

आयकर अपीलीय अधिकरण “एल” न्यायपीठ मुंबई में।

**IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI BENCH “L”, MUMBAI**

**श्री बी. रामकोटय्य, लेखा सदस्य एवं श्री विवेक वर्मा, न्यायिक सदस्य के समक्ष ।
BEFORE SHRI B. RAMAKOTAIAH, ACCOUNTANT MEMBER
AND SHRI VIVEK VARMA, JUDICIAL MEMBER**

आयकर अपील सं. 8975/मुम/2010

निर्धारण वर्ष A.Y. 2007-08

ITA No. 8975/Mum/2010

(Assessment year : 2007-08)

Germanischer Lloyd A.G.-India Branch, Branch, 308, Trade Centre, Bandra-Kurla Complex, Bandra, Mumbai-400051 स्थयी लेखा सं.:PAN: AAACG7903R	Vs	DDIT(IT)3(1), 1 st Floor, Scinida House, N.M.Marg, Ballard Estate Mumbai
अपीलार्थी (Appellant)		प्रत्यर्थी (Respondent)
अपीलार्थी की ओर से Applicant by	:	Sri Prakash Kotadia, Amit Ajmera, & Ms. Nikita Patel
प्रत्यर्थी की ओर से Respondent by	:	मिस. निरज प्रधान Ms Neeraja Pradhan

सुनवाई की तारीख /Date of Hearing : 30-04-2013

घोषणा की तारीख /Date of Pronouncement: 05-06-2013

आ दे श

ORDER

श्री विवेक वर्मा, न्या स:

PER VIVEK VARMA, JM:

The appeal is directed against the order of DRP read with order u/s 143(3) wherein the assessee has objected to the addition of Rs. 58,13,506/-, being the difference of amount remitted by the HO to its Branch in India and the amount remitted to the HO for an addition of

Rs. 25,33,340/- (Rs. 22,32,586/- and Rs. 3,00,754/-) made u/s 40A(2)(b), held to be related party remittance.

2. The facts of the case are that the assessee is a classification society, having the character of a non-profit organization, established in Germany and is engaged in providing inspection and certification services to the maritime industry.

3. As per the informal information gathered from the assessee company's resident Director, attending the instant proceedings, it was submitted by him that all sea faring vessels of each and every category must get sea faring validation on yearly basis and certification is provided to the vessel on complete inspection. The German HO has its affiliation in over 133 countries around the world, who carry out the survey and inspection on sea vessels and send their report to their HO in Germany, who, after applying strict regulations with regard to certification decide on the issue of certificate or validation or report as the case may be.

4. It was also submitted that the assessee company carries out repairs on the damages on the instructions received from the German HO, which is working 24X7 with fleet of expert engineers who are experts on various departments of the vessels and send instructions to the local engineers, as to what is to be done and how corrective measures are to be taken to render the vessel fit for voyage.

5. It was also submitted that it is the assessee, who is performing the repairs and inspection and carries out tests for validation for sea faring and on the basis of that report, which is submitted to the HO. After critical analysis on the report, the certification, is then granted to the ship/vessel for sea voyage/faring, by the HO.

6. It was submitted that fee splitting mechanism was devised way back in 1973, which is retained globally. Indian Branch Office was established on 06.11.1989, when fee splitting mechanism was already in place and was being followed worldwide. In this scenario Indian BO also followed the similar pattern, following the Korean Registry, under which the Indian BO is located.

7. It was further submitted that the consistent pattern was being followed from the inception of Indian BO up to assessment year 2001-02, when, for the first time, the issue of taxing the HO share was raised by the revenue. The issue traveled upto ITAT stage, where, the assessee filed additional evidence, which it could not file before the authorities. The coordinate Bench in ITA No. 2498/Mum/2005 in its order dated 16.10.2010, restored the issue to the CIT(A) for fresh adjudication on the issue, i.e. whether it would be correct to include the HO share and be taxed in the hands of the assessee.

