Deputy Commissioner Of Income-Tax vs Cit Alcatel on 20 September, 1993

Equivalent citations: [1993]47ITD275(DELHI)

ORDER

G. Krishnamurthy, President

1. This is an appeal filed by the revenue against an order passed by the Commissioner of Income-tax (Appeals) XVI, Delhi deleting the additions made by the IAC (Assessment).

2. A perusal of the order of the CIT(A) would convince anyone reasonably instructed as to the elementary principles and the provisions of the Income-tax Law that it is a well reasoned and well authenticated order. Be that as it may since the department felt aggrieved by the conclusions reached by the CIT we have to delve deep into the facts of the case, consider the arguments addressed to us and express our views thereon. But our temptation to reproduce the orders passed by the CIT at places is so intense that we cannot avoid it.

3. The assessee is a non-resident French company having extensive experience, know-how in the manufacture of Tele-communication systems. The Government of India entered into different Agreements with the assessee company for the development and manufacture of electronic digital telephone switching equipment of E-10 type in India. In all four Agreements were concluded on the very same day by the Government of India with the assessee company. The first Agreement entered into between the Indian Telephone Industries Ltd., a Government of India Undertaking and the Government of France through the Department of Tele-Communication was for the provision of technical collaboration and grant of licence and transfer technology by the assessee company to the Indian Telephone Industries. This Agreement dated 28th July, 1982 provided that the Government of India and the Government of France entered into a Financial Protocol on 28th May, 1982 providing for the necessary financing for a global tele-communication project, comprising-

- A technical collaboration agreement for licence and transfer of technology;

- An agreement for the supply of machinery, equipment, sub-assemblies, components and raw materials for local manufacture;

- An agreement for the supply of electronic digital telephone exchanges and performance of related services;

- An agreement for research and development assistance.

And by a separate Agreement of even date, the assessee company agreed for the supply of machinery for manufacture and also by another Agreement agreed to furnish research and development assistance to the Ministry of Communication, Government of India. This Agreement provided by various Articles, the definitions of the terms used, the scope of the Agreement, transmission of know-how and technical information, the rights granted, the prices, the royalties, the payments to be made, warranty, liquidated damages, secrecy, remedies for breach, post-contractual provisions, assignment for settlement for disputes etc.

4. The Second Agreement entered into on the very same day between Indian Telephone Industries Ltd., a Government of India Undertaking and the assessee was for the supply of machinery, equipment, sub-assemblies, the components and the raw materials for the manufacture of Digital Time Division Electronic Switching Systems in India. This Agreement also provided for more or less same items as provided for in the first Agreement and this Agreement is to be found in pages 29 to 56 of the paper book.

5. The third Agreement executed on the very same day was between the Secretary, Ministry of Tele-Communications and the assessee for the supply of Electronic Digital Telephone Exchanges and the performance related services. This Agreement is to be found on pages 57 to 89 of the paper book.

6. The 4th and the last Agreement executed on the very same day which was to be found on pages 90 to 118 was between The Secretary, Ministry of Communications, Government of India and the assessee company for provision of Research and Development assistance.

By these four Agreements, the assessee company is to supply the machinery equipment, sub-assemblies, the components and the raw materials and also grant licence and transfer technology and supply electronic Digital Telephone Exchanges and performance related services and also undertake to provide research and development assistance.

7. Now the question arose before the department as to whether the consequence of entering into agreements by the assessee company with the Government of India gave rise to any income taxable in India under the provisions of the Indian Income-tax Act read with the provisions of the Double Taxation Avoidance Agreements entered into between the Government of India and the Government of France.

8. For the assessment year 1984-85, the assessee filed a return showing an income of Rs. 4.61 crores which consisted of receipts of royalties of Rs. 5,00,30,296 and Rs. 22,02,473 as fees received for technical services. Against these receipts, a sum of Rs. 61,02,120 was claimed as expenditure; so that the net income was Rs. 4,61,30,650. Besides the assessee showed receipts of certain amounts as sale consideration of documentation and instrument but treated the same as not taxable by virtue of the provisions of Article III of the Double Taxation Avoidance Agreement between France and India. The assessment was completed by the ITO on 29-3-1985 accepting the income as returned. This assessment was cancelled by the CIT by invoking the provisions of Section 263 and the ITO was directed to make a fresh assessment taking into consideration an aspect namely whether any profit arose on the supply of the equipment by the assessee company to the Government of India in India and whether for that purpose it could be said that the assessee was having a permanent

establishment in India. These are in main the aspects on which enquiry was directed to be made by the Commissioner of Income-tax.

9. Another thing that has to be mentioned here in order to complete the narration of the relevant facts is: the assessee company bound by the Agreement entered into with the Government of India to render services in India to look after the installation of the equipment has to send FYench Engineers very often. The assessee company, therefore, thought it fit that there should be some arrangement in India for organising the reception of such Engineers, helping them in their customs clearance, their transportation, accommodation, maintenance of their residential buildings, making travel arrangements, providing facilities like telephones, telex, accounting Secretarial and other assistance. To achieve this, the assessee company entered into an agreement with an Indian company called Mekaster Consultants (P.) Ltd. on 5-4-1983 for providing, what are described as support services to the French Engineers. This Agreement provided :

> (1) Mekaster is to provide the engineers residing in India with support services including appropriate housing, adequate transport, suitable office facilities including telephone, telex, accounting, secretarial, technical, all travel arrangements, reception, help customs clearance, maintenance of building etc. and other services specified by CIT Alcatel from time to time.
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> (2) Mekaster shall not, in any way, be authorised or empowered to transact any business in the name or on account of CIT Alcatel.
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> (3) In consideration for such support services to the French Engineers, Mekaster was to receive a lump sum of Rs. 60 lakhs Indian Rupees for calendar year 1983. Thereafter the lump sum is to be revised twice a year by mutual agreement of the parties to reflect the volume of the services actually rendered.

10. Now the IAC (Asst.) treated this Agreement entered into with Mekaster Consultancy (P.) Ltd. as having a permanent establishment in India and, therefore, desired the assessee to say: (a) why the assessee-company should not be considered to have maintained an office in India; (b) why the profits from the sales of the equipment made by the assessee company to Indian concerns in pursuance of the contracts should not be taxable in India, notwithstanding the fact that the sales were FOB French Port; (c) why not the provisions of Section 44D of the Income-tax Act should not be applied and a higher rate of tax be levied as against the rate of 20 per cent provided for royalties; and lastly why not the payments made to Mekaster Consultancy (P.) Ltd. which was fixed at Rs. 60 lacs a year to be considered excessive.

The attempt of the IAC (Asst.) was to treat the Mekaster Consultancy (P.) Ltd. as an office maintained by the assessee company in India amounting to having a permanent establishment in India and treating the sales of equipment made to the Government of India, though delivered in France FOB French Port as sales made in India and bring the profits accrued therefrom to tax in India. His attempt was also to disallow a portion of the expenditure paid to Mekaster Consultancy (P.) Ltd.

11. In response to these queries the assessee company replied that it employed Mekaster Consultancy (P.) Ltd. only to arrange and provide the necessary support facilities for their technicians so that the work could be started immediately on arrival of their technicians at a minimum cost and that Mekaster Consultancy (P.) Ltd. and the assessee company entered into a principal to principal agreement for that limited purpose and that did not amount to maintaining an office in India so that it could be said that the assessee company had maintained a permanent establishment in India. It was made clear that Mekaster Consultancy (P.) Ltd. had no part to play in fulfilling these contracts at any point or for that purpose. It was also pointed out that the French technicians of the assessee company were not to involve themselves or in fact involved in the actual installation, erection or assembly work as per the terms of the contract with the Government of India. The actual work was to be performed only by the employees of the Indian Telephone Industries. Mekaster's role was, therefore, to arrange the reception of the French technicians so that they could supervise the work of the employees of the Indian Telephone Industries.

