Case Studies on Permanent Establishment including Attribution of Profits

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**Case Study III**

**FACTS:**

1. A US Co. was a leading supplier of equipment and related software products in relation to the turnkey project and carried out installation, commissioning and operation of such turnkey project.

2. It entered into a contract with an Indian Company for certain design services outside India in relation to the equipments supply of US Co Offshore supply of equipment, commissioning, India in relation to the equipments, supply of such equipments and installation, commissioning and operation of the turnkey project after the supply. **The design services and supply of equipment's take place in 2 phases i.e. Phase I (pre installation) & Phase II (post installation).**

3. Supply of equipment's was done offshore.

4. Remuneration for each part of contract is mentioned separately in the contract.

5. It established project office in India for carrying out installation activities after supply contract was concluded.

6. It also sent its employees for completing its job who remained in India for more than 120 days in the relevant financial year. Further the installation activities were carried out for a period of more 120 days. Consequently, the US Co. has an Installation PE in India.
FACTS:
1. A US Co. was a leading supplier of equipment and related software products in relation to the turnkey project and carried out installation, commissioning and operation of such turnkey project.
2. It entered into a contract with an Indian Company for certain design services outside India in relation to the equipments supply of US CO Offshore supply of equipment, commissioning, and operation of the turnkey project after the supply. The design services and supply of equipment's take place in 2 phases i.e. Phase I (pre-installation) & Phase II (post installation).
3. Supply of equipment's was done offshore.
4. Remuneration for each part of contract is mentioned separately in the contract.
5. It established project office in India for carrying out installation activities after supply contract was concluded.
6. It also sent its employees for completing its job who remained in India for more than 120 days in the relevant financial year. Further the installation activities were carried out for a period of more 120 days. Consequently, the US Co. has an Installation PE in India.
Case Study III

ISSUES:

1. Whether income from offshore supply of equipments qua Phase I can be said to be attributable to the Installation PE?

2. Assuming the offshore design services qua Phase I constitutes FIS/ Royalty, should it be taxed under Article 12 or Article 7?

3. Whether income from offshore supply of equipments and offshore design services qua Phase II can be taxed under Article 7?

4. What if the contract provides for rendition of certain training services in India? Can the income for such services be attributed to the Installation PE in India?
Issues 1: Whether income from offshore supply of equipments qua Phase I can be said to be attributable to the Installation PE?

Treaty Provisions

Indo-US DTAA – Article 7(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.”

Judicial Precedents

1. Ishikawajima Harima Heavy Industries Ltd. vs. DIT (288 ITR 408)(SC)

“What is to be taxed is profit of the enterprise in India, but only so much of them as is directly or indirectly attributable to that permanent establishment. All income arising out of the turnkey project would not, therefore, be assessable in India, only because the assessee has a permanent establishment…….

It is stated that the term ‘directly or indirectly attributable’ indicates the income that shall be regarded on the basis of the extent appropriate to the part played by the permanent establishment in those transactions. The permanent establishment here has had no role to play in the transaction that is sought to be taxed, since the transaction took place abroad.”
2. CIT vs. Hyundai Heavy Industries Ltd. 291 ITR 582 (SC)

"Applying the above test to the facts of the instant case, it was found that profits earned by the Korean GE on supplies of fabricated platform could not be made attributable to its Indian PE as the installation PE came into existence only after the transaction stood materialized. 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 could not be said to be attributable to the PE."

Other cases:

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<tr>
<th>3</th>
<th>(106 ITD 489) (Mum)</th>
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<td>15</td>
<td>145 ITD 158 (Del)</td>
<td>Hyundai Heavy Industries CO Ltd. vs. ADIT</td>
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Conclusion:

Income from offshore supply will not be taxable in India as the income is not attributable to the PE, since the PE had no role to play in earning the same and also because at the time of execution of the transaction, no PE had been established in India.
Offshore Design Services taxable under Article 7 or Article 12

Issue 2: Assuming the offshore design services qua Phase I constitutes FIS/Royalty, should it be taxed under Article 12 or Article 7?

