REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 12183 OF 2016

DIRECTOR OF INCOME TAX-II
(INTERNATIONAL TAXATION)
NEW DELHI & ANR. …Appellants

Versus

M/S SAMSUNG HEAVY INDUSTRIES
CO. LTD. ...Respondent

J U D G M E N T

R.F. Nariman, J.

1. This appeal by the Department revisits the question as to the taxability of income attributable to a "permanent establishment" set up in a fixed place in India, arising from the 'Agreement for avoidance of double taxation of income and the prevention of fiscal evasion' with the Republic of Korea ("**DTAA**").

2. On 28.02.2006, the Oil and Natural Gas Company ("**ONGC**") awarded a "turnkey" contract to a consortium comprising of the Respondent/Assessee, i.e. Samsung Heavy Industries Co. Ltd. (a Company incorporated in South Korea), and Larsen & Toubro Limited, being a contract for carrying out the "Work", *inter alia,* of surveys, design, engineering, procurement, fabrication, installation and modification at existing facilities, and start-up and commissioning of entire facilities covered under the 'Vasai East Development Project' ("**Project**").

3. On 24.05.2006, the Assessee set up a Project Office in Mumbai, India, which, as per the Assessee, was to act as "a communication channel" between the Assessee and ONGC in respect of the Project. Pre-engineering, survey, engineering, procurement and fabrication activities which took place abroad, all took place in the year 2006. Commencing from November, 2007, these platforms were then brought outside Mumbai to be installed at the Vasai East Development Project. The Project was to be completed by 26.07.2009.

4. With regard to Assessment Year 2007-2008, the Assessee filed a Return of Income on 21.08.2007 showing nil profit, as a loss of INR 23.5

lacs had allegedly been incurred in relation to the activities carried out by it in India.

5. On 29.08.2008, a show-cause notice was issued to the Assessee by the Income Tax authorities requiring it to show cause as to why the Return of Income had been filed only at nil, which was replied to in detail by the Assessee on 02.02.2009. Being dissatisfied with the reply, a draft Assessment Order was then passed on 31.12.2009 ("**Draft Order**") by the Assistant Director of Income Tax International Transactions at Dehradun ("**Assessing Officer**"). This Draft Order went into the terms of the agreement in great detail, and concluded that the Project in question is a single indivisible "turnkey" project, whereby ONGC was to take over a project that is completed only in India. Resultantly, profits arising from the successful commissioning of the Project would also arise only in India. This Court's judgment in **Commissioner of Income Tax and Another v. Hyundai Heavy Industries Co. Ltd.,** (2007) 7 SCC 422, was distinguished by the learned Assessing Officer stating that, in that case, the project was in two separate parts, unlike the Project in the present case. Referring then to the Mumbai Project Office, the Assessing Officer held:

> "It is evident from the above that the work relating to fabrication and procurement of material was very much a part of the contract for execution of work assigned by ONGC. The work was wholly executed by PE in India and it would be absurd to suggest that PE in India was not associated with the designing or fabrication of materials."

6. Having so held, the Draft Order then went on to attribute 25% of the revenues allegedly earned outside India (which totalled INR 113,43,78,960) as being the income of the Assessee exigible to tax, which came to INR 28,35,94,740. The Dispute Resolution Panel, by its order dated 30.9.2010, after considering objections to the Draft Order by the Assessee, then held:

> "The Assessing Officer has given a specific finding that the assessee had a project office in India, when it was given the contract. The assessee has not contested the existence of the Project office in India but it has only contested that the project was used merely for preparatory and auxiliary activities. This submission of the assessee does not hold merit because if it wanted to perform only preparatory and auxiliary activities then it could have opened a liaison office. The opening of a project office clearly shows that the assessee was doing something more than what would have been done through liaison office. In any case nature and purport of activities undertaken in India determine the existence of PE. Considering the nature of activities undertaken in India it is clear that PE existed in the case of assessee."

