICIAL MEMBER

Dated: 10-05-2013.
MP
Copy to :
1. Assessee
2. AO
3. CIT
4. CIT(A)
5. DR