Treaty Provision

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:

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.”

Judicial Precedent

1. Hon’ble Mumbai Tribunal in case of Toyo Engineering Corporation vs. DDIT (60 SOT 241) has held that “In the case in hand the assessee has categorically stated that the Permanent Establishment has no role in earning the Fees for Technical Services/Royalty in question. Having said so that the Permanent Establishment of the assessee has no role in earning of the income from Fees for Technical Services under offshore design contract then the exclusion clause under Article 12(5) of Indo-Japan treaty shall not be attracted and consequently the provisions of Article 12 relating to Fees for Technical Services will be applicable”
2. Hon’ble Supreme Court in case of Ishikawajima Harima Heavy Industries Ltd. vs. DIT (288 ITR 408) has held in respect of offshore services “Since the appellant carries on business in India through a permanent establishment, they clearly fall out of the applicability of art. 12(5) of the DTAA and into the ambit of art. 7.” and “The services are inextricably linked to the supply of goods, and it must be considered in the same manner.”

-- Thus, the Hon’ble Supreme Court has held that offshore services that forms part of a composite contract cannot be considered separately under Article 12 but under Article 7. Further, Hon’ble Bombay High Court has followed the above Apex Court judgment in case of DIT vs. Ishikawajima Harima Heavy Industries Ltd. (258 CTR 335). Further, the Hon’ble Mumbai Tribunal IHI Corporation vs. Addl DIT (155 TTJ 4) has also followed the Apex Court judgment wherein it held that:

“The learned Departmental Representative submitted that the case of the assessee cannot be considered under para 5 of Article 12 because the fees for offshore services cannot be considered as "effectively connected" with the permanent establishment……. so as to throw it in the scope of Article 7 …..

(12)The services are inextricably linked to the supply of goods, and it must be considered in the same manner…. It has further been held that since the entire services were rendered outside India having nothing to do with the permanent establishment, there can be no taxability of this amount in India."

-- However, the Tribunal in case of Toyo (supra) has not dealt with the decision of Hon’ble Supreme Court in case of Ishikawajima and Mumbai Tribunal in case of IHI Corporation, even though the same were cited. Thus, it may be possible to argue that the judgment in case of Toyo Engineering is per incuriam.

Conclusion

Thus, even if the offshore services constitute FIS/ Royalty, but if the same are connected and are inextricably connected to the composite contract for supply of equipment, then the same should be considered as Business income and dealt with by Article 7 and not by Article 12.
Offshore Services taxable under Article 7

--- Whether income from offshore services can be taxed under Article 7(1)

Treaty Provision

Indo- US DTAA – Article 7(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.”

Judicial Precedent

1. Ishikawajima Harima Heavy Industries Ltd. vs. DIT (288 ITR 408)(SC)

“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….. 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 the DTAA the taxation liability in respect of overseas services would not arise in India.”
Offshore Services taxable under Article 7

Other judgments:

<table>
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**Conclusion**

Income from offshore supply of services will not be taxable in India under Article 7 as the offshore services are inextricably connected with the offshore supply of the equipments and the same cannot be said to be attributable to the PE in India as the PE has no role to play in the rendition of the said services.
### Issue 3:
Whether income from offshore supply of equipments and offshore design services qua Phase II can be taxed under Article 7?

<table>
<thead>
<tr>
<th>Whether the income is taxable as being attributable to Installation PE</th>
<th>Income from supply of equipments</th>
<th>Income from design services</th>
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| Whether the income is taxable by Force of Attraction Rule            | B                               | B                           |

3A.