7. It then confirmed the finding contained in the Draft Order that the agreement was a "turnkey" project which could not be split up, as a result of which the entire profit earned from the Project would be earned

within India. Basing itself on data obtained from the database "Capital Line", the Panel picked up four similar projects executed by companies outside India, and found the average profit margin to be 24.7%, which, according to the Panel, would therefore justify the figure of 25% arrived at in the Draft Order. The Panel having dismissed the Assessee's objections, the Draft Order was made final by the Assessing Officer on 25.10.2010. The Assessee then filed an appeal against the Assessment Order before the Income Tax Appellate Tribunal ("**ITAT**").

8. The decision of the ITAT on 30.08.2011 went into the establishment of the Project Office at Mumbai in much more detail than had been gone into either in the Draft Order or the Dispute Resolution Panel's decision. The ITAT referred to and relied upon an application dated 24.04.2006, which had been submitted by the Assessee to the Reserve Bank of India ("**RBI**") for opening the Project Office, which in turn referred to a Board Resolution of the Company dated 03.04.2006 for opening the Project Office in India. It further referred to correspondence showing that one Mr. Sangsoon Park, the General Manager of the Assessee Company, had been appointed as a representative of the Company to sign documents for opening of the Project Office and a bank account in India,

and to look after operations of the Project Office. After setting out the Board Resolution dated 03.04.2006 in detail, the ITAT concluded:

> "70. It can be seen from all the above documents that the scope of Mumbai Project Office has neither been restricted by the assessee company itself or it has also not been restricted by RBI in any terms. This is relevant for the reason that in Hyundai Heavy Industries case, it is a matter of record that project office opened by the said assessee, according to permission given by the RBI, was to work only as a liaison office and was not authorised to carry on any business activity. This is the vital difference between the two cases namely the case of the assessee and Hyundai Heavy Industries case.
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> 71. There is a force in the contention of the ld. DR that the words "That the company hereby open one project office in Mumbai, India for coordination and execution of Vasai East Development Project for Oil and Natural Gas Corporation ("ONGC"), India" used by the assessee company in its resolution of Board of Directors meeting dated 3rd April, 2006 makes it amply clear that project office was opened for coordination and execution of impugned project. In absence of any restriction put by the assessee in the application moved by it to RBI, in the resolutions passed by the assessee company for the opening of the project office at Mumbai and the permission given by RBI, it cannot be said that Mumbai project office was not a fixed place of business of the assessee in India to carry out wholly or partly the impugned contract in India within the meaning of Article 5.1 of DTAA. These documents make it clear that all the activities to be carried out in respect of impugned contract will be routed through the project office only. Pre-surveys were to be first conducted which will determine the nature of the designing on the basis of which pre-engineering and pre-designing was to be done with respect to the entire project. The next main condition of the contract was that, as a condition precedent, the assessee had to obtain insurance with respect to the entire project which has been in fact obtained by the assessee in India for which the assessee has received major payment during

the year under consideration itself. The said policy has not been shown to be restricted only with regard to activities of the assessee outside India."

9. The ITAT thus confirmed the decisions of the Assessing Officer and the Dispute Resolution Panel that the contract was indivisible. It then went on to deal with the argument on behalf of the Assessee that the Project Office was only an auxiliary office, and did not involve itself in any core activity of business, as accounts that were produced would show that there was no expenditure which related to execution of the project. This argument was disposed of as follows:

"The way the terms of the contract are described and the way the work on contract has to proceed clearly describe that in all the activities of contract there will be the role of Mumbai project office as the same has to work as a channel between assessee company and ONGC. If PE of the assessee exists within the meaning of Article 5.1 and 5.2 and assessee claims that despite there being PE in terms of clause 5.1 and 5.2, it falls under exclusionary Article 5.4 then onus is on assessee to prove that activities of its PE are in the nature of preparatory or auxiliary in nature. No material has been brought on record by the assessee to prove the said fact. The arguments put forward in this respect are only by inference such as the accounts maintained by the assessee in India through which it is the argument of the ld. Counsel of the assessee that it does not contain any expenditure relating to execution of the contract. But such argument is not acceptable as the maintenance of account is in the hands of assessee and mere the mode of maintaining the accounts alone cannot determine the character of PE as the role of PE only will be relevant to determine what kind of activities it has carried on. As pointed out earlier the way the contract has to proceed,

> Mumbai project office of the assessee has to play a vital role in the execution of entire contract and if assessee wants to contend otherwise, the onus is on assessee and not on the revenue."

