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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**
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\+ **W.P.(C) 2156/2013 & CM No.4100/2013**

ORACLE SYSTEMS CORPORATION ..... Petitioner
Through: Mr M. S. Syali, Senior Advocate with Mr Mayank Nagi and Mr Husnal Syali, Advocate.

versus

DIRECTOR OF INCOME TAX (INTERNATIONAL TAXATION)-II AND ANR ..... Respondents
Through: Mr Rahul Chaudhary, Senior Standing Counsel with Mr Raghvendra Singh, Junior Standing Counsel with Mr Sharad Agarwal, Advocate.

CORAM:
JUSTICE S.MURALIDHAR
JUSTICE VIBHU BAKHRU

O R D E R

% **18.02.2016**

Vibhu Bakhru, J:

1. The Petitioner – a company incorporated under the laws of Delaware, United States of America – has preferred the present petition under Article 226/227 of the Constitution impugning a notice dated 28th March, 2012 issued by the Assessing Officer ('AO') under Section 148 of the Income Tax Act, 1961 ('Act'). The Petitioner also impugns an order dated 21st March, 2013 passed by the AO rejecting the objections raised by the Petitioner against assumption of jurisdiction under Section 148 of the Act.

2. The main controversy in the present petition is whether the conditions as

laid down under Section 147 of the Act for re-opening the assessment for the Assessment Year ('AY') 2005-06 were satisfied. The principal contention advanced by the Assessee is that there was no failure on its part to disclose fully and truly all material facts necessary for assessment; consequently, the condition as stipulated in the Proviso to Section 147 is not satisfied. It is further pleaded that the concluded assessment is sought to be re-opened on account of a change in opinion, which is impermissible. It is urged that, therefore, the assumption of jurisdiction under Section 147 of the Act is invalid.

3. Briefly stated, the relevant facts necessary to consider the controversy are as under:

3.1 The Assessee is engaged in the manufacture and production of business support software. The Assessee has a wholly owned subsidiary in India, namely, Oracle India Private Limited ('OIPL').

3.2 The Assessee filed its return of income for AY 2005-2006 on 30th November, 2006 declaring an income of Rs.1,79,27,09,864/-. Along with its return of income, the Assessee also filed a statement of computation of income, TDS certificates and a Chartered Accountants report in Form 3CEB specifying the international transactions carried out by the Petitioner. The return was picked up for scrutiny and notices under Section 143(2) of the Act were issued on 30th November, 2007 and 9th July, 2008, which were duly responded to by the Assessee. After culmination of the proceedings, an assessment order was passed on 21st November, 2008.

3.3 The Assessee has entered into a Software Duplication and Distribution License Agreement with OIPL pursuant to which OIPL sub-licenses software products to various customers in India. The Assessee offered the royalty received under the Software Duplication and Distribution License agreement to tax in its return of income.

3.4 After due scrutiny of the return and all explanations furnished by the Assessee, the AO concluded that the software development centres of OIPL located at Hyderabad and Bangalore constituted the Assessee's Permanent Establishment (hereafter 'PE') in India. Accordingly, the AO taxed the income of the Petitioner in respect of business of development of software as profits of the Assessee attributable to its PE in India. The AO also assessed income of the Petitioner from what he termed as "Global Deals", as chargeable to tax under the Act.

3.5 Aggrieved by the Assessment Order dated 21st November, 2008, the Assessee preferred an appeal before the Commissioner of Income Tax (Appeals) [CIT(A)] on several grounds including that the Petitioner did not have a PE in India. The said appeal is stated to be pending.

3.6 The Assessee received a notice dated 28th March, 2012 issued under Section 148 of the Act, *inter alia,* stating that the AO had reason to believe that income chargeable to tax for the AY 2005-06 had escaped assessment within the meaning of Section 147 of the Act and consequently, he proposed to re-assess the Assessee's income for the said year.

3.7 The Assessee requested for the reasons for re-opening and pursuant to its request, the AO provided the reasons as recorded. The Assessee objected to the reasons which were disposed of by an order dated 21st March, 2013.