12. The IAC (Asst.) concluded from the Agreement entered into with the Mekaster Consultancy (P.) Ltd. that the assessee did have a permanent establishment in India as defined in the Double Taxation Avoidance Agreement. Addressing himself to the income said to arise from the FOB sales in France, the IAC (Asst.) observed :

> Income from FOB sales was not shown in the return or offered for tax simply because the sales took place outside the Territory of India, totally ignoring the fact that the source of income is in India, the sales and purchases are part of and integrally related to ongoing projects in India in which the constant participation of the assessee is a primary requirement for the project to develop the concerned sales and purchases being only part of the process. The claim of the assessee is as unacceptable as the case of a resident company making sales to another resident company outside the country and thus claiming that it could not pay tax on the gains from the transactions as handing over of the goods and payments therefor took place outside the territory of India.
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> Thus he held that the profits from the sales made to the Indian concerns arose in India and, therefore, taxable in India. He required the assessee to furnish certain details of the quantities and materials supplied, the dates and the money. In response to which the assessee stated that the relevant details were then not readily available and would be supplied after collecting them from France. The assessee did not furnish the details by the time the IAC (Asst.) completed the assessment. The assessee reiterated once again that the profits from sales made outside India were not taxable in India. Rejecting this contention, the IAC (Asst.) proceeded to estimate the income of the assessee attributable to transactions in India on ad hoc basis at Rs. one crore and brought that sum to tax.

13. Turning his attention then to the payments made to the Mekaster Consultancy (P.) Ltd. and also to the application of the provisions of Section 44D, the Inspecting Asstt. Commissioner (Asst.) held that although the assessee had shown income from royalty and technical fee as income from two

separate and distinct sources and debited expenses only against the fees receivable for technical services, as per Section 44D neither any expenditure could be allowed against receipts from royalty nor did the assessee claim any expenditure against royalty. However, the assessee's expenses in respect of technical services far exceeded the fees received resulting in a loss and that loss was sought to be set off against receipts from royalty, thus indirectly deducting expenses from royalty income, which was opposed to the provisions of Section 44D of the Income-tax Act. From the fact that the expenses claimed against fees for technical services far exceeded the receipts, the Inspecting Asstt. Commissioner (Asst.) concluded that the expenses incurred were for other business activities also, which showed that the assessee has some business connection in India. By adopting this logic, the Inspecting Asstt. Commissioner (Asst.) allowed only 50 per cent of the receipts from technical services as expenses and adopted the rest of the expenses as attributable to the income received under the head "Income from business activities". In this manner he recomputed the income starting from the income already computed earlier. To that income of Rs. 5 crores shown as income from royalty, the Inspecting Asstt. Commissioner added the income from technical services received, deducting 50 per cent thereof as expenses and to the resultant sum of Rs. 5,11,31,533, he added the estimated income from business activities of Rs. 1 crore as stated above and arrived at a total income of Rs. 6,11,31,533.

14. For the assessment year 1985-86, adopting a similar basis and method, the Inspecting Asstt. Commissioner computed the income at Rs. 68,16,641 but for this year, he estimated the income from business at Rs. 25 lacs only (as against Rs. 1 crore estimated in the previous assessment year). As in earlier assessment year, he allowed only 50 per cent of the fees received from technical services as expenditure, which worked out to Rs. 43,16,641 (the technical fees received was Rs. 86,33,282). It may be pointed out here that expenses shown by the assessee were Rs. 92,97,267 out of which only Rs. 43,16,641 was allowed. No income from royalty was shown this year.

15. As against these assessments, the assessee felt aggrieved and filed appeals before the Commissioner (A), who by his consolidated order disposed of the appeals accepting almost all the contentions of the assessee. From the analysis of the agreement entered into by the Indian Telephone Industries and the Secretary, Ministry of Communications, Govt. of India and the assessee, he held that the following facts emerged :

> (a) The goods are manufactured by the assessee in France. Indian Telephone Industries have a right to inspect such goods in France.
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> (b) When goods are ready, the assessee company informs the forwarding agents in France, who are appointed by the Indian Telephone Industries and the forwarding agents arranged for the shipment of the goods for and on behalf of the Indian Telephone Industries.
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> (c) The title and risk to the goods supplied passed on to the Indian Telephone Industries in France FOB French Port (Articles 7.4 and 6.1 of the agreement, with Indian Telephone Industries).

(d) Indian Telephone Industries arranged for the insurance cover of the goods commencing from the FOB delivery point in France. The insurance charges are directly paid by the Indian Telephone Industries and settlement and recovery of insurance claim is also the responsibility of the Indian Telephone Industries.

(e) All payments to the assessee company for supply of goods were made in French Frank to the bank account of the assessee company maintained in France Banque Nationale de Paris. The payments were made against French Treasury Loans and the Bank Export Credit as provided for in the Financial Protocol signed on 28th May, 1982 between the Govt. of India and Govt. of France.

Besides the Commissioner (A) also found that there were certain other services to be rendered in France by the assessee company, which included preparation and supply of technical documentation, information and training to the personel of the Indian Telephone Industries in France against stipulated payments.

As regards the service rendered by the assessee company in India, the Commissioner (A) found that under the agreements they related only to supervision of installation. In this context he mentioned two facts, which are necessary and having a bearing on the subject, which we reproduce below :

(a) All amounts invoiced for supervisory services are returned for tax in India, subject to the deduction of expenses as per the Double Taxation Avoidance Agreement between India and France.

(b) The FOB supplies completed in France are anterior in point of time from supervision of their installation in India.

As we have already mentioned to render support services, the assessee company directly entered into an agreement with a company known as Mekaster Consultancy (P.) Ltd.

16. Accepting the assessee's contention, the Commissioner (A) held that under the provisions of Double Taxation Avoidance Agreement entered into between the Govt. of India and the assessee company, the FOB supplies of all the equipments were concluded in France and are not taxable in India under Article 3 of the Double Taxation Avoidance Agreement. The technical services fees for services rendered in India are, however, taxable under the head "Profits and gains of business" after providing for all the expenses in connection therewith as per the provisions of Article 16 of the Double Taxation Avoidance Agreement. Though in both the assessment years the expenses exceeded the technical service fees received resulting in a loss, this loss was liable to be set off against income from royalty treating the entire income as income under the head 'Profits and gains of business' under the provisions of Section 70(1) of the Income-tax Act.

17. On the question of assessee company having a permanent establishment in India, the Commissioner (A) categorically held that the agreement entered into with Mekaster Consultancy (P) Ltd. for providing support services did not amount to having a permanent establishment in India

and that the assessee company could not be said to have any office as such in India. According to the Commissioner (A) such an agreement on a principal to principal basis with a third party in whom the assessee company had no other interest, could not be construed to imply that the assessee company maintained any office when in fact no office space was let out and factually the assessee company had no office. The Commissioner (A) did not also agree with the view of the Inspecting Asstt. Commissioner that merely because the payment for support services were more than the technical services fee received, it could be inferred that a part of the payment to Mekaster Consultancy (P) Ltd. was attributable to the FOB supplies made in France for the reason that the FOB supplies were anterior in point of time to the supervision of the installation carried out by the French Engineers in India.

18. Turning his attention to Article II(1)(bb) of the Double Taxation Avoidance Agreement and the protocol dated 26th March, 1969 entered into between the Govt. of India and the Govt. of France, the Commissioner (A) held that merely because supervision charges were paid in India, it did not amount to having a permanent establishment in India within the meaning of that Article or the protocol. The Commissioner (A) had pointed out, in our opinion very rightly, that both under the Article II(1)(bb) and the Protocol, there must be a construction, installation and assembly project in one of the contracting States, so that it could be said that it has maintained a fixed place of business. Here he found that the installation was not carried out by the French Engineers nor by the assessee company. The installation was carried out entirely by the employees of the Indian Telephone Industries and the Indian Postal and Telephone Department not only in fact but also as per the agreement and that the French Engineers have only supervised or advised them on installation and that advice for installation did not amount to carrying on of the installation work as was understood or meant in the Article II(1)(bb) or the protocol referred to above. In this context he relied upon a decision of the Andhra Pradesh High Court in the case of CIT v. Hindustan Shipyard Ltd. [1977] 109 ITR 158 where the Andhra Pradesh High Court held that in a case where supplies were made outside India followed by supervision of installation in India, it did not amount to having any business connection in India. A similar view was also taken in another case by the same High Court in the case of CIT v. Visakhapatnam Port Trust [1983] 144 ITR 146 : 15 Taxman 72 where also it was held that when supplies were made outside India and when the installation was supervised by the engineers, it could not be said that there was a permanent establishment in India. The Commissioner (A) also placed reliance in this context on a decision of the Income-tax Appellate Tribunal, Delhi Bench in the case of Bharat Heavy Electricals Ltd. v. ITO [IT Appeal No. 233 (Delhi) of 1981]. Another important aspect that the Commissioner (A) noted was that on comparison the Double Taxation Avoidance Agreement entered into with France did not provide for supervisory activities as amounting to having a permanent establishment in India unlike the other Double Taxation Avoidance Agreement entered into with some other countries. Therefore this was added as an additional reason to conclude that there was no permanent establishment in India maintained by the assessee company.

