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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Date of Decision: 02.12.2022

\+ **ITA 503/2022**

COMMISSIONER OF INCOME TAX (INTERNATIONAL TAXATION)-2 .....Appellant

Through: Mr Sanjay Kumar, Adv.

versus

M/S NOKIA SOLUTIONS AND NETWORKS OY .....Respondent

Through: Mr Deepak Chopra & Mr Ankul Goyal, Advs.

CORAM:
HON'BLE MR JUSTICE RAJIV SHAKDHER
HON'BLE MS JUSTICE TARA VITASTA GANJU

[Physical Hearing/Hybrid Hearing (as per request)]

RAJIV SHAKDHER, J. (ORAL)

CM Appl.52239/2022

1. Allowed, subject to just exceptions.

CM Appl.52240/2022

2. This is an application filed on behalf of the appellant seeking condonation of delay in re-filing the appeal.

2.1 According to the appellant/revenue, there is delay of 90 days.

3. For the reasons given in the application, the delay is condoned.

4. The application is disposed of in the aforesaid terms.

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5. This appeal is directed against the order dated 07.12.2021 passed by the Income Tax Appellate Tribunal [in short "Tribunal"].

6. The appellant/revenue has proposed, for consideration of this Court, the following questions of law:

> *"A. Whether on the facts and in the circumstances of the case and in law, the Ld. ITAT erred in holding that the assessee does not have a permanent establishment within the meaning of Article 5 of the India-Finland Double Taxation Avoidance Agreement?*
> *B. Whether on the facts and circumstances of the case, the Ld. ITAT erred in holding that no profits are attributable to the PE of the Assessee relying on the decision of the Hon'ble Special Bench of the Ld. ITAT in case of Nokia Corporation for A Y. 1997-98 and A.Y. 1998-99?*
> *C. Whether on the facts and in the circumstances of the case and in law, the Ld. ITAT has erred in following the decision of the Ld. ITAT in case of Nokia Corporation for A.Y. 2004-05 to 2006-07 and the decision of the Hon'ble Delhi High Court in the case of Adobe Systems Incorporated Vs. ADIT W.P.(C) No. 2384/2013 while holding that the activities of Research and development activities do not constitute a PE of the assessee in India?*
> *D. Whether on the facts and circumstances of the case, the Ld. ITAT erred in holding that revenue from software supplies are not taxable as Royalty under Article 12 of the India-Finland Double Taxation Avoidance Agreement?"*

7. Even according to Mr Sanjay Kumar, who appears on behalf of the appellant/revenue, insofar as the questions of law set forth as 'C' and 'D' above are concerned, they are covered against the appellant/revenue.

7.1 The question of law set out as C above is covered by the decision dated 16.05.2016 rendered by this Court in W.P (C) 2384/2013 titled: ***Adobe Systems Incorporated Vs. Assistant Director of Income Tax and Anr.***

8. Likewise, insofar as the substantial question of law referred in 'D' above is concerned, it is admittedly covered by the decision of the Supreme Court rendered in ***Engineering Analysis Centre of Excellence Private***

Limited vs. Commissioner of Income Tax and Anr. (2022) 3 SCC 321.

9. This brings us to the remaining questions of law, as proposed by the appellant/revenue i.e.,'A' and 'B'.

10. We may note, that the impugned order passed by the Tribunal has proceeded on the basis, *albeit* on a demurrer, that the respondent/assessee has a Permanent Establishment ["PE"] in India, and thereafter gone on to discuss, as to whether any profits could be attributed to it.

11. The Tribunal has returned a finding of fact, that the respondent/assessee recorded a "global net loss" in the relevant assessment year, and therefore no profit could have possibly been attributed to it.

11.1 A discussion on this aspect is set forth in the following paragraphs of the impugned judgment passed by the Tribunal:

> *"19. The assessee emphatically denies that the Appellant has a P.E. in India. However, without any prejudice to that basic contention, the assessee submitted that even assuming without conceding that the assessee has a P.E in India, no profit or income can at all be attributed to the P.E as the net profit of the assessee is loss and there are no taxable attributable profits available. The AO has incorrectly determined the profits taking into GP into consideration and if the net profit is taken into consideration rightly, then the issue as to whether the assessee has a P.E in India is would end up as an academic issue.*
>
> *20. The attribution of profits (Net Profit) stands covered in favour of the Appellant by the Judgment of the Special Bench in the case of Nokia Corporation for A.Ys 1997-98 and 1998-99 (involving. Same business as carried out by the Appellant) as mentioned in the PB Volume C-page 936, at 949-950 (para 287). The Special Bench held that the Appellant Company's world wide* ***Net Profit margins*** *as per its audited accounts are to be applied for determining the quantum of the income to be attributed to the P.E. The effect*

being if the Appellant Company is in net loss as per its audited accounts or the calendar years 2009 and 2010, which relate to the present A.Y. 2010-11, there would be no profit or income attributable to the P.L. There are losses in both years as per the audited accounts. PB- Volume A of Compilation page 164, at 169 and page 180 at 185.