4. Section 147 of the Act provides that where an AO has reason to believe that any income chargeable to tax has escaped assessment, he may assess or re-assess such income that has escaped assessment. The first proviso to Section 147 is relevant; it further restricts the power of an AO to re-assess the income of an assessee after the expiry of four years from the end of the relevant assessment year. By virtue of the said proviso, such assessment can be re-opened only when there is a failure on the part of the assessee to fully and truly disclose all material facts necessary for his assessment. In the present case, the Petitioner questions the assumption of jurisdiction to re-open the assessment principally on the ground that there has been no failure on the part of the Petitioner to fully and truly disclose all material facts necessary for its assessment. The Petitioner also disputes the claim of the Revenue that any of its income chargeable to tax under the Act has escaped assessment but for the purposes of the present petition, the learned counsel for the Petitioner has, without prejudice to other contentions, restricted his arguments to (a) the applicability of the first proviso to Section 147 of the Act, that is, the Petitioner has not failed to disclose fully and truly all material facts necessary for its assessment; and (b) that the re-opening of assessment has been occasioned by change in opinion, which is impermissible.

5. Accordingly, we are proceeding to address the controversy urged on the assumption - although it may not be correct - that the Revenue's contention

that the Petitioner's income for AY 2005-06 has escaped assessment, is correct. However, in order to address the issue at hand, it is necessary to understand the Revenue's contention with regard to the merits of its claim that the Assessee's income has escaped assessment.

6. The dispute essentially revolves around the royalty payments received by the Petitioner from its Indian subsidiary - IOPL. The Petitioner had filed the return declaring an annual income of Rs.1,79,27,09,864/- for the AY 2005-06. It was duly disclosed that the aforesaid sum comprised of (a) royalty payments for non-exclusive non-assignable right to duplicate and sub-license software aggregating Rs.1,75,08,57,931/-; and (b) a further sum of Rs.4,18,51,933/- as interest on delayed payment of such royalty. By an order dated 29th September, 2008, the Transfer Pricing Officer (TPO) accepted the aforesaid transactions as being at 'Arms Length Price' ('ALP').

7. The assessment order indicates that the Petitioner had entered into a Software Duplication and Distribution License Agreement with its Indian Subsidiary, OIPL, in terms of which OIPL was granted a license for duplication and distribution of Oracle Software in India. In consideration for the said license, the Petitioner charged royalty @ 56% of the revenue being the actual sales price, updates and product support revenue. In addition, the Petitioner had also entered into a Software Support Services Agreement with OIPL in terms of which the Petitioner was entitled to receive royalty @ 56% of the new revenue recognized by OIPL as programme license, updates and product support revenue under multi jurisdictional transaction. The royalty incomes in respect of above said agreements were duly declared by the

Petitioner and offered to tax. In addition to the royalty surrendered to tax, the AO also found that the Petitioner was liable to pay tax on income which was described as "income in the nature of royalty from Global Deals"; and "Profit from Software Development in India". The Assessing Officer noticed that in several cases the associate concerns of Petitioner had granted software license abroad and the software was used in India by the associated concerns of Multi National Corporations (MNCs) who had obtained the licenses abroad. The Petitioner contended that royalty on such global deals was not exigible to tax in India as the same would amount to double taxation.

8. The AO also concluded that the Petitioner was carrying on software development activity through its PE in India and sought to tax so much of Petitioner's income as, according to the AO, was attributable to the Petitioner's PE in India.

9. It is relevant to note that the AO had consistently held from AY 1997-98 onwards that the Petitioner had a PE in India as it was conducting its business through the facility of its wholly owned subsidiary - OIPL. In addition, the AO had also concluded that the Petitioner was liable to pay tax on Royalty on what he termed as 'Global Deals'. The Petitioner had disputed that it had a PE in India and continued to agitate the issues by filing appeals before CIT (A). Further, the Petitioner had also invoked the Mutual Agreement Procedure (MAP) as per Article 27 of the Indo-US DTAA for avoidance of double taxation in respect of transactions which were sought to be taxed in USA as well as in India.