10. Having so held, the ITAT found that there was a lack of material to ascertain as to what extent activities of the business were carried on by the Assessee through the Mumbai Project Office, and therefore it was considered just and proper to set aside the attribution of 25% of gross revenue earned outside India – which was attributed as income earned from the Mumbai project office – the matter being sent back to the Assessing Officer to ascertain profits attributable to the Mumbai project office after examining the necessary facts. An appeal from the ITAT was filed in the High Court at Uttarakhand by the Assessee. Five substantial questions of law were framed by the High Court in the appeal as follows:

> "(i) Whether, on the facts and in the circumstances of the case, the Tribunal erred in law in holding that the appellant had a fixed place 'Permanent Establishment' (PE) in India under Article 5(1)/(2) of the Double Taxation Avoidance Agreement between India and Korea ('the Treaty'), in the form of project office in Mumbai?
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> (ii) Whether, on the facts and circumstances of the case and in law, the finding of the Tribunal that the project office was opened for co-ordination and execution of the VED project and all activities to be carried out in relation to the said project were routed through the project office only, is perverse inasmuch as the same is based on selective and/or incomplete reference to the material on record, irrelevant considerations and incorrect appreciation of the role of the project office?

> (iii) Without prejudice, whether, on the facts and the circumstances of the case and in law, the Tribunal erred in not holding that even if the appellant had fixed place PE in India, no income on account of offshore activities, i.e. the operations carried out outside India (viz., designing, engineering, material procurement, fabrication, transportation activities) was attributable to the said PE, instead, in setting the issue to the file of the assessing officer?
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> (iv) Without prejudice, whether, on the facts and circumstances of the case and in law, the Tribunal erred in not holding that even if the appellant had fixed place PE in India, no income could be brought to tax in India since the appellant had incurred overall losses in respect of the VED project?
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> (v) Whether, on the facts and circumstances of the case, the contract was divisible/distinguishable pertaining to the activities associated with designing, fabrication and installation of platforms and, if so, whether the activities pertaining to designing and fabrication took place in any part of India?"

11. By the impugned judgment dated 27.12.2013, the High Court found that the order of the Assessing Officer had been confirmed by the ITAT, and concerned itself only with the following question:

> "In other words, can it be said that the Agreement permitted the India Taxing Authority to arbitrarily fix a part of the revenue to the permanent establishment of the appellant in India?"

12. The High Court held that the question as to whether the Project Office opened at Mumbai cannot be said to be a "permanent establishment" within the meaning of Article 5 of the DTAA would be of no consequence. The High Court then held that there was no finding that

25% of the gross revenue of the Assessee outside India was attributable to the business carried out by the Project Office of the Assessee. According to the High Court, neither the Assessing Officer nor the ITAT made any effort to bring on record any evidence to justify this figure. This being the position, the appeal of the Assessee was allowed in the following terms:

> "10. That being the situation we allow the appeal, set aside the judgment and order under appeal as well as the assessment order insofar as the same relates to imposition of tax liability on the 25% of the receipt upon the appellant in the circumstances mentioned above, and observe that the questions of law formulated by us, while admitting the appeal, have not, in fact, arisen on the facts and circumstances of the case, but the real question was, whether the tax liability could be fastened without establishing that the same is attributable to the tax identity or permanent establishment of the enterprise situate in India and the same, we think, is answered in the negative and in favour of the appellant."