8. On this background, the AR filed a synopsis, wherein he submitted, in order to operate at sea, vessels are required to be classified by a classification society. A classification society or its inspection office undertakes the survey of the ship and assigns a particular class to the vessel on the basis of classification rules prescribed by the society. In certain cases, the government authorities may necessitate a classification done by specific classification society as approved by them.

Business Model

2.1 The Indian Branch is mainly engaged in undertaking the following activities:

- *Classification and certification of ships and inspection of the ship*
- *Certification of marine related materials and components*
- *Certification relating to International Safety Management Co.*

2.2 Such classification is done at the instance of the ship owner, but on behalf of the respective Government and while in some cases, the finding in pursuance to the classification are reported directly to the ship owner and in other cases, the

reports are submitted to the respective Government which, after examination, hands it over to the ship owner whose flag the vessel is flying.

2.3 In case of foreign assignments, the survey request emanates from the arrangements between the HO and the foreign ship owner, entered outside India. The HO then communicates its branch to deploy its surveyors on the job which subsequently undertakes the survey under guidance and in co-operation with the HO technical department.

2.4 Upon completion of survey, Indian Branch submits its report, bearing the GL seal, duly signed and bringing out the extent of compliance of the ship with GL class requirements. The report so submitted is then reviewed by the HO and final certificate is issued by the HO to ship owner. From the time of communication received by the Indian Branch till the issue of final report/certificate by GL there are number of activities undertaken by the HO and the Branch.

2.5 The invoices for the above surveys are raised by the HO on the foreign ship owners. The consideration is received from the ship owners by the HO in Germany. The HO remits the share of the branch, after keeping its share for the services rendered by it in Germany.

2.6 The above explains the invoicing mechanism for survey assignments emanating from foreign ship owners. Similarly, there are instances where assignments are received by Indian Branch from its local clients and the invoices for the same are raised by Indian Branch. In these cases, the invoices are raised by the Indian Branch on its local clients. The consideration is received by it in India and it remits the share of HO for the services rendered by it in Germany.

3 Fee Split

3.1 The above fee sharing ration between the HO and Indian Branch is based on the following Global policy documents:

- GL classification Rules which defines the roles and responsibilities for the jointly performed services. In conformity with these rules, the HO performs certain activities in Germany while certain activities are performed by Indian Branch in India while some are to be performed by either the HO or Indian Branch only.
- The activities undertaken by the HO independently whereas the activities referred in point no. 2.4 are to be undertaken by the HO and the respective inspection office jointly.
- Based on the above referred GL Classification Rules, GL Service code list was prepared which prescribes the percentage of HO's share depending on the nature of services to be provided.

3.2 Your appellant submits that the above referred service code list specifying the revenue split ratio between the HO and the Inspection Offices across the globe was prepared based on the study conducted in 1980. A copy of the study Report is enclosed herewith as Annexure-B page no. 703 to 712. The said study determining the revenue split ratios was conducted prior to the incorporation of the Branch in India and since then the percentages defined in the service code list have been applied consistently till date.

3.3 As may be noted, the revenue split ratios as defined in the said service code list for the HO and inspection offices are used for revenue sharing by the HO with its inspection offices across the globe including the Indian Branch. It can be seen from the Study Report that the HO undertook a detailed study to evaluate the role played by the HO and its group entities across the globe, based on which the revenue sharing ratios were decided.

3.4 The Head Office of your appellant operates in 80 countries across the globe and it follows identical fee split mechanism with all its office worldwide. A

confirmation to this effect has been obtained from the Head Office and enclosed herewith as Annexure-C at page no. 713.

Third Party Contract

The HO represented by Indian Branch had entered into a Service Agreement with an independent party viz. Korean Register of shipping (hereinafter referred to as 'KR'). Both the parties had agreed that the HO will be the Employing society and the Indian Branch's Office will be the Joint exclusive station for the purpose of the said agreement. A copy of the Service agreement has been enclosed herewith as Annexure-D at page no. 714 to 716.

It was agreed that for KR, the Indian Branch will cover the port of Mumbai and nearby areas. Further KR will not be registered as company or branch office in the area and the Indian Branch will be regarded as representation of KR.