10. It is not in dispute that the Petitioner had produced all the relevant documents pertaining to the international transactions entered into by it. During the assessment proceedings, the AO also examined the other activities of the Petitioner in India and concluded that the Petitioner was also liable to pay tax on income by way of royalty on the total revenues transferred to OIPL in respect of 'global deals', that is, the software licensed to various Multi National Corporations ('MNCs') which were utilized by the said MNCs in India and the revenue pertaining to it was transferred to OIPL. Further, the AO was also of the view that in respect of software development business, the Petitioner had a Permanent Establishment in India in the shape of software development centres at Hyderabad and Bangalore which were operated by OIPL. The AO held that OIPL being a wholly owned subsidiary of the Petitioner had undertaken the core activities relating to software development in India. The AO held that the taxable income of Rs.2,80,03,95,306/- was attributable to the Petitioner's PE in India. The AO did not accept the Petitioner's contention that OIPL was an independent agent and was acting in its ordinary course of business in so far as the software development business was concerned. However, the AO accepted that "the ordinary course of business of OIPL is replication and licensing of software" and therefore, royalty for license to replicate and distribute was taxed as Royalty in accordance with Article 12 of the Indo-US DTAA and not as business income.

11. The Petitioner has not accepted the AO's conclusion and therefore, has appealed before the CIT (A) which is pending consideration.

12. Whist the proceedings are pending as aforesaid, the AO issued a notice under Section 148 of the Act on 28th March 2012, which is impugned in this petition. At the request of the Petitioner, the AO provided the reasons for his belief that income of the Petitioner had escaped assessment. At this stage, it is relevant to refer to those reasons and the same are reproduced as under:

> "The assessee is a foreign company. For the AY 2005-06, assessment was completed after scrutiny in November 2008. Pursuant to order u/s 154/143(3), an income of Rs ,474,92,07,166/- was determined. This includes two streams of revenue: business and royalty. OIPL has been held to be PE of the assessee in India. The royalty was taxed at 15%. Subsequently, it was observed that the assessee has business connection and PE in form of OIPL, in India, under provisions of section 9(1) (1) of IT Act and in terms of Article 5 of the DTAA, respectively. The assessee company is earning Royalties in India which is linked to the PE. Therefore, this royalty income must be taxed @ 20% gross instead of 15%.
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> Further, the royalty income offered by the assessee includes Rs *4,18,51,933/-* towards interest on delayed royalty which should be taxed @ 41.82 percent.
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> It was the duty of the assessee to disclose fully and truly all material facts necessary for the assessment but it has not done so. The facts pertaining to existence of PE in India and income earned/linked to it have not been disclosed. This has led to underassessment of income. Therefore, I have reasons to believe that income of more than Rs 1 lakh of the assessee company for AY 2005-06, has escaped assessment. I am therefore satisfied that it is a suitable case to be reopened for reassessment."

13. A bare perusal of the reasons indicate that the disputes relating to the

income of the Petitioner escaping assessment are twofold: The first being whether the tax payable on royalty is chargeable at the rate of 20% instead of 15% as accepted earlier; and the second being, whether the interest payable on royalty is chargeable to tax at the rate of 41.82% instead of 15% as accepted earlier.

14. The Revenue contends that the royalty payable to the Petitioner is taxable as business profits in terms of Article 7 of the Double Tax Avoidance Agreement between India and USA (hereafter 'Indo-Us DTAA') and not as royalty in terms of Article 12 of the Indo-US DTAA.