21. The relevant portion of the said Special Bench Judgment is quoted herein below (page 287 of Volume C, at page 949-950):

> *"287 .... Taking all these into consideration, we consider it fair and reasonable to attribute 20% of the net profit in respect of the Indian sales as the income attributable to the PE:*
>
> *The following steps are involved in computing the income attributable to the PE:*
>
> *First the global sales and the global net profit have to be ascertained. From the accounts presented before us as well as before the Income-tax authorities, the global net profit rate has been ascertained at 10.8% and 16.1% by the CIT (Appeals), to which no objection has been taken by either side. This percentage has to be applied to the Indian· sales and by Indian sales, we mean the total contract price for the equipment as a whole and not the bifurcated price which the Assessing Officer has referred to in the assessment order. This will also be consistent with our view that the software and the hardware constitute one integrated equipment. The resultant figure would be the net profit arising in respect of the Indian sales.Out of this figure of net profit 20% shall be attributed to the PE to cover the three activities mentioned above. The Assessing Officer is directed to compute the income of the PE as directed above."*

22. The revenue appealed before the Hon'ble Delhi High Court against the said Special Bench Judgment and the only

*ground raised by the Department was with regard to the rate of **Net Profit** (20%) applied by the Special Bench and not with regard to the method of taking the net profit rate of the foreign enterprise. The revenue department has thus accepted the finding of the Special Bench with regard to the **Net Profit** margin method and has allowed that finding to become final. The same method of attribution of profits to the P.E, on the basis of the **Net Profit** rate of the foreign enterprise has been applied by the revenue in the cases of three other assesses who were in the same field of business as the Appellant viz. ZTE, Huawei and Nortel. Each of these assessees was engaged in the supply of telecom equipment to Indian telecom operators. The ITAT order passed in the case of Notel specifically records that in the cases of each of these two assessees, the revenue had adopted the **Net Profit** rate of the foreign enterprise for determining the amount of profit income which was attributable to each enterprise's respective P.E.*

23. Hence, applying the said Special Bench Judgment to the facts of the present case, as the Appellant has globa1 net loss as per its audited accounts, no profit or income can be attributed to the assessee in India.

24. To mention Special Bench ruling is in line with the provisions of Article 7(1) of the India Finland Double Taxation Avoidance Agreement (DTAA), which is set out at page 719, at 723 of Volume B of the Compilation. For the - sake of convenience, Article 7(1) is reproduced hereunder:

> *"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 enterprises 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.*

25. Article 7(1) thus provides as under:

> *"(a) The profits of an enterprise can ordinarily be taxed only by the country in which it is located.*
> *(b) If however, the enterprise has a P.E. located in another country (which is also a signatory to the DTAA), through which it carries on its business, then a portion of its profits, to the extent it is attributable to the P.E. can be taxed in the other country."*

26. On a plain reading of Article 7(1) of the DTAA, the question of attributing profits to the P.E. arises only if the foreign enterprise is making a profit. This is the condition precedent. If it is making a loss then no question arises at all of attributing any profit to the P.E., which would be taxable in India.

*27. The Assessing Officer has taken gross profit margins of the Appellant Company for 2009 and 2010 as per its audited accounts instead of the net profit margins. The gross profits margins of the Appellant Company for 2009 and 2010 were positive, and that was how the A.O. could attribute profits to the P.E. In so adopting the gross profit margins of the Appellant Company, the A.O. has acted in a manner which is directly contrary to Article 7(1) of the DTAA and also contrary to the said Special Bench Judgment. It is the **Net Profits** margins which are to be considered as for attribution as per the DTAA.*

*28. The computation made by the A.O. in his assessment order is incorrect as the AO has **not** allowed the payments made by the Appellant to NSN India for the services rendered by NSN India as a deduction from the profit attributable to the alleged PE. If the said payments are allowed as a deduction from the gross profit figures taken by the A .O., then again the resultant figure would be losses. Consequently, even if the method of attribution adopted by the A.O. is considered to be correct, in any event, there would be no profit/income attributable to the PE. The computation is as under:*

Particulars	*Amount (INR)*

Gross Margin of the alleged PE (as determined by the AO)	*6,62,39,89,219*
Less: Deduction for actual payments to NSN India during the relevant A.Y.: *(a) Compensation for network management support* *(b) Compensation for marketing support* *(c) Compensation for R&D Support*	 *1,28,53,61,568* *2,49,01,07,317* *5,60,25,53,834*
Net operating profit/loss of the alleged PE	*(2,75,40,33,500)*

29. Consequently, even if the Appellant has a PE in India, no profit or income can in law at all be attributed to PE which would be taxable in India. Hence, we hold that, the adjudication on issue of PE would be academic in nature."

12. Having regard to the following finding of fact returned by the Tribunal, we are of the view that the proposed questions of law i.e., A and B would not arise for consideration.

13. We may also note, that a plain reading of the Article 7 of the Double Taxation Avoidance Agreement entered into between India and Finland also persuades us to take the same view as that which is taken by the Tribunal.

13.1 A plain reading of the Article 7(1) would show, that the issue of taxability would arise *qua* the respondent/assessee only if profits accrue to the respondent/assessee, and that too only to the extent they can be attributed to its PE in India.

14. Given this position, we are not inclined to entertain the appeal.

15. The appeal is, accordingly, dismissed.

16. Pending applications shall stand closed.

RAJIV SHAKDHER, J

TARA VITASTA GANJU, J

DECEMBER 2, 2022/r

Click here to check corrigendum, if any