**Whether income from offshore supply of equipments and offshore design services qua Phase II can be taxed under Article 7 as being attributable to Installation PE?**

Income from offshore supply of equipment and design services made after the PE has been established will not be taxable in India since, as already discussed the Installation PE has played no role in the offshore supply of the equipments or services. Consequently, income from such offshore supply cannot be said to be attributable to the PE in India. Thus, it cannot be taxed on the ground of being attributable to the Installation PE in India.
3B. Whether income from offshore supply of equipments and offshore design services qua Phase II can be taxed under Article 7 by virtue of Force of Attraction Rule?

**Treaty Provision**

Indo- US DTAA – Article 7(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.”

i. As evident from the earlier slide that income from offshore supply of equipments and offshore design services qua Phase II cannot be said to be attributable to the PE.

ii. Sale of offshore equipment cannot be said to be same or similar to the goods sold by the Installation PE. Also, the said sale has not taken place in the state where the PE exist.

iii. Activity of the offshore design services cannot be considered as same or similar to the activity of the Installation PE.
1. Hon’ble Mumbai Tribunal in case of Roxon OY (106 ITD 489) Mum Tribunal has held that
“By no stretch of logic art. 7(1)(b) would cover such a situation. The contents of the Commentary on UN Model Convention, bearing in mind the fact that the UN Model Convention Commentary is to be treated as contemporanea expositio since the treaty article in question is based on the UN Model Convention, suggests that installation PE is not covered by the force of attraction principle even if installation PE is selling the same or similar goods as sold directly by the enterprise abroad. The reason appears to be that while in the case of an installation PE, it may only be incidental to the main activity of installation and commissioning of a project that some local supplies may have to be made to the customer, the direct sales by a foreign enterprise in the PE State are to be covered by the force of attraction principle only when the PE is for the purpose of selling goods or merchandise. There are protocol clauses in certain recent Indian treaties, which provide that in the cases of, inter alia, contracts for supply, installation or construction of industrial, commercial or scientific equipment or public works, the PE profits shall be determined only on the basis of that part of contract which is effectively carried out by the PE. Therefore, in the case of a turnkey contract, which includes offshore supply of machineries, etc., the profits which are to be taxed will only be the profits which can be attributed to the work effectively carried out by the PE.”

2. Also see ADIT v WNS Global Services (UK) Ltd. (40 taxmann.com 315) (Mum)
“Therefore, the two essential conditions emerge for applying the force of attraction rule are (i) the business activity carried on should be in the other State where the PE is situated (ii) the business activity carried on must be of the same or similar kind as those effected through PE. In the case in hand the condition of business activity carried on in the other State where the PE is situated is not satisfied because the marketing and management services in question are provided by the assessee outside India.”

Conclusion:
As held by the Hon’ble Mumbai Tribunal that installation PE cannot be covered by the Force of Attraction Rule, thus income from offshore supply of equipment and rendition of services cannot be brought to tax by applying the said rule.
Issue 4: What if the contract provides for rendition of certain training services in India? Can the income for such services be attributed to the Installation PE in India?

Hon’ble Delhi ITAT in case of Posco Engineering & Construction Co Ltd. vs. Addl. DIT (31 ITR(Tri) 255) dealing with the issue of training services rendered in India after offshore supply of equipments had held as under:

“Training Services rendered in India shall be definitely be attributable to the Installation PE in India and the income from the same shall be taxable in India.”

Conclusion:

Training services rendered in India shall be attributable to the Installation PE in India and the income from the same shall be taxable in India.
Case Study II

FACTS:

1. **F Co.**, a company incorporated in **UK**, is engaged in the activity of supervision, erection, commissioning of plant and machinery for steel and allied plants in India.

2. **F Co.** entered into contracts with **A Co., B Co. and C Co.** in India to render technical and supervision services for their plants.

3. **F Co.** rendered services through its foreign technicians at the work sites of these companies.