15. At this stage it is necessary to refer to Article 7 and Article 12 of the Indo-US DTAA and the relevant paragraphs of Article 7 and Article 12 of the DTAA are reproduced hereunder:-

> "**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 (a) that permanent establishment; (b) sales in the other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or (c) other business activities carried on in the other State of the same or similar kind as those effected through that permanent establishment.
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"**ARTICLE 12** – *Royalties and fees for included services* – 1. Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State; but if the beneficial owner of the royalties or fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed :

(a) in the case of royalties referred to in sub-paragraph (a) of paragraph 3 and fees for included services as defined in this Article [other than services described in sub-paragraph (b) of this paragraph] :

> (i) during the first five taxable years for which this Convention has effect,
>
> > (a) 15 per cent of the gross amount of the royalties or fees for included services as defined in this Article, where the payer of the royalties or fees is the Government of that Contracting State, a political subdivision or a public sector company ; and
> >
> > (b) 20 per cent of the gross amount of the royalties or fees for included services in all other cases ; and

(ii) during the subsequent years, 15 per cent of the gross amount of royalties or fees for included services ; and

(b) in the case of royalties referred to in sub-paragraph (b) of paragraph 3 and fees for included services as defined in this Article that are ancillary and subsidiary to the enjoyment of the property for which payment is received under paragraph 3(b) of this Article, 10 per cent of the gross amount of the royalties or fees for included services.

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> 6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State, in which the royalties or fees for included services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the royalties or fees for included services are attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be shall apply."

16. By virtue of paragraph 6 of Article 12 of DTAA, the provisions of paragraph 1 and 2 of the said Article would not be applicable if the beneficial owner of royalties being a resident of a contracting state carries on business in the other contracting state in which the royalties arise, through a PE situated therein. Thus, by virtue of paragraph 1 of Article 7 of the DTAA, the income of the Petitioner which is attributable to (a) its PE; (b) sale of goods or merchandise which is similar to those sold through the PE; and (c) business activities carried on by the Assessee which are similar to the business activity carried on through its PE, is taxable as business profits.

17. According to the Revenue, the royalty payable to the Petitioner by OIPL is linked to its PE in India and by applying the principle of 'force of attraction', the said royalty would also be taxable as business profits and not as royalty under Article 12 of DTAA.

18. In the aforesaid context, the central issue to be addressed is whether such income could be stated to have escaped assessment on account of omission or failure on the part of the Petitioner to fully and truly disclose all material facts.

19. The Supreme Court in the case of ***Calcutta Discount Company v. Income Tax Officer: [1961] 41 ITR 191(SC)*** explained the meaning of the expression "omission or failure to disclose fully and truly all material facts necessary for his assessment" and observed as under:

> "The words used are "omission or failure to disclose fully and truly all material facts necessary for his assessment for that year". It postulates a duty on every assessee to disclose fully and truly all material facts necessary for his assessment. What facts 'are material and necessary for assessment will differ from case to case. In every assessment proceeding, the assessing authority will, for the purpose of computing or determining the proper tax due from an assessee, require to know all the facts which help him in coming to the correct conclusion. From the primary facts in his possession whether on disclosure by the assessee, or discovered by him on the basis of the facts disclose, or otherwise, the assessing authority has to draw inferences as regards certain other facts; and ultimately, from the primary facts and the further facts inferred from them, the authority has to draw the proper legal inferences, and ascertain on a correct interpretation of the taxing enactment, the proper tax leviable."

20. In a later judgment, ***CIT v. Burlop Dealers Ltd.:*** **AIR (1971) SC 1635**, the Supreme Court referred to the above quoted passage from ***Calcutta Discount Company*** (*supra*) and explained that if an Assessee had disclosed

the primary facts relevant for the assessment, he was under no obligation to instruct the Income Tax Officer about the inference which the Income Tax Officer would draw from the facts. The said view was again reiterated by the Supreme Court in ***ITO v. Madnani Engineering Works Ltd:*** **(1979) 118 ITR 1 (SC).**

21. It is not in dispute that the Assessee has produced all relevant material that was required. The AO had further examined the transactions in question and had accepted that the royalty payable to the Petitioner was chargeable to tax at the rate of 15%. The AO had concluded that the software development centres in Hyderabad and Bangalore constituted the Petitioner's PE in India insofar as the Petitioner's income from software development is concerned. However, the AO accepted that "the ordinary course of business of OIPL is replication and licensing of software" Accordingly, the Petitioner's income from royalty was taxed in accordance with Article 12 of the Indo - US DTAA. The AO now wants to tax this royalty as income from business by applying the principle of 'force of attraction' to the Petitioners alleged PE in India.