19. Dealing with the alternative argument that even if a permanent establishment was maintained in India, whether any part of the profits relating to the FOB sales could be taxed in India, the Commissioner (A) held that even this was not possible because no activities whatsoever relating to the FOB supplies in France were carried out in India. Unless there are operations carried on by the

permanent establishment in India, no profits can be attributed to the operations and therefore no profit could be said to arise in India. He thus found that neither there was any permanent establishment in India maintained by the assessee company nor there were any activities carried on by only permanent establishment in India even if there was one, so that any profit could be attributed to those operations. He then referred to Section 9(1)(i) of the Income-tax Act to find out whether there was any business connection. Here again he held that even in the case of a business of which all operations are not carried out in India, the income that can be said to accrue or arise in India could only be that which could reasonably be attributed to the operations carried out in India. Since no operations were carried out in India at all, no profits could be attributed even assuming that there was a business connection. In this context he placed reliance upon two Supreme Court judgments, one in the case of Carborandum Co. v. CIT [1977] 108 ITR 335 and again in CIT v. Toshoku Ltd. [1980] 125 ITR 525 : 4 Taxman 1 . Since all the steps relating to the completion of the FOB supplies were concluded in France, the goods were delivered to the Indian Telephone Industries Forwarding agents in France and since Indian Telephone Industries paid for the insurance and freight, the Commissioner (A) held and again in our opinion rightly, that the ownership in the goods was transferred in France to the Indian Telephone Industries and no activities relating to such supplies were done in India. Having come to this conclusion, he held that no income can be attributed as having arisen in India in respect of FOB supplies made by the assessee company and were completed in France. He therefore deleted the addition of Rs. 1 crore made in the assessment year 1984-85 and Rs. 25 lacs made in the assessment year 1985-86.

20. Dealing with the disallowance of a portion of the expenses claimed against technical service fees received, the Commissioner (Appeal) held:

> I have carefully considered the position. The fact remains that-
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> (1) the agreement with Mekaster was on a principal to principal basis and the appellant is in no way connected or otherwise interested in Mekaster.
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> (2) the payments to Mekaster were contractual obligations and there is no dispute that the amounts had actually been paid.
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> (3) the agreement specifically provides that the payments are for support services to be provided by Mekaster to the French Engineers who come to India. The payments have nothing to do with FOB supplies already concluded in France and which are anterior in point of time.
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> (4) Article XVI of the DTA agreement with France specifically provides for deduction of the expenses incurred in India in connection with the rendering of the technical services, the said article reads as under :
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> Amounts paid by an enterprise of one of the Contracting State for technical services furnished by an enterprise of the other Contracting State shall not be subjected to tax in the first-mentioned Contracting State except insofar as such amounts are

> attributable to activities actually performed in the first-mentioned Contracting State. In computing the income so subjected to tax, there shall be allowed as deductions the expenses incurred in the first-mentioned Contracting State in connection with the activities performed in that Contracting State.
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> The factual position remains that the payments to Mekaster and other expenses which are essentially salary, travelling and transport in connection with the French Engineers were incurred in India. The provisions of the DTA overrides the provisions in the Income-tax Act.
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> In view of the above, the disallowances of the expenses claimed were not justified and the IAC(Asst.) is directed to allow Rs. 60,97,120 in asst. year 1984-85 and Rs. 92,97,267 in asst. year 1985-86.

21. Dealing with the question that when as a result of the allowance of full expenses from technical service fees, such loss could be set off against income from royalty, the Commissioner (A) held that as per Section 70(1) of the Income-tax Act, if the net result in any source falling under any head of income is a loss, such loss can be set off against the income from any other source under the same head and therefore the loss from the technical service fees in the assessment year 1984-85 could be set off against the income from the source royalty and only the balance of royalty could be subjected to tax. In this connection, he compared the Double Taxation Avoidance Agreement and found no suggestion to the contrary in it. Thus the Commissioner (Appeals) held on almost all the important points against the view held by the Inspecting Asstt. Commissioner (Assessment), aggrieved by which the department has filed the further appeals before us.

22. The learned Departmental Representative Shri Sandeep Tandon made a very valiant effort assisted by his learned colleagues to impress upon us that the views adopted by the Commissioner (A) on the study of this agreement was totally unjustified, untenable and those agreements do not bear out those conclusions. In this effort, he took us through all the agreements, throughout almost all the clauses and submitted that all the four agreements related to only one transaction, namely, developing, manufacturing and installation of the Digital Time Division Electronic Switching System under the designation E-10 in India through the Ministry of Communications of the Government of India and with a view to avoid payment of tax under the Indian Tax Laws a deliberate attempt was made by the assessee company to split up this single transaction into four different transactions as if each one of them is separate, independent and distinct from the other. He points out that unless all of them are put together or one after the other and carried out systematically, the main object of establishing in India the system mentioned in the agreements was not possible. Granting of Licence under one agreement, supply of machinery, equipments etc. in another agreement, supply of Electronic Digital Telephone Exchanges and performance of the related services in another agreement and lastly providing for research and development assistance under another agreement, all constituted the series of one transaction, namely, supply of machinery, equipment for undertaking the manufacture of the said Electronic Digital Switching Equipment in India and therefore these agreements, though entered as separate agreements but all on one day, should not be seen as separate agreements but should be seen as only one agreement. This was his first

submission, perhaps the bedrock of his argument to contend that the Inspecting Asstt. Commissioner made a correct addition. Now building upon this foundation, he submitted that again relying upon various clauses of the agreement, the end-product is establishment of a factory in India for the manufacture of equipment. All the four agreements put together would only lead to the achievement of that object, namely, it is like a works contract for the supply of materials also and therefore there was no sale involved in it. In the case of a works contract, where there was no sale of material involved and when the end result was installation of the licensed system, the question of conveying the title in the goods in France when FOB sales were made to a Port in France, did not arise. The entire contract is turnkey contract but cleverly shown as if they are four different contracts. Since the entire thing is only one contract, the title in the goods passed on to the Government or its agency only when the installation was complete and when an acceptance certificate as provided for in the agreement was issued by the concerned authority in India, namely, the Secretary, Ministry of Communications. Till the certificate of acceptance was issued by the concerned authority, the title in the equipment remained with the assessee company and did not pass on to the Indian Telephone Industries as was wrongly assumed by the Commissioner (Appeals). These machines are such that they cannot run on their own. They do not have any independent existence. They come into a working condition into an integrated whole only when they are properly erected, installed and assembled and put on trials. That was the reason why there was insistence for the issue of an acceptance certificate. Purpose of insisting on an acceptance certificate was only to show that the responsibility of the assessee company was not absolved on handing over a perfected system, however much the performance might have been, which meant that they continue to have interest over the entire equipment. Reckoning from the time the equipment was shipped in France, received in India, installed in India under the supervision of their engineers, the entire transaction being one integrated whole, it is impossible to say as was held by the Commissioner (Appeals) that there were no operations carried on in India. The Commissioner (A) was also wrong in saying that since the property in the goods passed on to the Indian Telephone Industries in France, no operation could be said to have been carried on in India, which ignores the fact that installation was carried out in India and each one of the French Technicians, who came to India, stayed for more than three months, which was the minimum period required under the Protocol for the purpose of giving rise to a presumption that a permanent establishment in India was maintained. This aspect has totally been ignored by the learned Commissioner (A).

23. He then made a reference to warranty clause and then submitted based upon it, that the intention was to instal the system as a whole and consequently the property in the goods did not pass on to the Indian Telephone Industries. In this context he placed reliance upon the provisions of Section 19 of the Indian Sale of Goods Act, which provided that the property in the goods would pass only on the completion of the installation, because that was the terms of the contract of sale. He pointed out in this context that the intention of the parties was never to purchase the machinery in parts though for the purpose of facility, shipment might have been made in parts by dismentling the machinery and mentling it here. He made again a reference to the three ingredients provided in the Sale of Goods Act to impress upon us that the property in the goods did not pass on to the Indian Telephone Industries till the completion of the installation. When the attempt of the assessee was to avoid payment of tax by cleverly adopting methods to defeat the provisions of law, he submitted that the Courts including the Tribunals should not be a party thereto and should not encourage it.