4. The total stay in India of foreign technicians for above projects was as follows:
   - A Co. – 7 mnths
   - B Co. – 4 mnths
   - C Co. – 3 mnths

5. Stay and transportation of technicians are undertaken by Indian company.
Case Study II

ISSUES:

1. Whether F Co. has a PE under Article 5(2)(j) [Supervisory PE]?

2. Whether F Co. has a PE under Article 5(2)(k) [Service PE]?

3. In case F Co. has also undertaken assembly of plant and machinery and rendered supervisory activities also
   a. Whether it can have a PE under Article 5(2)(j) for A Co.?
   b. Whether the period of all the 3 contracts can be aggregated to say that PE has been constituted for each of the three contracts?

4. If subsidiary of F Co. has undertaken assembly of plant and machinery, then whether PE can said to be formed for F Co. if supervisory activities are rendered in connection to such assembly services?
Issue 1: Whether F Co. has a PE under Article 5(2)(i) [supervisory PE]?

Treaty Provision

India UK DTAA – Article 5(2)(j)

“a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period exceeding six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 percent of the sale price of the machinery and equipment”

Judicial Precedents:

- GFA Anlagenbau GMBH v. DDIT(IT) (2014) 34 ITR(T) 73 (Hyd ITAT) (Germany Treaty)

“a literal reading of the Article leads to the conclusion that supervisory activities by themselves cannot constitute a PE; they are to be in connection with a building, construction or assembly activity of the non-resident which is not the case here as the assessee provides only supervisory activities… It is very clear that Article 5(2)(i), though it talks about supervisory activities, does not cover the instant case as assessee do not have any building site or construction site of its own.”

However, in case of Steel Authority of India Ltd v. ACIT (2007) 105 ITD 679 (Del ITAT) (Germany Treaty) it has been held that the words of the said clause have to be read in their plain meaning and the building site or construction, installation or assembly project need not be that of the assessee and supervisory activities carried out in connection therewith becomes PE of the assessee if they continue for a period exceeding 6 months.
Supervisory PE

Klaus Vogel Commentary

Page 306, Para 74 is as follows:

“….. planning and supervision is included in the term 'building site or construction project' only if carried on by the building contractor himself (that is overlooked by OstBMF 2 SWI 288 (1992); DTC Austria/Korea; correctly, OstBMF 4 SWI 6 (1994): DTA Austria/Germany; of, also infra m.no.81). Planning and supervision proper carried on by a separate enterprise is not covered, according to MC Comm. An enterprise that did no more than plan and supervise building works could at most, MC Comm. continues, constitute a permanent establishment under the general rule of Article 5(q), but its fixed place of business could normally not be considered as 'permanent'“

Conclusion:

Supervisory activities in the instant case will not constitute PE as such services are not rendered in connection with installation or assembly project carried out by F Co. Mere rendering supervisory activities without carrying out installation or assembly activities will not constitute PE.
Issue 2: Whether F Co. has a PE under Article 5(2)(k) [Service PE]?

Treaty Provision

India UK DTAA – Article 5(2)(j) and 5(2)(k):

“(j) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or

(ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period:

Provided that for the purposes of this paragraph an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with, or supplies plant and machinery on hire used or to be used in, the prospecting for, or extraction or production of, mineral oils in that State.”
Supervisory PE v. Service PE

Judicial Precedents:


   “The services rendered by the personnel supplied by the non-resident company would therefore fall under both the clauses, namely (j) and (k) of Article 5(2). It is the settled legal position that if the two provisions are applicable to a fact situation then the one which is beneficial to the assessee would be applicable. Reliance can be placed on the decision of the Authority for Advance Ruling in the case of Brown & Root Inc. (supra). Therefore, in our opinion, the CIT(A) was justified in holding that clause (j) being more beneficial to the assessee would be applicable inasmuch as the period of stay is six months or more.” (Para 20)