13. Shri N. Venkataraman, learned Additional Solicitor General appearing for the Appellants, has read to us in copious detail the Draft Order, the Dispute Resolution Panel Order, the ITAT judgment and the impugned High Court judgment. He argued that the facts of the present case would show, as was correctly held by all the authorities and the Tribunal, that the Project, being a "turnkey" project, was one and indivisible, and the entire revenue earned would therefore be taxable in India. He said that

the judgment in **Hyundai Heavy Industries Co. Ltd.** (supra) was correctly distinguished by the authorities, as that was a case where a turnkey project was in fact bifurcated into two parts, namely, a separate agreement as to design, manufacture, erection etc. culminating in another separate agreement relating to installation. On the facts of that case it was found that the permanent establishment was set up only at the stage of installation, i.e. long after the revenue had been earned from manufacture, design etc., and it was for that reason that it could not be brought to tax. He also sought to distinguish the judgment in **M/s DIT (International Taxation), Mumbai v. M/s Morgan Stanley & Co. Inc.**, (2007) 7 SCC 1, and relied upon certain passages in a recent judgment reported as **Asst. Director of Income Tax, New Delhi v. E-Funds IT Solution Inc.** (2018) 13 SCC 294. He argued that the High Court judgment was cryptic and did not address any of the real issues that arose on the facts of this case. He further argued that it was completely incorrect to state that there was no finding that 25% of the gross revenue of the Assessee was attributable to the business carried out by the Project Office of the Assessee. On the contrary, he referred to all the documents that ITAT had looked at to show that the Project

Office at Mumbai was not a mere liaison office, but was vitally connected with the core business of the Assessee and that therefore, in the absence of figures given by the Assessee, a "best-judgment" assessment had to be made of profits attributable to such permanent establishment. That best-judgment assessment, though made in the Draft Order and the Dispute Resolution Panel Order, has been set aside by ITAT, resulting in a remand to the Assessing Officer. There was nothing wrong, therefore, with the ITAT judgment, which should not have been interfered with by the High Court without answering a single substantial question of law raised before it.

14. Shri S. Ganesh, learned Senior Advocate appearing on behalf of the Respondent/Assessee, relied heavily upon Articles 5 and 7 of the DTAA, and argued that the Project Office in Mumbai consisted of only two employees, neither of whom had any technical qualification whatsoever. Secondly, the accounts that were produced would show that the Project Office had not incurred any expenditure on execution of the project. He read to us in copious detail the documents relied upon by the ITAT, and argued that the ITAT had come to a perverse finding that the Project Office had been set up not merely as a liaison office but as an office

through which core activities of the Assessee were carried out. He further argued, that in any case, the burden of establishing that a foreign Assessee has a permanent establishment in India is on the tax authorities, which burden had not been discharged on the facts of the present case. He then relied heavily on **Hyundai Heavy Industries Co. Ltd.** (supra) to state that the facts in the present case were similar to the facts in that case, which would therefore apply on all fours to this case. He then argued that even assuming that there is a permanent establishment in India through which the core business activity of the Assessee was carried out, no taxable income can be attributed to it, as audited accounts that were produced showed that the project did not yield any profit, but in fact resulted in only losses.

15. Having heard learned counsel for both parties, it is important to first set out the relevant provisions of the DTAA. The relevant provisions of Article 5 of the aforesaid treaty reads as follows:

> "ARTICLE 5 - Permanent establishment –
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> 1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
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> 2. The term "permanent establishment" shall include especially— (a) a place of management; (b) a branch; (c) an office; (d) a

factory; (e) a workshop; and (f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term "permanent establishment" likewise encompasses a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than nine months.

4. Notwithstanding the preceding provisions of this article, the term "permanent establishment" shall be deemed not to include—

(a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or for collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, the supply of information, scientific research or any other activity, if it has a preparatory or auxiliary character in the trade or business of the enterprise;

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

16. Article 7(1) and 7(2) of the DTAA, which are also of some significance, read as follows:

> "ARTICLE 7 - Business profits –
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> 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 that permanent establishment.
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> 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 separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment."