It was also agreed that KR shall provide an orientation and initial training course to the surveyors of Indian Branch and will also provide quality manuals and procedures, classification rules and instructions including all the standard forms and stamps required for the activities of the Indian Branch.

The invoices for the fees and expensed (incurred for services performed by it) were to be raised by the Indian Branch and sent to KR head office. The settlement of invoices was also to be done between KR and Indian Branch directly. The above referred invoices were to be raised by the Indian Branch at the standard tariff of fees prescribed by the HO. Further, while making the payments for said invoices, KR was to deduct its share of 30% and pay the remaining share of fees to the Indian Branch.

Your honor will appreciate that the share of KR under the above agreement is 30% which is higher than the share of income that your appellant has shared with its HO during the year under appeal i.e. 19% (as placed in the paper book). To explain the fee split mechanism with reference to sample invoices, which is as under

- A summary of the invoices raised by the HO during the year along with details such as invoice no., invoice amount, expenses recovered, net share of HO and share of Kolkata branch for the services rendered by it.
- A summary of the invoices raised by the HO during the year along with details such as invoice no., invoice amount, expenses recovered, net share of HO and share of Mumbai branch for the services rendered by it.
- A summary of the invoices raised by the Indian Branch during the year along with details such as invoice no., invoice amount, expenses recovered, net share of HO and share of branch.

9. Based on the submission and evidence already on record, the AR submitted that the fee retained or remitted to the HO is the income of the HO and cannot be taxed in the hands of the assessee.

10. The DR, on the other hand, submitted that the basic job of the HO was merely to provide the back office assistance wherein it only organize the mails etc. and facilitates the actual working of the BOs, which,

typically, gets initiated, if a ship is in India, GL-HO then communicates to GL India, to assign one of the surveyors to the job. As some of the classification activities, can only be performed by surveyors employed by the GL-HO, surveys are carried out by the GL India in co-operation with the HO technical department, during the course of the assignment. Upon completion of the survey, GL India submits its report bearing the GL seal, duly signed, and bringing out the extent of compliance of the ship with GL Class requirements. The report so submitted by GL India is then reviewed by GL-HO. Based on the review, GL-HO issues certificate to foreign ship owner.

- *Invoices for the above surveys are raised by GL-HO on the foreign ship owners.*
- *The consideration is received by GL-HO from foreign ship owners outside India.*
- *GL-HO remits GL India's share after keeping its share for the services rendered by it.*
- *To elaborate, GL-HO provides the following services to the foreign ship owners:*
 - *Receiving order for survey, organizing survey in respective country/office.*
 - *Communication with client in order to clarify scope of survey.*
 - *Technical review of order, preparation of Instruction for survey forwarding same to responsible office, clarification with attending surveyors regarding scope.*
 - *Preparing and forwarding technical solution for technical issues.*
 - *Communication with Flag State Authorities regarding statutory matter, preparation of instruction and forwarding to surveyor.*
 - *Plan approval – in case of damages, conversions, reconstruction, plans are reviewed, approved technical solution are being worked out and suggested to client by H.O.*
 - *Technical support of the surveyors in all other matters (24/7 – round-the-clock)*
 - *Training of surveyors, organized and conducted by H.O.(up to 12 months/surveyor).*

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11. The DR referred to the submission made wherein the demarcation had been drawn with regard to the function of the HO & BO and submitted that the job performance was conducted only in India, only the intimation was forwarded to the HO. She referred to some of the details wherein job were performed by the BO and the invoice raised mentioned the place of conduct of job, i.e. Kochi, Kolkata, Vishakapatnam etc., the DR submitted that the conduct of the job can be further clarified from section-2 classification, wherein clause 2.3 notes,

2.3 GL Head Office or one of the Society's representations are to be immediately informed about any average or deficiencies and damages to hull and machinery or other equipment classed, where these may be of relevance to the vessel's class and also from the business model referred to earlier Upon completion of survey, Indian Branch submits its report, bearing the GL seal, duly signed and bringing out the extent of compliance of the ship with GL class requirements. The report so submitted is then reviewed by the HO and final certificate is issued by the HO to ship owner. From the time of communication received by the Indian Branch till the issue of final report/certificate by GL there are number of activities undertaken by the HO and the Branch.