24. By referring to the agreements and the activities that were carried on by the assessee company in India through Mekaster Consultancy (P.) Ltd., the learned Departmental Representative Shri Tandon submitted that there was a business connection in India and therefore profits must be deemed to accrue in India and that profit, which accrued in India, had to be estimated because the assessee had failed to cooperate with the Department by furnishing the necessary details called for. Once it was established that there was a business connection in India, there was no option left to the Income-tax Department except to estimate the profits attributable to those operations. The Act itself gave the authority to the Income-tax Officer to estimate the profit. The only thing that could be said was whether the estimate was excessive or not but the factum of arisal of income and its quantification by estimate could not be questioned.

25. Dealing with the agreement entered into with Mekaster, he pointed out that that amounted to having a permanent establishment in India because the engineers who came to India stayed for more than three months. The inferences drawn by the Commissioner (A) in this behalf are, according to him, only fallacious. He made references to the interpretation of Statutes by invoking what is known as Heydon's rule, that the Court must see what the mischief the assessee was trying to do and frustrate it by placing proper interpretation on the documents. He placed reliance on the decisions in Bengal Immunity Co. Ltd. v. State of Bihar AIR 1955 SC 661, lastly R.M.D. Chamarbaugwalla v. Union of India AIR 1957 SC 628 and CIT v. Smt. Sodra Devi AIR 1957 SC 832. By referring to the famous treatise on Partnership Act by Pollock and Mulla, he submitted that the property in the goods passed on to the assessee in India and not in France. He made references to the decisions of the various High Courts in the cases of CIT v. Tata Chemicals Ltd. [1974] 94 ITR 85 (Bom.), Toshoku Ltd.'s case (supra), Carborandum Co.'s case (supra) and CIT v. Atlas Steel Co. Ltd. [1987] 164 ITR 401 : [1986] 28 Taxman 462 (Cal.) to wind up his argument by saying that the entire contract must be seen as integrated whole, the property in the goods passed on in India, there were operations carried on in India, there was a permanent establishment maintained by the assessee company in India through Mekaster Consultancy (P.) Ltd. and therefore profit has to be estimated and the estimate made by the department having been reasonable should not have been interfered with by the Commissioner (Appeals).

26. Dealing with the question of set off of expenditure, the learned Departmental Representative submitted that the entire expenditure should not have been allocated to technical services. Under Section 44D of the Income-tax Act, no allowance can be made against income from royalty. Therefore the Commissioner (Appeals) erred in setting off the loss against the income from royalty by which he contravened the express provisions of Section 44D. The income from royalty has to be taxed under Section 115A of the Income-tax Act at 20 per cent. There is no scope to reduce the income from royalty by allowing any expenditure against it. He then submitted that since the object of enacting Section 115A is to levy tax at 20 per cent on the gross amount of royalty and this was sought to be achieved by enacting Section 44D prohibiting allowance of any expenditure from income from royalty, even if there is any ambiguity in the language used, that ambiguity must be resolved in favour of the Revenue because in construing a fiscal Statute if the construction sought to be placed defeats the very object sought by the Legislature, that construction must be avoided. For this rule of interpretation and proposition, he placed reliance upon the decision of the Supreme Court in the case of CIT v. S. Teja Singh [1959] 35 ITR 408 and supported it by referring to another

decision of the Supreme Court in the case of CIT v. Godavari Sugar Mills Ltd. [1967] 63 ITR 310 and also in the case of S.A.L. Narayan Row v. Ishwarlal Bhagwandas [1965] 57 ITR 149 and AIR SC 395 (sic). In sum his argument was that the expenditure incurred should not have been allowed against technical service fees and in any case setting it off against the income from royalty was against the specific law. The plea of the department that a part of the expenditure was incurred in a bid to support the entire activity relating to the installation, supply and supervision of the entire project in India should have been upheld.

27. Reacting to these arguments the learned senior Advocate Shri N.A. Palkhivala submitted that the attempt of the revenue appears to be to rewrite the agreements in a bid to support its contention, which was not only impermissible in Law but also was based upon suppositions and conjectures. When the parties to the agreement were none other than a Government undertaking, the Indian Telephone Industries, the Indian Post and Telegraph Department and the Secretary, Ministry of Communications, Government of India, how can it be possible that they being part of the Government and custodians of the revenue of the Government become a party to tax avoidance deliberately by contributing to the idea said to have been floated by the assessee company. How can this argument be countenanced except when we say that there was a collusion between the Secretary, Ministry of Communications, who entered into agreement on behalf of the President of India and the assessee company. The purpose of the Court is not to rewrite the agreement but to interpret the agreement. Each agreement is for a specific purpose and each purpose is delienated and distinguished and a separate fee was fixed with separate conditions. All of them cannot be integrated into one so as to call it as a turnkey project. The effort of the Government of India is to train its officers in France in the manufacture and operations of the system and instal them in India for the betterment of the communication system in the country. It has no other purpose. This is not a commercial transaction entered into by the Government of India with the assessee-company. This is purely a service orientated contract to improve the conditions of communications in the country. The foreign technicians were required to assist the installation of the equipment in India by the employees of the Indian Telephone Industries. This was amply, clearly, vividly provided for in the agreements. Those agreements cannot be forsaken or jettisoned to give a different colour and a meaning which the parties never intended. Therefore there can be any question of forging. Since the Government of India is a party to the agreement, the question of tax avoidance could never arise. The agreements have to be understood as they are and they must be interpreted as they are and the legal conclusions therefrom must be drawn as they are and not by interpreting them as one, which the department intends in their bid of conjectures.

28. Secondly he pointed out that under the agreements, the Government of India agreed to pay the tax due by the assessee. Whatever tax that was levied by the Income-tax Department on the assessee company, under the agreement will have to be paid by the Government of India, Ministry of Communications. If the agreement is to be interpreted in the manner in which the Department wants it to be done, the loser is certainly the Government of India because the Revenue goes from one pocket of the department to another pocket of the same Government. There could not have been therefore any contemplation of tax avoidance because under the agreement convenience, facility, economy and early execution and imparting of training to our personnel, which is so important in the interest of the Nation were the basic motives and none else. This aspect should not have been

given a go-bye by the department in putting upon this agreement a queer interpretation of a turnkey project, which was never intended by the parties.

29. He then referred to the written arguments filed before the Commissioner (A), which were at pages 179 to 290 in the paper book and submitted that every aspect was very properly explained and was understood by the Commissioner (A) and the Commissioner (A) has given a very cogent, sustained and correct reasons and conclusions and those are unassailable and unexceptionable and should not be interfered with. Under the terms of the contract, the material was delivered in France to the Indian Telephone Industries, the payment was received in France, the insurance cover on the material was taken by the Indian Telephone Industries from the Port in France to the Port in India, the entire expenditure was borne by the Government of India and consequently the sale was complete in France. There was no other operation connected to or connectable to the sale or receipt of the equipment. Therefore the Commissioner (A) was right in saying that in respect of those sales, which were completed in France on delivery, in respect of which the title in the goods had passed on to the Indian Telephone Industries, no services whatsoever were rendered in India. We cannot therefore impute any service just to bring it in the net of Indian taxation by all too round a method. He then submitted that the warranty in a contract of sale does not have anything to do with the passing of the title. It only gives rise to damages. That will not prove that the title in the goods had not passed. He therefore tried to demolish the argument of the department based upon the warranty clause.

30. Dealing with the agreement entered into by the assessee company with Mekaster, the learned Advocate Shri N.A. Palkhivala submitted that it was to give assistance to the engineers, who came to India. That assistance would not amount to maintaining either a permanent establishment in India or amounts to a business connection or amounts to maintaining an office in India. If Mekaster had not done this arrangement, it would have been done by some one else and the expenditure to be incurred thereon would be either more or less or in the same neighbourhood. Instead of leaving the foreign technicians to fend for themselves in India, if a reception in India was organised, it does not amount that it was maintaining a permanent establishment in India. Therefore the agreement with Mekaster was misconstrued by the Inspecting Asstt. Commissioner and so also by the learned Departmental Representative but the Commissioner (A) has correctly understood it and that understanding should be upheld.