22. The principle of 'force of attraction of the Permanent Establishment' - as explained by Klaus Vogel on Double Taxation Conventions - is a principle where the state in which a permanent establishment of a non-resident is allowed to *"tax all income derived by the enterprise from sources in that State irrespective of whether or not such income is economically connected with the permanent establishment."*

23. Under the OECD and UN Model Convention, a non-resident is taxable

in the State where it carries on business through a PE. However, only so much of its income that is attributable to the PE is liable to be taxed in that State. However, the UN Model Convention accepts the principle of force of attraction to a limited extent and also includes a non residents income that is attributable to sale of goods in the other State which are similar to those as sold through a PE in that State as well as from any business activities carried on in that State which are similar to those carried on through a PE situated in that State. In other words, even though sale of goods or merchandise or any business activity is not carried on by a non-resident through its PE, it nonetheless would be taxable if the goods or merchandise sold or the business activities carried on in the other State are similar to that sold or carried on through a PE in that State. The Indo-US DTAA is similar to the UN Model Convention.

24. Mr Rahul Chaudhary, learned Senior Standing Counsel sought to contend that the facts discovered by the AO subsequently indicated that a PE of the Petitioner existed in the context of the income taxed as royalty; and, the Petitioner's receipt of royalty was attributable to its PE in India. However, a closer examination of the counter affidavit expressly affirms that the Revenue is seeking to tax the royalties received by the Petitioner by applying the principle of 'force of attraction' which is embodied in paragraph 1 of Article 7 of the Indo-US DTAA. In other words, the Revenue is not seeking to tax such royalty as it has discovered another concealed permanent establishment but is seeking to link the royalty received to the Petitioner's alleged extant PE by applying the principle of force of attraction to that PE. The reasons for forming a belief that income of the Petitioner has

escaped assessment also does not indicate that the AO had discovered that the royalty in question was earned by the Petitioner through a PE, it only alleges that it is observed that such royalty is "linked" to the Petitioner PE.

25. Clearly, there was no other primary fact which was material to the assessment and not disclosed by the Petitioner. The question whether the royalty receivable by the Petitioner is chargeable to tax at the rate of 20% is dependent on the AO's inference as to (a) whether the principle of 'force of attraction' is applicable to the royalty payable to the Petitioner, that is, whether the royalty can be attributed to business activities similar to those carried on through the Petitioner's PE in India; and (b) whether the royalty receivable by the Petitioner falls within the exclusion of paragraph 6 of Article 12 of the Indo-US DTAA.

26. Insofar as the interest on royalty is concerned, the same was clearly disclosed by the Petitioner in the audit return (form 2 CEB). Further, the TPO has also recorded the same as a disclosed international transaction in his order dated 29th September, 2008. Thus, the contention that the Petitioner had failed to fully and truly disclose any material fact relevant for assessment of that income is plainly unsustainable. The question whether such income was to be taxed as interest income and not as royalty is again a matter of inference. The earlier decision of the AO to assess the same as royalty cannot be traced to any failure on the part of the Petitioner to disclose fully and truly any primary fact.

27. The next aspect that needs to be examined is whether the AO had any tangible material which provided him a reason to believe that income of the

Petitioner had escaped assessment or whether the same was on account of a change in opinion?

28. It is apparent that whereas the AO while framing the assessment had not applied the rule of "force of attraction", the present incumbent apparently feels that the rule of force of attraction ought to have been applied; he now infers that income by way of royalty can also be taxed under Section 44D of the Act as business income in terms of paragraph 1 of Article 7 of the Indo-US DTAA read with paragraph 6 of Article 12 of the Indo-US DTAA. Plainly, this is a change of opinion. It is now well settled that it is impermissible to re-open concluded assessments on the basis of such change of opinion.