17. Some of the judgments of this Court have dealt with similar double taxation avoidance treaty provisions and therefore need to be mentioned at this juncture. In **Morgan Stanley & Co. Inc.** (supra), the Double Taxation Avoidance Agreement (1990) between India and the United States of America was construed. The facts in that case made it clear that the Morgan Stanley Group is one of the world's largest diversifying financial services companies. Morgan Stanley and

Company, which is a part of the Morgan Stanley Group, is an investment bank engaged in the business of providing financial advisory services, corporate lending and securities underwriting. One of the group companies of Morgan Stanley Group, namely, Morgan Stanley Advantages Services Pvt. Ltd. ("**MSAS**") entered into an agreement for providing certain support services to Morgan Stanley and Company. MSAS, being an Indian Company, was set up to support the main office functions in equity and fixed income research, account reconciliation and providing IT enabled services such as back office operation, data processing and support centre to Morgan Stanley and Company. Tackling the question as to whether a "fixed place" permanent establishment existed on the facts of that case under Article 5 of the India-US treaty – which is similar to Article 5 of the present DTAA – this Court held:

> "**10.** In our view, the second requirement of Article 5(1) of DTAA is not satisfied as regards back office functions. We have examined the terms of the Agreement along with the advance ruling application made by MSCo inviting AAR to give its ruling. It is clear from reading of the above Agreement/application that MSAS in India would be engaged in supporting the front office functions of MSCo in fixed income and equity research and in providing IT enabled services such as data processing support centre and technical services as also reconciliation of accounts. In order to decide whether a PE stood constituted one has to undertake what

is called as a functional and factual analysis of each of the activities to be undertaken by an establishment. It is from that point of view, we are in agreement with the ruling of AAR that in the present case Article 5(1) is not applicable as the said MSAS would be performing in India only back office operations. Therefore to the extent of the above back office functions the second part of Article 5(1) is not attracted.

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14. There is one more aspect which needs to be discussed, namely, exclusion of PE under Article 5(3). Under Article 5(3)(*e*) activities which are preparatory or auxiliary in character which are carried out at a fixed place of business will not constitute a PE. Article 5(3) commences with a non obstante clause. It states that notwithstanding what is stated in Article 5(1) or under Article 5(2) the term PE shall not include maintenance of a fixed place of business solely for advertisement, scientific research or for activities which are preparatory or auxiliary in character. In the present case we are of the view that the abovementioned back office functions proposed to be performed by MSAS in India falls under Article 5(3)(*e*) of DTAA. Therefore, in our view in the present case MSAS would not constitute a fixed place PE under Article 5(1) of DTAA *as regards its back office operations*."

18. The Court then went on to hold that activities performed by stewards who were deployed by the American Company to work in India as employees of the Indian company were so employed merely to protect the American companies' interests in a competitive world, by ensuring quality and confidentiality of services performed in India. It was therefore found that so far as stewardship was concerned, this activity would fall within Article 5(2)(l) of the US-India treaty, and therefore would be

outside the term "permanent establishment" as defined. On the deputation of certain employees of the American Company to work as employees of the Indian Company, it was found, however, that the American Company was rendering services through its employees to the Indian Company, as a result of which a "service" permanent establishment would stand established on this count.

19. The judgment in **Hyundai Heavy Industries Co. Ltd.** (supra) was heavily relied upon by Shri S. Ganesh and sought to be distinguished by Shri N. Venkataraman. The facts in **Hyundai Heavy Industries Co. Ltd.** (supra) made it clear that the turnkey contract entered into between Hyundai Heavy Industries Co. Ltd. and ONGC was divisible into two parts, and as a result the Court found:

> "**16.** On reading Article 7 of the CADT, it is clear that the said Article is based on OECD Model Convention. Para (1) of Article 7 states the general rule that business profits of an enterprise of one contracting State may not be taxed by the other contracting State unless the enterprise carries on its business in the other contracting State through its PE. The said Para (1) further lays down that only so much of the profits (*sic* as is) attributable to the PE is taxable. Para (2) of Article 7 further lays down that the attributable profit can be determined by the apportionment of the total profits of the assessee to its various parts OR on the basis of an assumption that the PE is a distinct and separate enterprise having its own profits and distinct from GE.