31. Dealing with Section 70 of the Income-tax Act and the allowance of expenses from income from royalty, the learned Advocate submitted that it is a settled law that royalty is a separate source, so is the income from technical services. Section 70 provided for the set off of loss from one source to another source under the same head. There was therefore, no disharmony except a misunderstanding of the provisions. The Commissioner (A) has rightly understood this provision and gave the appropriate relief. Anything other than what the Commissioner (A) had done would contravene and violate the specific provision of the Income-tax Act. The department does not deny or dispute that royalty was not a separate source of income as is the fees received from technical services and so Section 70 was automatically attracted if there is a loss in one source and income from another source, both of them falling under the same head. The set off was therefore inevitable and was rightly done by the Commissioner (A).

32. Shri Palkhivala went to the extent of saying that he would even concede that there was a permanent establishment in India as well as a business connection. But even then he submitted that only a reasonable profit can be estimated attributable to the operations carried on in India provided there are operations in India attributable to the FOB sales. The operations carried on in India were only supervising the installation, which do not amount to installation and therefore falls outside the scope of the provisions of the Double Taxation Avoidance Agreement. The provision of services to the engineers, that come from France, cannot also amount to carrying on any operation. Therefore the question of estimating profit did not arise. In any case the profit estimated at Rs. 1 crore in the assessment year 1984-85 is exorbitantly high, baseless and arbitrary. It cannot therefore be sustained even on the ground of reasonableness, fairness and equity. He thus submitted by referring us to the relevant Articles and refuting the arguments raised on behalf of the department, that the conclusions of the Commissioner (A) were correct and should be upheld. These are in main the arguments addressed to us from both the sides.

33. Shri Palkhivala did not in particular deal with the question as to when the property in the goods can be said to have passed on to the Indian party under the Sale of Goods Act, as in his view that question did not arise at all in this case as everything both in fact and in law, that could be said in favour of passing of the title in the goods under the Sale of Goods Act and other decided cases of law, had already passed on to the Indian party in France and nothing else remained to be done in India to convey the title from the assessee company to the Indian party. Shri Palkhivala wound up his arguments by reiterating the fact that the contracts entered into between the assessee company and the Government of India being different and distinct contracts not being one, should not be seen as one as urged on behalf of the department much less a turnkey project or a works contract so as to say that the title in it passed on to the Indian party only when the contract was totally completed in execution and handed over to the Indian party after the issue of acceptance certificate. The issue of acceptance certificate was insisted upon not. for the purpose of conveyance of title but for the purpose of settling the payments. Settling the payments is totally a different concept from the doctrine of conveyance of title.

34. After carefully considering these arguments, perusing the agreements and the orders passed by the learned Commissioner (A) and the Inspecting Asstt. Commissioner (Asst.), we have come to this conclusion that the Commissioner (A) was eminently justified in deleting the entire addition made on ad hoc basis as baseless and uncalled for. To recapitulate the entire case of the department was that some transactions in respect of these agreements relatable to the sale of goods had taken place in India and in respect of those transactions some profit has to be estimated. For this purpose they went into the question of the assessee company having to maintain a permanent establishment in India. Since no permanent establishment was maintained by the assessee company directly or indirectly, the agreement entered into with Mekaster Consultancy (P.) Ltd. was construed as amounting to maintaining a permanent establishment in India all because the Mekaster Consultancy (P.) Ltd. have been entrusted with the task of receiving the foreign technicians as and when they arrive, look after their accommmodation, transport and other facilities. Having thus interpreted the agreement with Mekaster Consultancy (P.) Ltd. as amounting to maintaining a permanent establishment in India, it ignored the fact that the equipment handed over to the Indian party in France FOB France Port did not complete the conveyance of title in full. It then proceeded

to tag on the supervision of installation by the foreign technicians of the assessee company as amounting to some part left over for the purpose of completing the performance of conveyance of title in the goods sold to the Indian party. Having thus laid the scheme of attributing a part of the profit to the alleged transactions attributable to the sale in India by invoking the provisions of Section 9 of the Indian Income-tax Act and also the relevant provisions of the Double Taxation Avoidance Agreement, they did not find any material to estimate on. Therefore the Inspecting Asstt. Commissioner (Asst.) very abruptly estimated this part of the income at Rs. 1 crore throwing the blame upon the assessee for not furnishing the details, overlooking the fact that those very details could have been obtained by simply writing a letter to the Ministry of Communications, which was the party for the receipt of the goods and was responsible for the installation of the equipment. This appeared to us to be the view and object of the department in bringing this sum to tax. In this process as we have endeavoured to summarise the action of the department as above, there are certain assumptions made. The very first assumption was that the title in the goods was not passed to the Indian party at France. This is contrary to the agreement. We do not propose to quote the Articles relevant in the agreement entered into between the assessee company and the Government of India because it is agreed that all the sales are FOB a France Port. The goods were delivered to a designated agent of the Government of India in the Ministry of Communications represented by the Indian Telephone Industries. When the representative received the goods in France FOB French Port, under the relevant law of sale of goods, the property in the goods passed on from the assessee company, the seller, to the Indian Telephone Industries, the buyer. This is very clear from the provisions of Sections 20 to 24 of the Sale of Goods Act, which we are not deliberately reproducing here in order not to burden this order with those provisions. If the title in the goods continues to vest in the seller, i.e., the assessee company, the assessee company would have taken the insurance cover for the goods during transit. That was not done. The insurance cover was taken by the buyer, namely, the Indian Telephone Industries and it paid the entire money. If any damage had taken place during transit, the seller i.e. the assessee company was completely exonerated from the risk of paying the damages. The seller did not even retain the lien because under the agreement it received the entire payment in French Francs in a named French Bank. Thus the goods under the contract were appropriated to the buyer in France, delivered to the buyer in France, the risk from then on was taken over by the Indian Telephone Industries, the title in the goods having passed on to the Indian Telephone Industries. The payment was also made in France. Nothing therefore remained to be done to complete the conveyance in the title of the goods from the assessee company to the buyer i.e. the Indian Telephone Industries. Nothing therefore remained by way of conducting any operation in India in order to complete the sale so as to convey the title. The title in the goods had already been conveyed to the Indian party in France and the assessee company ceased to be the owner of the goods in any sense of the term.

35. The agreements that were entered into with the assessee company were executed by the Government of India through the Ministry of Communications. As rightly observed by Shri Palkhivala, it is too much to expect that the Government of India through its Secretary in the Ministry of Communications had consciously become a party for the purpose of tax planning all to help the assessee company to avoid payment of the due tax being fully aware of the tax implications by permitting the foreign party i.e. the assessee company to split up the agreement into four different transactions. Unless there was imperative need, which the revenue department is unable to

grasp, these four agreements would not have been entered into if the transaction was only one. As we have pointed out in the beginning of this order the scope of the first agreement, which provides for technical collaboration, grant of licence and the transfer of technology was provided in Articles 2 and 3 of the agreement and it was clearly provided in Article 2 that:

> The extent of cooperation and assistance by and between CIT-Alcatel and the Licensee shall be:
>
> (a) granting the licence under Patents and the Know-how including Technical information, for the manufacture, use and sale of the Licensed system, Licensed Components and Improvements;
>
> (b) furnishing of Technical Information by CIT-Alcatel to the Licensee;
>
> (c) training of the Licensee's Engineers/technicians by CIT-Alcatel;
>
> (d) rendering of Technical Assistance by CIT-Alcatel;
>
> (e) mutual transmission of information relating to Improvements and outline information relating to New Systems.

Then Article 3 provided the means of transfer. This is the scope and object of the first agreement, which is essentially for the grant of licence and parting with the know-how and technical information for the manufacture, use and sale of the licensed system, which has nothing to do with the installation, equipment etc. Nor can it be said that the furnishing of technical information can be a part of erection; nor can the training be associated with erection. These are all independent objects which have to be independently dealt with and that was the reason why these agreements were separately entered into and it is therefore not possible to see them as one and the same. May be, it can be viewed that the object being the erection of this equipment in India, which is a major head, the other aspects are complementary and auxilary meant to perfect the system and make it operationally independent in order that after erection the system continue to work efficiently without having to depend upon the foreign technicians either for repairs or for training or for the use of that information or erection of similar equipment elsewhere in the country.