12. The invoices for the above surveys are raised by the HO on the foreign ship owners. The consideration is received from the ship owners by the HO in Germany. The HO remits the share of the branch, after keeping its share for the services rendered by it in Germany.

13. The above explains the invoicing mechanism for survey assignments emanating from foreign ship owners. Similarly, there are instances where assignments are received by Indian Branch from its local clients and the invoices for the same are raised by Indian Branch. In these cases, the invoices are raised by the Indian Branch on its local clients. The consideration is received by it in India and it remits the share of HO for the services rendered by it in Germany.

14. She therefore, pleaded that the concept of the splitting has not been accepted by the coordinate Bench at Mumbai in the case of Linklaters LLP vs ITO, International Taxation, reported in 40 SOT 51(Mum), wherein it has been held

"the basic philosophy underlying the force of attraction rule is that when an enterprise sets up a permanent establishment in another country, it brings itself within the fiscal jurisdiction of that another country to such a degree that such another country can properly tax all profits that the enterprise derives from that country whether the transactions are routed and performed through the PE or not.

The provisions of article 7(1) include the same results as sought to be achieved by article 7(1)(c) of the UN Model convention. As to the scope of this provision, one may find guidance from the UN Model Convention Commentary in this regard.

Therefore, the connections of 'profits indirectly attributable to permanent establishment' do indeed extend to incorporation of the force of attraction

rule being embedded in article 7(1). In addition to taxability of income in respect of services rendered by the PE in India, any income in respect of the services rendered to an Indian project, which is similar to the services rendered by the permanent establishment is also to be taxed in India in the hands of the assessee irrespective of the fact whether such services are rendered through the permanent establishment, or directly by the general enterprises. There cannot be any professional services rendered in India which are not, at least indirectly, attributable to carrying out professional work in India. This indirect attribution, in view of the specific provisions of India-UK tax treaty, is enough to bring the income from such services within ambit of taxability in India. The twin conditions to be, thus satisfied for taxability of related profits are (i) the services should be similar or relatable to the services rendered by the PE in India; and (ii) the services should be 'directly or indirectly attributable to the Indian PE', i.e. rendered to project or client in India. In effect, thus, entire profits relating to services rendered by the assessee, whether rendered in India or outside India, in respect of Indian projects are taxable in India. That is precisely, what the Assessing Officer had done. The grievance of the Assessing Officer was indeed justified and the same was to be upheld. Therefore, relief granted by the Commissioner (Appeals) was to be vacated and the order of the Assessing Officer in that regard was to be restored.

15. She also referred to the decision of the AAR ruling in the case of Worley Parsons Services Pty. Ltd. reported in 179 Taxman 274 wherein it was held, (full text of the decision not placed),

"The applicant, which is a company incorporated in Australia, provides professional services to the energy and resource industries. It entered in to a contract with an Indian company 'S' in connection with the setting up on an alumina refinery in India. Under the contract, the application s responsible for development of a set of basic engineering documents which involves preparation of various diagrams, designs, drawings and layout plans. It has its design centers in Australia from where the design services were performed. However, for the purpose of gathering input for preparation of designs and documents, its personnel came to India for collecting data and information from 'S' which was done at 'ground level'. The staff also visited India to 'explain deliverables to the officer/engineers of 'S' and to help 'S' in testing the same. Therefore, according to the applicant, there were three steps involved in the whole process, i.e. collection of data, preparation of deliverables and transfer of deliverables and testing the same. The applicant avers that the collection of data and transfer of deliverables had taken place in India. However, preparation of deliverables, which was the crucial activity in the transaction, was done in Australia. The applicant has moved the instant application seeking advance ruling on the following questions:

- (a) Whether the receipts of the applicant under the contract with 'S' are in the nature of royalties as defined in article 12 of the DTAA between India and Australia;*
- (b) Whether it does not have a PE in India in respect of this contract; and*
- (c) Whether if answers to (a) and (b) are in affirmative, the receipts from this contract are taxable only to the extent of services utilized as well as*

rendered in India and the receipts for services outside India were not to be taxed.