29. In ***Oracle Systems Corporation v. Assistant Director of Income-tax, Circle 2(1), International Taxation, New Delhi [2015] 235 Taxman 337 (Delhi)***, a Co-ordinate Bench of this Court considered the Petitioner's challenge to re-opening of assessment for the AY 2002-03 and 2003-04. The reasons recorded for re-opening the assessments for those years were more or less similar to the reasons as recorded in the present case. In that case, the Court observed that "*in the present case, having examined all the relevant facts and circumstances, it is clear that the aspect of attribution was too obvious and apparent for the Assessing Officer to have been ignored in the first round/original proceedings*" and following the decision of the Full Bench in ***CIT v. Usha International Ltd. 2012 348 ITR 485*** held that "*what the Assessing Officer is now seeking to do amounts to a clear change of opinion and that is not permissible.*"

30. The Supreme Court in the case of ***CIT v. Kelvinator of India Limited:[2010] 320 ITR 561 (SC)*** had held that the expression “reason to believe” as used in Section 147 of the Act must be given an schematic interpretation. The Court held that an assessing officer had no power to review but only to re-assess an Assessee’s income that had escaped assessment on fulfilment of certain conditions. Thus, re-assessment on the basis of change of opinion must be excluded from the scope of Section 147.

31. In view of the settled legal position as aforesaid, even if the proviso under Section 147 of the Act is not pressed into service, the re-opening of assessment for the reasons as disclosed would be impermissible as it merely reflects an endeavour to charge enhanced tax on the basis of a change in opinion.

32. Mr Syali, learned Counsel for the Petitioner had also contended that the assessments were sought to be re-opened on the basis of audit objections which had not been accepted by the Department. He contended that the Revenue was seeking to re-open the assessment based on CBDT Instruction No. 9 of 2006. He also drew attention of this Court to a letter dated 1st September, 2009 sent by the AO to the Audit Officer wherein the AO had not accepted the objection of the Audit party that royalty ought to have been taxed at the rate of 20% by virtue of section 44D read with section 115A (b) (A) of the Act.

33. Mr Rahul Chaudhary disputed the aforesaid contention and contended that the AO’s decision to re-open was not pursuant to any audit objection but pursuant to facts that came to the knowledge of the AO subsequently. He

pointed out that whereas the audit objection was raised on 09th June, 2009, the notice under Section 148 of the Act was issued much later on 28th March, 2012.

34. This Court in a recent decision in ***Sun Pharmaceuticals Industries Ltd. v. Deputy Commissioner Of Income Tax & Anr.: W.P. (C) 6729/2011*** decided on ***14th January, 2016*** had examined the CBDT Instruction No. 9 of 2006 and held that the same could not over-ride the statutory powers exercised by an AO in terms of Section 147 of the Act. The said CBDT instruction cannot be understood to compel the AO to re-open assessments that are inconsistent with his views. In the present case, the letter dated 1st September, 2009 clearly indicates that the AO had not accepted the view that the royalty paid to the Petitioner was liable to be taxed at the rate of 20% under Section 44D of the Act. He had expressly stated that *"no inference may be drawn that the royalty income has accrued to the petitioner from its PE in India"*.

35. Mr. Syali is probably correct in assuming that the Petitioner's assessment for AY 2005-06 is being re-opened only on the basis of CBDT Instruction No. 9 of 2006. This, as held in ***Sun Pharmaceuticals Industries Ltd*** (*supra*), is impermissible. Even if, Mr Chaudhary's contention is accepted that the decision to re-open the assessment is not based on the audit objections but on independent reasons, it is apparent that the same is on account of a change in opinion. Whereas the AO by its letter dated 1st September, 2009 had reasoned to the contrary, he seems to have veered in favour of the opinion that was espoused by the audit party. As stated earlier,

re-opening of assessment on account of change in opinion is also impermissible.

36. In view of the above, the order dated 21st March, 2013 and the notice dated 28th March, 2012 are set aside. The Petition is allowed and the application is also disposed of. In the given circumstances, the parties are left to bear their own costs.

VIBHU BAKHRU, J

S.MURALIDHAR, J

FEBRUARY 18, 2016
MK/pkv