36. The second agreement which is in a way the most crucial agreement for our present purpose, deals with the supply of machinery, equipment, sub-assemblies, the components and the raw materials for the manufacture of Digital Time Division Electronic Switching System in India. The scope of this agreement was laid down in Article 2 and it says that it was for the supply of the components, pieces, parts including semi-knocked down/completely knocked down materials, proprietary items and the raw materials under the conditions mentioned in Annexure 3 and to supply the knowledge and expertise, advice concerning the installation and the operation of the machinery and also to supply the integrated lay out of all sections of the factory including the machinery, production and service shop. Under this agreement by Article 6 shipment and deliveries were provided. It stated that the machinery shall be delivered FOB French Port or Airport, according

to the Incoterms 1953 as amended. It also provided that in case of any delay in despatch of shipping documents or discrepancies attributable to the assessee, the assessee shall be responsible to compensate the Indian Telephone Industries for losses. Most significant term in this Article 6 is provided in Clauses 6.2 and 6.3. Article 6.2 provided that immediately on the agreement becoming effective, the assessee shall contact the Secretary, Shipping Coordination Committee, Transport Bhavan, New Delhi and furnish data to him in the prescribed proforma to enable him to make arrangements with the accredited Forwarding Agent. Article 6.3 then provided that the shipping arrangements will be made by the Indian Telephone Industries Forwarding Agent. The rest of the clause is not necessary for our present purpose. This shows that the delivery of the goods contracted to be supplied under this agreement is to be delivered to the ITI's Forwarding Agent FOB French Port according to the Incoterms of 1953, which also substantiated that the delivery is complete and the title in the goods had passed on to the Indian Telephone Industries in France itself. Under Article 6.8 a special provision was made for insurance by providing that the payment of insurance charges to the insurer and settlement and recovery of insurance claims will be done by the Indian Telephone Industries and the Insurance shall be for destination value by Indian Telephone Industries and the insurance cover will commence from FOB delivery point.

There is another point which needs mention here because the particular emphasis was made by the learned Departmental Representative i.e. Article 7 - Inspection Clause. This clause provided that the machinery manufactured by the assessee company may be inspected by the representatives of the Indian Telephone Industries only for the purpose of checking, adherence to quality and operation standards usually applied by the assessee company, on assessee company giving a reasonable advance notice before the inspections are due. The Inspectors are given the right to access to all parts of the assessee company where the machinery has to be inspected and that the inspection shall be free. The relevant clause on which reliance was placed with greater emphasis was on the following provision of Clause (a) :

> Where the standards are met, the inspectors shall issue a certificate regarding the machinery which shall not constitute an acceptance as in Article 9 (which shall occur only after delivery and acceptance test of the machinery at Site). The inspectors shall have the right to reject the machinery if the standards are not met.
>
> The learned Departmental Representative's argument was that the inspection provided is subject to the issuance of an acceptance certificate in Article 9 and therefore, the provisional inspection certificate issued by the Inspectors does not amount to conveying the title, inasmuch as, under Article 9, which we shall presently show, the power is given to the Indian Telephone Industries to reject even the Inspector's certificate of acceptance. In Article 9 it was provided that the inspection and test by the Inspectors have to take place within 90 days after arrival of the machinery at site or at the latest within 120 days after arrival of the machinery in India. Then it says further down that :
>
> Where ITI is satisfied that the results of such inspection and tests for acceptance indicate that the standards are met, ITI shall issue an acceptance certificate which

shall constitute an acceptance. ITI shall have the right to reject the Machinery if the standards are not met. CIT-Alcatel shall within the appropriate time for acceptance, at its own expense, repair or replace such rejected machinery.

Relying upon this provision, the learned Departmental Representative submitted that since acceptance was made a condition for the acceptance of the goods, the title in the goods shall be deemed to have been conveyed only after the issuance of the acceptance certificate and since acceptance certificate is to be issued by the Indian Telephone Industries in India, the title in the goods had not passed till the issue of the acceptance certificate. Then Clause 9.5 provided :

9.5 Upon issuance of the Acceptance Certificate, CIT - Alcatel shall be released from its obligations relating to the Machinery, with the exception of warranty obligations provided in Article 10.

This argument was also pressed into service to support the argument that till the issuance of the acceptance certificate, the assessee company was not released from its obligations related to the machinery and therefore the conveyance of the title was not complete. Therefore the operations carried out in India do constitute operations within the meaning of Section 9 of the Income-tax Act.

37. Upon a careful consideration of these submissions and Articles, we are unable to agree with him because the inspection originally provided for in Article 7 was at the site in France within a period of 90 days. That inspection was insisted upon as a provisional inspection prelude to the shipment of the goods. Since there is a possibility for the Inspectors to omit certain essentials due to inexperience and in the actual execution some defects might crop at by another Article 9, it was provided that the power to issue the final acceptance certificate was retained with the Indian Telephone Industries. It therefore says that it has the right to reject the machinery if the standards are not met. It then immediately provided that the assessee company shall at its own expense repair, replace such rejected machinery. The obligation of the assessee company is only to supply at its own expense replacements and carry out repairs. If the goods belonged to the assessee company, as was argued on behalf of the Department, the question of repair or replacement does not arise. Therefore this is a clause which ensures that the equipment after installation shall work smoothly and for any defect found in the running of the machinery, no extra expense was to be incurred by the Indian Telephone Industries. That was the reason why in Article 9.5 it was provided that upon issuance of the acceptance certificate, the assessee company is released from its obligations related to the machinery. Now what are those obligations related to the machinery? They are all provided in Articles 2, 6, 7, 8 and 9, which provided for scope of the agreement, inspection, shipment and installation. When we go to the installation of machinery in Article 8, it clearly provides that :

Article 8 - Installation of Machinery 8.1 The Installation of Machinery shall be carried out by qualified employees of ITI.

8.2 CIT-Alcatel may have one representative present at each Site during the Installation of the Machinery as per programme and planning to be mutually agreed.

8.3 CIT-Alcatel shall supply ITI with general installation specifications (assembling instructions and drawings) issued by CIT-Alcatel or the relevant manufacturers.

8.4 A general plan for installation at the Site and a particular plan for the installation of each Machinery shall be prepared by mutual agreement of the Parties.

8.5 Should there be need to store the Machinery ITI will do so at its expense under conditions recommended by CIT-Alcatel.

8.6 Installation supervision CIT-Alcatel's supervisor(s) shall:

- plan the Installation Work in cooperation with ITI's representative.

- supervise the Installation Work in cooperation with ITI's representative.

- advise ITI on the Installation and testing procedure to prevent fault and/or deviations or to correct faults and/or deviations if they have occurred in the course of ITI's performance of installation.

- ITI's representatives shall have full authority to act in the name and on behalf of ITI concerning installations and testing under this agreement and will:

- discuss problems that may occur during Installation and testing with CIT-Alcatel's supervision in order to avoid delays, deviations and/or faults that may occur during performance of the Installation.

8.7 Obligations and liabilities

(a) It is mutually agreed that in fulfilling the obligations under this Agreement, neither Party shall make changes or deviations in the volume, the provisional schedule or kind of Installation services agreed upon without the approval of the other Party.

(b) Any changes in the volume, the schedule or the kind of installation services will be approved by both Parties in writing.

(c) Defective Installation by ITI's personnel resulting from incorrect instructions given by CIT-Alcatel's personnel or in consequence of its drawings shall be the responsibility of CIT-Alcatel.

(d) ITI shall use its best efforts to facilitate temporary import of tools and grant of the necessary visas for French personnel deputed to India for Installation.