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Wherein as held, (extracted)

.....Though as stated by the applicant, the core activities of preparation of designs and plans took place in Australia, the activities and services undertaken by the applicant at various stages (both before and after the preparation of designs and other deliverables) were, by no means, negligible or insufficient. In fact, they were essential to carry out the obligations under the contract. Hence, it cannot be said that there is no sufficient territorial nexus for the levy of tax under the Act read with the provisions of the DTAA. In the case of Ishikawajima-Harima Heavy Industries Ltd. (supra), the entire offshore services which according to the Supreme Court were inextricably linked to Offshore supply of goods, were rendered from outside India and therefore, the Supreme Court held that the deeming provisions in section 9 cannot reach such income. Therefore, the applicant cannot press into service the ratio of the decision in Ishikawajima-Harima Heavy Industries Ltd. case (supra) in support of its contention.

The applicant has relied on the following observation of the Supreme Court in Ishikawajima-Harima Heavy Industries Ltd. case (supra) 'section 9 raises a legal fiction, but having regard to the contextual interpretation and furthermore in view of the fact that one is dealing with a taxation statute, the legal fiction must be construed having regard to the object it seeks to achieve'. At the same time, the observation of the Supreme Court may be noted; 'the provisions of section 9(1)(vii) are plain and capable of being given a meaning. Therefore, there may not be any reason not to give full effect thereto. However, a qualification has been added in the next sentence by stating 'even in relation to such income, the provisions of article 7 of the DTAA would be applicable as services rendered outside India would have nothing to do with the PE in India'. This observation reiterates the principle that section 9(1)(vii) is subject to the provisions of the DTAA. In the instant case, there is no permanent establishment of the applicant in India and, therefore, the qualifying sentence regarding the applicability of article 7 does not apply.

Further, in terms of the observation of the Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd. (supra) on territorial nexus and the principle of apportionment, one must proceed on the basis that the utilization of services of non-resident in India, by itself, does not establish territorial nexus where the entirety of services giving rise to FTS or royalty were performed abroad. In ultimate analysis, the requirement of rendering services read into section 9(1)(vii)(c). At the same time it was pointed out that 'it (income) must have direct 'live link' with the services rendered in India'. Thus the 'live link test' was also referred to.

In the ruling in Application No. AAR/747/2007, it has been observed that the territorial nexus cannot be understood in a narrow sense especially when the Treaty itself concedes the power to tax royalties to the contracting State in which they arise it has also been pointed out relying on the decision of the Federal Court in A.H. Wadia v CIT [1949]. That the extent of territorial connection is not a material factor to determine fiscal jurisdiction of the State which seeks to tax subject. Adopting such approach and further, applying the test of 'live

line' enunciated by the Supreme Court in the very same decision, there is no difficulty in reaching to the conclusion that in the instant case, sufficient territorial nexus exists to subject the royalty income to tax in India. Not only the services have been utilized in India for work done in India and for the benefit of a resident of India, but even a part of activities/services under the contract were actually undertaken in India.

Once it is held that the principle of territorial nexus is not infringed by levying tax on the income by way of royalty arising in India, the principle of apportionment pales into insignificant.

Therefore, the entire receipts representing royalty income under the contract in question are liable to be taxed in India at the appropriate rate, both under the provisions of the Act as well as the DTAA between India and Australia. The splitting up of such income is not permissible. The applicant cannot draw support from the decision of the Supreme Court in the case of Ishikawajima-Harima Heavy Industries Ltd. (supra).