17. Applying the above test to the facts of the present case, we find that profits earned by the Korean GE on supplies of fabricated platforms cannot be made attributable to its Indian PE as the installation PE came into existence only after the transaction stood materialised. The installation PE came into existence only on conclusion of the transaction giving rise to the supplies of the fabricated platforms. The installation PE emerged only after the contract with ONGC stood concluded. It emerged only after the fabricated platform was delivered in Korea to the agents of ONGC. Therefore, the profits on such supplies of fabricated platforms cannot be said to be attributable to the PE.

18. There is one more reason for coming to the aforestated conclusion. In terms of Para (1) of Article 7, the profits to be taxed in the source country were not the real profits but hypothetical profits which the PE would have earned if it was wholly independent of the GE. Therefore, even if we assume that the supplies were necessary for the purposes of installation (activity of the PE in India) and even if we assume that the supplies were an integral part, still no part of profits on such supplies can be attributed to the independent PE unless it is established by the Department that the supplies were not at arm's length price. No such taxability can arise in the present case as the sales were directly billed to the Indian customer (ONGC). No such taxability can also arise in the present case as there was no allegation made by the Department that the price at which billing was done for the supplies included any element for services rendered by the PE.

19. In the light of our above discussion, we are of the view that the profits that accrued to the Korean GE for the Korean operations were not taxable in India."

20. In **Ishikawajma-Harima Heavy Industries Ltd. v. Director of Income Tax, Mumbai**, (2007) 3 SCC 481, this Court went into a similar double

taxation treaty agreement entered into between Japan and India, stating as follows:

> "**84.** The distinction between the *existence* of a business connection and the *income accruing or arising out of such* business connection is clear and explicit. In the present case, the permanent establishment's non-involvement in this transaction excludes it from being a part of the cause of the income itself, and thus there is no business connection.
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> **85.** Article 5.3 provides that a person is regarded as having a permanent establishment if he carries on construction and installation activities in a contracting State only if the said activities are carried out for more than six months. Para 6 of the Protocol to India-Japan Tax Treaty also provides that only income arising from activities wherein the permanent establishment has been involved can be said to be attributable to the permanent establishment. It gives rise to two questions, firstly, offshore services are rendered outside India; the permanent establishment would have no role to play in respect thereto in the earning of the said income. Secondly, entire services having been rendered outside India, the income arising therefrom cannot be attributable to the permanent establishment so as to bring within the charge of tax.
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> **86.** For attracting the taxing statute there has to be some activities through permanent establishment. If income arises without any activity of the permanent establishment, even under DTAA the taxation liability in respect of overseas services would not arise in India. Section 9 spells out the extent to which the income of non-resident would be liable to tax in India. Section 9 has a direct territorial nexus. Relief under a double taxation treaty having regard to the provisions contained in Section 90(2) of the Income Tax Act would arise only in the event a taxable income of the assessee arises in one contracting State on the basis of accrual of income in another contracting State on the basis of residence. Thus, if the appellant had income that accrued in India and is liable to tax because in its State all residents (*sic*) it was entitled to relief

from such double taxation payable in terms of Double Taxation Treaty. However, so far as accrual of income in India is concerned, taxability must be read in terms of Section 4(2) read with Section 9, whereupon the question of seeking assessment of such income in India on the basis of Double Taxation Treaty would arise.

87. In cases such as this, where different severable parts of the composite contract are performed in different places, the principle of apportionment can be applied, to determine which fiscal jurisdiction can tax that particular part of the transaction. This principle helps determine, where the territorial jurisdiction of a particular State lies, to determine its capacity to tax an event. Applying it to composite transactions which have some operations in one territory and some in others, it is essential to determine the taxability of various operations.

88. Therefore, in our opinion, the concepts of profits of business connection and permanent establishment should not be mixed up. Whereas business connection is relevant for the purpose of application of Section 9; the concept of permanent establishment is relevant for assessing the income of a non-resident under DTAA. There, however, may be a case where there can be overlapping of income; but we are not concerned with such a situation. The entire transaction having been completed on the high seas, the profits on sale did not arise in India, as has been contended by the appellant. Thus, having been excluded from the scope of taxation under the Act, the application of the Double Taxation Treaty would not arise. The Double Taxation Treaty, however, was taken recourse to by the appellant only by way of an alternate submission on income from services and not in relation to the tax of offshore supply of goods."