A reading of this Article would show that the installation of the machinery is to be carried out by qualified employees of the Indian Telephone Industries. The assessee company may have one representative present at the site during installation to supply with general installation specifications. If there is any need to store the machinery, ITI will do so at its own expense. The assessee company's supervisor would only plan installation, that too supervise installation again in cooperation with the ITI's representative, tender advice as and when it was needed to remove the faults. It is ITI's representative, that shall have full authority to act in the name and on behalf of the ITI concerning installation and testing under the agreement. Under the agreement the obligations cast upon the assessee company was only in the event of the defective installation by the employees of the ITI as a consequence of any incorrect instruction. The responsibility for the import of necessary tools was cast upon the ITI. We do not think that this installation in India under this agreement can amount to any sale of services because the entire price to be paid is provided for in Article 4 of the agreement, which is by drawing on the French Treasury Loans as provided for in the Financial Protocol signed between the Government of India and the Government of France. All the payments are to be made in French Francs to its bank account maintained with Banque Natlonale de Paris, France. Therefore a provision for supervision of installation is not installation. We therefore agree with the view expressed by the learned Commissioner (A) that supervision is something different from installation work and as we have seen the specific provision in the Articles was that the installation shall be carried out only by the employees of the Indian Telephone Industries and not by the employees of the assessee company. Therefore the installation cannot be said to amount to carrying out any operations in India. Now we have seen that the sale of goods was complete outside India and in the process of installation, the assessee company has nothing to do other than to tender advice. The acceptance certificate, which was insisted upon under the agreement, on which reliance was placed by the learned Departmental Representative, does not also refer to any retention of even a modicum of title in the assessee company. That was to facilitate their own convenience. So the issue of acceptance certificate not having to do anything with the passing of the title, cannot be construed as urged on behalf of the Revenue that the passing of the title has been kept in abeyance. The intention to insist upon issuance of acceptance certificate is only to ensure that the machinery supplied answered to the description and performance to the satisfaction. Nothing beyond that. That was why it was said that all the obligations of the assessee company relating to machinery shall be complete only on the issuance of the acceptance certificate, which means such of those obligations, which are related to the machinery, namely, installation, their proper performance etc. We are therefore not able to subscribe to the view that acceptance certificate has anything to do with the conveyance of the title. In the same strain, we cannot also construe that the training of the personnel in India has anything to do with the performance of any services or operations related to the sale of machinery. Whatever is payable for rendering technical services by way of royalty has already been brought to tax and that is not in dispute. Since the object of setting aside the assessment pursuant to the order passed by the Commissioner of Income-tax under Section 263 was to find out whether there was any profit attributable to the transaction of sale of machinery and since we have seen none of the transactions relatable to the sale of machinery was performed in India, no part of the profit can be said to have arisen in respect of such transactions, which were completed outside India and therefore the estimate of income at Rs. 1 crore is totally uncalled for, unwarranted and arbitrary also. The view taken by the Commissioner (A) on this issue is perfectly justified.

38. In conclusion we would like to mention that under the agreement for the supply of Electronic Digital Telephone Exchanges and performance of related services, Article 5.3.2 provides :

> Any Indian duty, tax or charge on prices will be paid by the Purchaser or if amounts are withheld from such prices by any Indian Governmental Authority or sub-division thereof, they will be immediately reimbursed by the Purchaser to the Supplier.
>
> Similarly in the next Article 5.3.3 it was provided that :
>
> Any tax or duty imposed by the French Governmental Authority up to the point of FOB delivery shall be borne by the Supplier.
>
> The above clause would show that whatever be the tax that is levied by the Government of India in respect of these transactions will have to be paid by the purchaser, i.e., Government of India in another Department, provided the interpretation of this clause is that the expression any tax would mean tax on income and not tax on purchases. If so and assuming the claims of the Revenue are correct, then the tax levied by the Income-tax Department will have to be paid by another Department of Government of India. In view of this Article it cannot any more be said that all the four agreements constitute one single transaction as was construed by the department and that there was an apparent collusion to evade proper payment of tax which contention was the foundation to file these appeals before us.

39. Secondly under Article 7.4 of the same agreement to be found at page 69 of the paper book, it is provided :

> The title and risk of the exchange equipment supplied by the supplier under this order shall pass from the supplier to the purchaser from the FOB point as per incoterms 1953 as amended.
>
> What more is needed to conclude that the title and risk of the equipment supplied by the assessee company had passed to the purchaser, namely, the Indian Telephone Industries in France itself. To quote further from the same Article :
>
> The Exchange Equipment to be supplied under this Agreement shall be delivered in the proper export packing suitable and adequate for the kind of transport chosen, as described in Article 27 hereinafter.
>
> All risks of damage/loss caused due to defects in packing provided by the supplier . . . who shall make good the loss or damage, free of cost to purchaser at Site provided it is proved by the purchaser that such defects are caused by the supplier.
>
> This shows that everything that was necessary in respect of this equipment was supplied in France and what remained in India to supervise the installation, for

which technical fees were separately paid, which sum was brought to tax as royalty. It is therefore, highly improper, in our view, to bring to tax some income as attributable to the supply of equipment by invoking the provisions of Section 9 of the Income-tax Act as if there was a business connection.

40. We are also of the considered view that the Commissioner (A) had rightly placed reliance on the decision of the Supreme Court in Carborandum Co.'s case (supra) and properly appreciated the principle enunciated therein and held that the activities of the foreign personnel lent or deputed for supervision did not amount to a business activity carried on by the assessee in India. In this case of Carborandum Co. (supra), the Supreme Court has also laid down the principle that even assuming that there was a business connection, no part of the fee could be said to have arisen in India because there was no activity or business operation carried on by the assessee in India.

41. Before we conclude this issue, we would like to mention in sum our answers to the positive questions raised by the learned Departmental Representative during the course of arguments:

(a) The first question was whether the property in the goods passed to the Indian Telephone Industries in France or in India. According to the documents and according to the facts present in this case, the property in the goods passed in its entirety in France and therefore it was the responsibility of the Indian party to bring them to India under their care and responsibility.

(b) The second question was whether there was a business connection within the meaning of Section 9(1) of the Income-tax Act. Our answer to this also is in the negative because according to our understanding, tendering of advice for the installation of the machinery does not establish any business connection nor can it be said that the performance of services to receive the engineers deputed for the purpose of supervision work had lent any credence to the view that there was a business connection. With or without the services of Mekaster Consultancy (P.) Ltd. the personnel sent from France have to be received by some one in India for the purpose of supervision. That act of receiving them and providing them with facilities of accommodation etc. does not mean that there was a business connection as the expression 'business connection' was understood and used in Section 9 of the Income-tax Act. Even assuming on the basis of the concession given by Shri Palkhivala the learned counsel for the assessee that there was a business connection in India and yet there were no operations attributable to the sale of machinery in India and therefore under Section 9(1)(i)(a) no income can be deemed to arise in India in respect of those transactions.

(c) The third question was whether income had resulted on account of a business connection and if so such income was exempt under the Double Taxation Avoidance Agreement entered into between the Government of India and the Government of France. Our answer to this question is again in the negative because no income according to us resulted on account of any business connection.

Thus all the questions raised by the learned Departmental Representative have to be answered against his propositions although the effort put in was so valient and the study he made was so thorough that we cannot but compliment him for the extraordinary work put in by him in a bid to save the situation which is otherwise unsaveable, according to our lights. He referred to several judgments in support of his conclusions. We do not think it is necessary to go into all those matters now because of two reasons: one is that there was a concession made on behalf of the assessee by Shri N.A. Palkhivala that the assessee has a permanent establishment in India but yet our conclusion was that in spite of it there was no income attributable in India because of lack of operations in India. The second reason was the case law relied upon by him centred round the rules laid down under the Sale of Goods Act as to when the property in the goods can be said to have passed from the seller to the buyer. We have already held that the title in the goods had passed to the buyer in France and not in India and therefore the case law relied upon this aspect is not necessary for us to discuss, except for the rights of the unpaid sellers, the assessee company has no other right in the property. The third line of argument taken by him in support of which he referred to some cases was that the whole thing must be seen as one contract and that contract was a turnkey contract like a works contract and that was completed on the issuance of an acceptance certificate. Even this was not found acceptable for the reasons given above, namely, that all these four contracts were different and distinct contracts and cannot be integrated into one transaction, which would amount to re-writing the contracts nor can we read into this any tax planning or tax avoidance, which would mean certain amount of attributing collusory part on the Government of India.

42. For these reasons we hold that the addition of Rs. 1 crore made by the Assessing Officer for the assessment year 1984-85 and Rs. 25 lacs for the assessment year 1985-86 was totally unwarranted and we delete them.