16. She also referred to the decision of the Coordinate Bench in Mumbai in ITA No. 6329, 6330 & 6331/Mum/2007 in the case of Nippon Kaiji Kyokoi vs ITO and referred to the submissions of the DR

"the learned Departmental Representative took this Bench through the facts of the case and submits that it was the case of the assessee before the Assessing Officer that the P.E. has not rule to play in providing services through independent acting surveyors. She submits that the Assessing Officer has accepted this position and levied tax in terms of Article-12(2) of the DTAA. She further submits that as the entire service was rendered in India, the Head Office should pay the tax @ 20% of the gross FTS received. She submits that the Commissioner (Appeals) has erred in relying on Article-12(5) of the Indo-Japan DTAA. She elaborate by submitting that for attracting the provisions of Article-12(5), the following conditions are to be fulfilled viz., (i) the beneficial owner of the FRS should carry on the survey through a P.E. in the other State and the FTS is paid for the services effectively connected, with the P.E. She vehemently contends that when there is only a procedural role for the P.E., it cannot be said that the FTS is effectively connected with the P.E. She submits that there is no dispute that fee received for the FTS and that 55% of the same is taxed in India and what is in dispute is only 45% belonging to the Head Office".

17. The DR submits that the in the instant case as well, since the assessee is a part of the same organization the question of splitting of fee does not arise and the difference, thus, of Rs. 58,13,506/ should be added to income of the assessee.

18. The AR submitted that the only dispute is with regard to quantum of attribution of fee. He submitted that in the objections filed

before DRP it was pointed out that the attribution fell within the Protocol to the India Germany DTAA, which reads, *“Income derived by a resident of a contracting state from planning, project construction or research activities as well as income from technical services exercised in that state in connection with a permanent establishment situated in the other Contracting State, shall not be attributed to the permanent establishment”*.

19. On facts, the AR pointed out that HO is conducting planning activities, which cannot be called as services. He, therefore submitted that the case laws relied upon by the DR in the case of Linklaters (*supra*) is distinct on facts and hence not reliable. To strengthen the argument, that the HO is not just a back office support office but perform the job of planning and instruction, the AR relied upon the submissions wherein it has been pointed out,

in India, for the purposes of certain types of inspection/certification, the necessary survey activities are carried out with the cooperation and assistance from the technical department of the Head Office (HO) situated in Germany.

GL-HO has branch office in India (GL India). Assignment of survey emanates from the arrangement between the HO and the foreign ship owner, entered into outside India

Typically, if a ship is in India, GL-HO then communicates to GL India, to assign one of the surveyors to the job. As some of the classification activities, can only be performed by surveyors employed by the GL-HO, surveys are carried out by the GL India in co-operation with the HO technical department during the course of the assignment.

Upon completion of the survey, GL India submits its report bearing the GL seal, duly signed, and bringing out the extent of compliance of the ship with GL Class requirements. The report so submitted by GL India is then reviewed by GL-HO. Based on the review, GL-HO issues certificate to foreign ship owner.

- *Invoices for the above surveys are raised by GL-HO on the foreign ship owners.*
- *The consideration is received by GL-HO from foreign ship owners outside India.*
- *GL-HO remits GL India's share after keeping its share for the services rendered by it.*
- *To elaborate, GL-HO provides the following services to the foreign ship owners:*

Receiving order for survey, organizing survey in respective country/office.

Communication with client in order to clarify scope of survey.

Technical review of order, preparation of Instruction for survey forwarding same to responsible office, clarification with attending surveyors regarding scope.

Preparing and forwarding technical solution for technical issues.

Communication with Flag State Authorities regarding statutory matter, preparation of instruction and forwarding to surveyor.

Plan approval – in case of damages, conversions, reconstruction, plans are reviewed, approved technical solution are being worked out and suggested to client by H.O.

Technical support of the surveyors in all other matters (24/7 – round-the-clock)

Training of surveyors, organized and conducted by H.O.(up to 12 months/surveyor).