21. A recent judgment of this Court, namely, **E-Funds IT Solution Inc.** (supra), concerned itself with the India-US Double Taxation Avoidance

Agreement with similar provisions. Dealing with what was referred to as a "fixed place", permanent establishment, this Court held:

> "**16.** The Income Tax Act, in particular Section 90 thereof, does not speak of the concept of a PE. This is a creation only of the DTAA. By virtue of Article 7(1) of the DTAA, the business income of companies which are incorporated in the US will be taxable only in the US, unless it is found that they were PEs in India, in which event their business income, to the extent to which it is attributable to such PEs, would be taxable in India. Article 5 of the DTAA set out hereinabove provides for three distinct types of PEs with which we are concerned in the present case: fixed place of business PE under Articles 5(1) and 5(2)(*a*) to 5(2)(*k*); service PE under Article 5(2)(*l*) and agency PE under Article 5(4). Specific and detailed criteria are set out in the aforesaid provisions in order to fulfil the conditions of these PEs existing in India. The burden of proving the fact that a foreign assessee has a PE in India and must, therefore, suffer tax from the business generated from such PE is initially on the Revenue. With these prefatory remarks, let us analyse whether the respondents can be brought within any of the sub-clauses of Article 5."

22. Dealing with 'support services' rendered by an Indian Company to American Companies, it was held that the outsourcing of such services to India would not amount to a fixed place permanent establishment under Article 5 of the aforesaid treaty, as follows:

> "**22.** This report would show that no part of the main business and revenue earning activity of the two American companies is carried on through a fixed business place in India which has been put at their disposal. It is clear from the above that the Indian company only renders support services which enable the assessees in turn to render services to their clients abroad. This outsourcing of work

to India would not give rise to a fixed place PE and the High Court judgment is, therefore, correct on this score."

23. A reading of the aforesaid judgments makes it clear that when it comes to "fixed place" permanent establishments under double taxation avoidance treaties, the condition precedent for applicability of Article 5(1) of the double taxation treaty and the ascertainment of a "permanent establishment" is that it should be an establishment "through which the business of an enterprise" is wholly or partly carried on. Further, the profits of the foreign enterprise are taxable only where the said enterprise carries on its core business through a permanent establishment. What is equally clear is that the maintenance of a fixed place of business which is of a preparatory or auxiliary character in the trade or business of the enterprise would not be considered to be a permanent establishment under Article 5. Also, it is only so much of the profits of the enterprise that may be taxed in the other State as is attributable to that permanent establishment.

24. At this stage, it is important to go into some of the documents that were relied upon by the ITAT. The application submitted by the Assessee to the RBI dated 24.04.2006 for opening a project office, reads as follows:

"Letter dated 24th April 2006

General Manager
Reserve Bank of India
Regional Office
Mumbai

Dear sir,

Re: M/s Samsung Heavy Industries Co. Ltd. (SHI)
Application for Registration of Project Office

Our aforesaid client (SHI) has entered into contract with M/s Oil and Natural Gas Corporation Ltd. (ONGC) vide contract number MR/OW/MM/VED/O3/2005. Under the instructions of our above-referred client, we have to enclose following documents in connection with Registration of Project office in India:

1. Letter dated (…) on the letter head of the company for the details of the project as Notification FEMA 95/2003-RB dated 2nd July, 2003 Foreign Exchange Management (Establishment in India of Branch or Office or other place of business) (Amendment) Regulations 2003 along with the copy of letter from ChoHung Bank for opening Bank account.
2. Copy of the POA in our favour and in favour of M/s Hemand Arora and Co., CA.
3. Certified copy of the POA in the name of the Mr. S.S. Park, who has signed the application.
4. Certified copy of the certificate of registration of the company in South Korea.
5. Certified copy of the notarised Board resolution for opening a Project office in India.
6. Certified copy of Extract of contract entered into by our client.