43. The next question that we have to consider is whether the Commissioner (A) was justified in allowing the expenses claimed by the assessee against fees for technical services although the expenses were incurred all along to support the entire activity relating to the installation, supply and supervision of the entire project in India. The answer to this question is related to and consequent to our conclusion with regard to the justification of the addition of Rs. 1 crore as profit arising out of FOB sales. As a consequence of our conclusion, it cannot be said that the fees agreed to be paid for technical services included fees in a bid to support the entire activity of installation, supply and supervision of the entire project in India. We have held that these four agreements are separate and distinct agreements and cannot be integrated as to see that all the four is one covering the activity of, as claimed by the department, the installation, supply and supervision of the entire project. As we have quoted above the reasons for entering into separate agreements because each one is a specific service though in ultimate analysis connected to the installation of the Licensed System in India of the Digital Telephone equipment. Thus the ultimate connection cannot be seen as to integrate all the four separate transactions into one so as to call it one activity in respect of which fee was paid as for technical services. The reason given by the Inspecting Asstt. Commissioner (Asst.) and also urged upon before us by the learned Departmental Representative was that the expenses paid to Mekaster Consultancy (P.) Ltd. was less than the fee paid for technical services and therefore the amount paid for support services to Mekaster Consultancy (P.) Ltd. should be deemed to have been paid also for rendering technical services. We are not able to appreciate this argument. What came in our way to

appreciate this argument was the fee payable for support services to be rendered by Mekaster Consultancy (P.) Ltd. was an independent agreement which has nothing to do with the technical services. Mekaster Consultancy (P.) Ltd. were not even remotely connected or obliged to render any technical services. Under the agreement, they are specifically prohibited to transact any business in the name or on account of the assessee company. A lump sum was fixed as fee for their services to cover their expenses, which was to be revised twice a year by mutual agreement depending upon the volume of the services actually rendered. Such an agreement cannot be construed as having any relation to or connected with the rendering of technical services. Secondly even though the payment for support services was less in the year 1983 (Accounting year), in the other years 1984, 1985 and 1986 the payments made for technical services were more than the payments made for support services. The technical service fee paid was received by the assessee company directly and it was not routed through Mekaster Consultancy (P.) Ltd. Therefore we are not able to find any connection or nexus between the payments by the assessee company to Mekaster Consultancy (P.) Ltd. for support services it rendered to it for its engineers and the technical service fee received by the assessee company from Indian Telephone Industries was directly for services rendered under the agreement. They are therefore distinct and separate and one is not connected with the other, though there may be dependence in the sense that Mekaster Consultancy (P.) Ltd. has to provide reception to the engineers that were deputed by the assessee to go over to India.

44. The other question that is related to this is about the expenses. As we have pointed out earlier the Inspecting Asstt. Commissioner (Asst.) has allowed only 50 per cent of the fees received for technical services as expenses as against the claim of the assessee for the allowance of Rs. 60,97,120 in the assessment year 1984-85 and Rs. 92,97,267 in the assessment year 1985-86. The reasons that prevailed with the Commissioner (A) in agreeing with the assessee's contention were that the agreement with Mekaster Consultancy (P.) Ltd. was on a principal to principal basis and that the assessee was in no way connected or interested in Mekaster and the payments to Mekaster were contractual obligations, that the payments were for support services to be provided by Mekaster to the French Engineers and in any case under Article 16 of the Double Taxation Avoidance Agreement with France, all the expenses incurred in rendering technical services have to be deducted in computing the income. Article 16 of the Double Taxation Avoidance Agreement, on which reliance was placed is as under :-

> Amounts paid by an enterprise of one of the Contracting State for technical services furnished by an enterprise of the other Contracting State shall not be subjected to tax in the first-mentioned Contracting State except insofar as such amounts are attributable to activities actually performed in the first-mentioned Contracting State. In computing the income so subjected to tax, there shall be allowed as deductions the expenses incurred in the first-mentioned Contracting State in connection with the activities performed in that Contracting State.
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> This clearly provides that in computing the income so subjected to tax i.e. the fees received for technical services, there shall be allowed as deduction the expenses incurred in India in connection with the activities performed in India. The finding of the fact recorded by the Commissioner (A), which was not disputed before us, was

> that the payments made to Mekaster and other expenses were essentially consisted of salary, travelling and transport in connection with the French Engineers. Therefore the provisions of Double Taxation Avoidance Agreement, which have the overriding effect over the provisions of the Income-tax Act and since these provisions only prevail, the expenditure incurred in India has to be allowed as a deduction and there is no reason to restrict them to 50 per cent in any sense of the term. That would be, in our opinion, doing violence to the specific provision of the Double Taxation Avoidance Agreement. The Commissioner (A), in our opinion, is therefore right in arriving at this conclusion and we endorse it.

45. At this point of time, the learned Departmental Representative has pointed out, as urged in the grounds of appeal also, that the Commissioner (A) should not have directed the Inspecting Asstt. Commissioner (Asst.) to set off the loss computed under the head "Fee for technical against income from royalty", which was prohibited under the express provisions of Section 44D of the Income-tax Act.

46. We have already mentioned above the answer of Shri Palkhivala for this objection. Section 44D provides for special provisions for computing income by way of royalties in the case of a foreign company. It says that:

> 44D. Notwithstanding anything to the contrary contained in Sections 28 to 44C, in the case of an assessee, being a foreign company,-
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> ** ** **
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> (b) no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or with the Indian concern after the 1st day of March, 1976;

Shri Tandon's argument was that when there is a specific prohibition on the deduction in respect of any expenditure or allowance under any of the provisions of the Income-tax Act in computing the income by way of royalty or fees for technical services received from the Government by a foreign company, the Commissioner (A) erred in ignoring this provision and in directing the Inspecting Asstt. Commissioner (Asst.) to still allow as a deduction from the income from royalty the loss incurred under the head "Fees for technical services received". We see in this argument a certain amount of misconception and if we may use the expression, a misunderstanding of the provision also. It is no doubt true that under Section 44D(b) no deduction in respect of any expenditure or allowance shall be allowed in computing the income by way of royalty or fees for technical services received. There is no gainsaying of this fact. The entire amount of royalty or fees received for technical services has to be brought to tax at the rates prescribed in Section 15A of the Income-tax Act. Section 15A provided the rate of tax to be levied on dividends, royalty and technical service fee received in the case of a foreign company. Section 15A(1)(b) provided for levy of tax at the rate of 30 per cent with effect from 1-4-1987 but at the relevant time it was 20 per cent. But Section 44D opens with a non obstante clause as we have quoted above "Notwithstanding anything to the contrary contained in Sections 28 to 44C..." In other words whatever deductions are provided for in those Sections 28 to 44C are not to be allowed as a deduction or expenditure in computing the income by way of royalty or fee for technical services rendered. Section 44D did not refer to any other section of the Income-tax Act more particularly to Section 70 and onwards, which deal with carry forward and set off of losses. Under Section 70 of the Income-tax Act, where the net result for any assessment year in respect of any source falling under any head of income other than capital gains is a loss, the assessee shall be entitled to have the amount of such loss set off against his income from any other source under the same head. Section 71 deals with the set off of loss from one head against income from another head with which we are not concerned in this appeal. Under Section 70 which is mandatory if the net result in respect of any source falling under any head of income is a loss, that loss has to be set off against the income from any other source under the same head except as otherwise provided in the Act. There is no provision to the contrary in the Income-tax Act insofar as the set off of loss from one source against the income from another source under the same head is concerned. The income from royalty as well as income from fees for technical services is to be assessed either under the head business or under the head other sources. We shall not go into that controversy because the department appeared to have treated these two incomes as income from business i.e. if royalty and fees for technical services are assessed under the head business, these two become too distinct sources of income under the same head. When royalty is one source of income and the fees for technical services is another source of income, then if there is loss from fees for technical services, then by operation of the provision of Section 70, that loss from that source is to be set off against the income from another source i.e. royalty. Once the expenditure incurred for rendering technical services in India is determined, that expenditure having to be allowed as a deduction under the overriding provisions of the Double Taxation Avoidance Agreement and as a result, that computation results in a loss, that loss has to be set off from the income from royalty taking it as a whole i.e. gross. Setting off of loss from one source under the same head is not equal or can be considered as equal to in any sense of the term as allowing of expenditure or deduction of any sum referred to in Sections 28 to 44C of the Income-tax Act as provided for in Section 44D. Thus when the loss computed under the source of fees for technical services is set off against the income from another source of royalty, it was not Section 44D(b) that was being violated as urged on behalf of the Revenue but it was Section 70 that was being given effect to and which is mandatory. There is no dispute before us that royalty and fees for technical services are two distinct and separate sources falling under the same head. Therefore the conclusion reached by the Commissioner (A) even on this score cannot be said to be incorrect. We therefore endorse his view and hold that the loss computed from source fees for technical services has to be set off against the income from the source royalty and was rightly done and this kind of set off is not to be construed as allowing a deduction in computing income from royalty in violation of the provisions of Section 44D(b) of the Income-tax Act.

47. For the above reasons, we hold that the Commissioner (A) is right in his conclusions and we uphold his order and dismiss these appeals.