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We give below our understanding of the manner of determination of HO share of fees by way of a numerical example:

- *INR 5,000 is received directly by GL-HO from the foreign ship-owner.*
- *Of the above amount of INR 5,000 depending upon the kind of assistance provided by HO to Branch for rendering the filed service, HO share is say 30% i.e. INR 1,500. This amount of INR 1,500 will be income of HO in Germany.*
- *The balance INR 3,500 is credited to GL India by GL-HO.*

20. He further pointed out that experts and qualified and experienced engineers, sitting in Germany in the HO, keep referring to the problems and the instructions are given on continuous basis. As an example, the AR submitted that a job was assigned to Mumbai office to inspect a vessel named “Jordan Express” with the damaged generator (APB 275), which was conveyed by the Mumbai office to its HO via emails and photographs and details of the defects. The AR demonstrated and submitted, that APB 185 to 275 pertained to continuous exchange of problem and receiving of solution to those problems from HO to BO.

21. The AR pointed out that HO provides 24X7, i.e. continuous assistance to its BO on emails and other electronic media without actually coming to site.

22. He further pointed out that the fee attribution formula was adopted by the parent affiliate way back in 1980 after in depth study conducted by the German HO and its branches worldwide. Since India

BO falls under Korean Registry, the fee attribution is based on the formula entered into by German HO and Korean Registry and in any case similar attribution is followed worldwide/globally.

23. The AR pointed out that dispute with regard to fee attribution first arose in assessment year 2001-02, wherein, the AO made additions, because the assessee was unable to provide detailed documents. These documents were produced at appellate stage and the coordinate Bench had restored the issue back to the AO. In the intervening period, the AO also initiated penalty proceedings u/s 271(1)(c) and levied the penalty. In the proceedings before CIT(A) in penalty, the CIT(A) held, *“So from the above discussion, it is clear that the head office also contributes to the activities carried out by the branch office in India. It is also seen that for certain activities, the entire receipts are taken into account only in the branch office. It is also seen that this kind of allocation of receipts was followed in the earlier year also. In view of this, I am of the view that there is a well defined system in the appellant’s case about the sharing of the receipts of the head office and branch office. I am of the view that the revenue earned from the activities of the head office cannot be taxed in India”*. The CIT(A), concluded, on the facts as above, *“it is clear that there should be some intention on the part of the assessee to hide or conceal income so as to avoid the imposition of tax thereon then only penalty can be levied u/s 271(1)(c) of the I.T. Act, 1961. In this case, the appellant has made a claim under a bonafide belief based on a system formulated by the head office for sharing of revenues. It is evident that head office has also done some services and such revenues are not taxable in India”*.

24. The AR, thus, submitted that in view of the fact as accepted by the appellate authority, though in penalty proceedings, the fee attributed to the German HO cannot be taxed in India, *cannot be*

ignored. He submitted that this being a finding of fact is a correct finding and must be accepted. He also placed reliance on the decision of Intergrafia Print & Pack, Gmbh vs DDIT (International Tax) reported in 47 SOT 134 (Del ITAT), wherein the Coordinate Bench accepted the fee attribution of 60:40 between Indian BO & German HO. It was held from the terms of the agreement between the head office and 'Man Ronald' it transpired that the head office was chosen as sales and service partner only because it had local set-ups to provide information and logistic support and business in Asia and for the reason that there was no regular business for 'Man Roanld' in India justifying a full office operation. The branch office (the assessee) made the initial contracts with the customers, collected information about the customer's requirements and forwarded it to the head office. Thereafter the head office arranged the meeting between the 'Man Ronald' and the customer and all meetings took place in Germany. It was the head office which coordinated with 'Man Ronald' and followed up the enquiry, negotiated and finalized all contracts. The branch office had engineers on its pay rolls, provided assistance during installation and commission whenever required. No doubt at the time of the conclusion of the contract it provided logistic support coordination. After the supply of machinery, during the warranty period, it was the sole responsibility of the 'Man Ronald' for breach of any warranty terms. The role of the branch office after the warranty period was only to provide support to the customers for procuring spare parts and other engineering services from time to time. The negotiations of the contract and ultimate conclusion of the contract required more efforts and since those were done in Germany by head office allocation of income at 40 per cent to the role played by the head office was justified. After the conclusion of the contract the role to be played by the branch office was of a routine nature. Considering the role played by the head office and branch office in earning this commission income, the attribution 60 per cent of

commission so received to the role played by the branch office was justified.