Kindly take the above documents on record. Please take on record our client's Project office and register the same. If you require any clarification, please let us know…"

25. The Board Resolution dated 03.04.2006 referred to in this letter reads as follows:

"MINUTES OF BOARD OF DIRECTORS' MEETING OF SAMSUNG HEAVY INDUSTRIES CO. LTD.

A meeting of the Board of Directors of Samsung Heavy Industries Co. Ltd. (the "Company") was duly called and held on the 3rd day of April 2006 at the office of the Company in Seoul the Republic of Korea, at which 3 of 3 Directors were present and acting throughout.

Jing Wan Kim, President and CEO of Samsung Heavy Industries Co. Ltd. announced that the notice of meeting was duly given to all Directors and a quorum was present and the meeting was duly called to order and held.

RESOLVED:

1. That the Company hereby open one project office in Mumbai, India for coordination and execution of Vasai East Development Project for Oil and Natural Gas Corporation Limited ("ONGC"), India.
2. That the Company hereby does make and constitute Mr. Sangsoon Park Yard General Manager of the Company, as the Company's true and lawful representative with full power and authority for the purpose of establishing a project office and coordinating and executing delivery of documents in connection with construction of offshore platform modification of existing facilities for ONGC above.

IN WITNESS WHEREOF, the President and Directors present at the meeting have hereunto affixed their names and seals on this 3rd day of April 2006.

Sd/-

Samsung Heavy Industries Co., Ltd.
President and CEO
Jing Wan Kim"

26. Based on the letter given to RBI which contained this resolution, the RBI approval dated 24.05.2006 reads as follows:

"FEO, Mumbai CAD/080/04.02.2001/05-06

24th May, 2006

M/s Davesh K. Shah and Co.,
Chartered Accountants,
106, Banaji House,
361, Dr. D.N. Road,
Flora Fountain,
Mumbai 400 001.

Dear sirs,

Registration of Project Office – M/s Samsung Heavy Industries Co. Ltd. (SHI)

Please refer to your letter dated 24th April, 2006 on the captioned subject. In this connection, we advise having noted a Project Office in India in terms of provision contained in AP (Dir Series) Circular No.37 dated 15th November 2003."

27. A reading of the Board Resolution would show that the Project Office was established to coordinate and execute "delivery documents in connection with construction of offshore platform modification of existing facilities for ONGC". Unfortunately, the ITAT relied upon only the first paragraph of the Board Resolution, and then jumped to the conclusion

that the Mumbai office was for coordination and execution of the project itself. The finding, therefore, that the Mumbai office was not a mere liaison office, but was involved in the core activity of execution of the project itself is therefore clearly perverse. Equally, when it was pointed out that the accounts of the Mumbai office showed that no expenditure relating to the execution of the contract was incurred, the ITAT rejected the argument, stating that as accounts are in the hands of the Assessee, the mere mode of maintaining accounts alone cannot determine the character of permanent establishment. This is another perverse finding which is set aside. Equally the finding that the onus is on the Assessee and not on the Tax Authorities to first show that the project office at Mumbai is a permanent establishment is again in the teeth of our judgment in **E-Funds IT Solution Inc.** (supra).

28. Though it was pointed out to the ITAT that there were only two persons working in the Mumbai office, neither of whom was qualified to perform any core activity of the Assessee, the ITAT chose to ignore the same. This being the case, it is clear, therefore, that no permanent establishment has been set up within the meaning of Article 5(1) of the DTAA, as the Mumbai Project Office cannot be said to be a fixed place

of business through which the core business of the Assessee was wholly or partly carried on. Also, as correctly argued by Shri Ganesh, the Mumbai Project Office, on the facts of the present case, would fall within Article 5(4)(e) of the DTAA, inasmuch as the office is solely an auxiliary office, meant to act as a liaison office between the Assessee and ONGC. This being the case, it is not necessary to go into any of the other questions that have been argued before us.

29. The appeal against the impugned High Court judgment is therefore dismissed, but for the reasons stated by us.

……………………..………………J.
(R. F. Nariman)

……………..……………………..J.
(Navin Sinha)

……………..……………………..J.
(B.R. Gavai)

New Delhi.
22nd July, 2020