25. He, therefore, concluded that there was no justification of making an addition of Rs. 58,13,506/-.

26. He also submitted that similar addition of Rs. 22,32,586/- and 3,00,754/- made u/s 40A(2)(b) were unfounded.

27. We have heard the arguments of both the parties at length and perused the material placed before us. The three issues pertaining to attribution of Rs. 58,13,506/-, to the HO, Rs. 22,32,586/- being HO share of fee and Rs. 3,00,754/- being expenses incurred by HO on behalf of the BO are being taken up together.

28. It is an undisputed fact that India Branch Offices are under the Korean Registry wherein the India BO undertakes inspection and validation of ocean fairing vessels by physically examining the vessels. After physical examination, the reports are sent to HO located in Germany, who issues validation certificate, regarding the fitness of the vessel.

29. The business model followed by the assessee and its parent in Germany are, ships and vessels, in order to operate in sea are required to be classified by a classification society approved by an authority. The classification is done at the insistence of the ship owner on behalf of the respective government. In certain instances, classification is done as per report coming directly from the ship owner. In either case, the post examination approval reports are submitted to the respective government, which is then hands it over to the ship, whose flag it is carrying.

30. The Indian Operations were started from 06.11.1989 as a branch of its German parent, who in turn is a member of International Association of Classification Societies, who decides the scope of monitoring activities of its members. The scope of Indian Branch could be summarized as :

- a) Classification and certification of ships.*
- b) Certification of marine related materials and components.*
- c) Certification relating to International safety management Co.*

31. These activities are carried out with the technical assistance and cooperation of its HO in Germany, who, as submitted are available 24X7. On computation of its classification, invoice is raised by the Indian BO or the German HO, as the case may be, and the receipts are assigned as per the agreed standard module herein followed globally, whereby, the HO retains 30% and the BO retain 70% as per fee splitting arrangement.

32. *We find that as per Article 7 of the India Germany DTAA, the business profits of the permanent establishment in India, only are offered to tax.*

33. Treading strictly on the DTAA route, the issue becomes clear, that the split of fee which is attributed to its German parent HO, become non taxable under the Indian tax regime. This would become applicable on all the three figures that are impugned before us, because the share of Rs. 22,55,981/- is also of the similar nature & character, as that of fee attributed towards HO by the Indian BO at Rs. 58,13,506/- and the expenses incurred by the HO on behalf of India BO at Rs. 3,00,754/- u/s 40A(2)(b).

34. We are in agreement with the decision of Intergrafia Print & Pack GMBH (*supra*), where after following the India German DTAA treaty, the Coordinate Bench at Delhi had approved of the fee split arrangement. We are also in agreement to the decision of the assessee own case in penalty proceedings, wherein, the CIT(A) came to a factual finding that, *“following a well defined system, the revenue earned from the activities of the HO cannot be taxed in India”*, which ultimately has been attributed to the HO and fully backed by the India German DTAA and Para1(b) of the Protocol, as was recited by the AR and reproduced by us earlier.

35. In these circumstances, we reverse the decision taken by the DRP and direct the AO to delete the three impugned amounts of Rs. 58,13,506/-, Rs. 22,55,981/- and Rs. 3,00,754/- from the income of the assessee.

36. In the result, the appeal filed by the assessee is allowed.
Order pronounced in the open court on 05 June, 2013.

Sd/-

(बी. रामकोटय्य / B.RAMAKOTAIAH)
लेखा सदस्य / ACCOUNTANT MEMBER
मुंबई/Mumbai,

दिनांक/Date: **05 June, 2013**

Shekhar

Sd/-

(विवेक वर्मा / VIVEK VARMA)
न्यायिक सदस्य / JUDICIAL MEMBER

Copy to:

1. Applicant
2. Respondent
3. The concerned CIT (A)..... concerned
4. The concerned CIT concerned
5. DR “L” Bench, ITAT, Mumbai
6. Guard File

सत्यापित प्रति //True Copy//

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार Dy./Asst. Registrar
आयकर अपीलीय अधिकरण, मुंबई / ITAT, Mumbai