   “We do not find much force in the argument of the department that the activity of installation of the pipeline could be brought under other clauses of DTAA such as clause (a), (e) or (f) of article 5(2) or under article 12(3)(b) of DTAA. In our opinion, the contention that the installation of gas pipeline clearly falls within the scope of other clauses such as (a) would militate against the well-established principles that a specific provision will override a general one and that the assessee/subject is entitled to invoke the provision most beneficial to him be they the provisions of a treaty or statute. Since the activity falls short of 120 days, the applicant could not be said to have a PE in India. The element of permanence in relation to an establishment, if any, would be attracted under article 5(2)(k) only if the installation project continues for a period of more than 120 days and that condition is not satisfied here.” (Para 13)
Supervisory PE v. Service PE

3. CIT v. BKI/HAM (2011) 203 Taxman 58 (Uttarakhand HC) (India-Netherland DTAA – Installation PE v. Other PE)


C. Conclusion:

1. **Article 5(2)(k) is a general provision** which covers all services rendered others than as those provided in Article 13.

2. **As Article 5(2)(j) is a specific provision**, it will prevail over Article 5(2)(k)

3. If services rendered falls within provision of Article 5(2)(j) and if the condition of the said article is not satisfied then no Permanent Establishment can be alleged to exist by invoking the provisions of Article 5(2)(k)
Issue 3.a: In case F Co. has also undertaken assembly of plant and machinery and rendered supervisory activities also - Whether it can have a PE under Article 5(2)(j) for A Co.?

Treaty Provisions

India UK DTAA – Article 5(2)(j)

“a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period exceeding six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 percent of the sale price of the machinery and equipment”

Conclusion

As F Co. has undertaken assembly of plant and machinery and along with the same supervisory services has been rendered. Since the total stay of technicians for project rendered for A Co. is more than 6 months, Supervisory PE to the extent for project for A Co. is formed.
Issue 3.b : In case F Co. has also undertaken assembly of plant and machinery and rendered supervisory activities also - Whether the period of all the 3 contracts can be aggregated to say that the criteria is satisfied for all 3 contracts and thus PE has been constituted for all three contracts?

Treaty Provisions

India UK DTAA – Article 5(2)(j)

“a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period exceeding six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 percent of the sale price of the machinery and equipment”

Judicial Precedents

1. ADIT(IT) v. Valentine Maritime (Mauritius) Ltd (2011) 45 SOT 34 (Mum ITAT)

“even a plain reading of Art. 5(2)(i) would show that, for the purpose of computing the threshold time-limit, what is to be taken into account is activities of a foreign enterprise on a particular site or a particular project, or supervisoryactivity connected therewith, and not on all the activities in a tax jurisdiction as whole…. In other words, each of the building site, construction project, assembly project or supervisory

…contd
...contd

activities in connection therewith is to be viewed on standalone basis. Broadly, the underlying rationale of this approach is that various business activities performed by one and same enterprise, none of which constitutes a PE, cannot lead to a PE, if combined. In our humble understanding, the very conceptual foundation of this approach rests on the assumption that various business activities of the enterprise in different locations are not so inextricably interconnected that these are essentially required to be viewed as a coherent whole. (Para 9)

The two situations, referred to in the OECD Model Convention commentary and which have been incorporated in UN Model Convention Commentary as well, are thus essentially illustrative in nature, and the common thread, and the highest common factor, in both these situations is that in both the cases the activities are so inextricably interconnected that these cannot be viewed in isolation but only in conjunction with each other. The relevant considerations, in our considered view, are the nature of activities, their interconnection and interrelationship and whether these activities are required to be essentially regarded as a coherent whole in conjunction with each other. (Para 17)

2. JDIT(IT) v. Krupp Uhde GMBH (2010) 1 ITR 614 (Mum ITAT)

Conclusion:

PE cannot be constituted for all three contracts for the following reasons:-

1. All three contracts are independent and are not in any way interconnected.
2. Period has to be calculated with respect to qua individual site or individual project or individual activity.
3. Therefore, for contract with B Co. and C Co., supervisory activities carried out for each contract is less than 6 months, hence, supervisory PE cannot be constituted with respect such sites.
Issue 4: If subsidiary of F Co. has undertaken assembly of plant and machinery, then whether PE can said to be formed for F Co. if supervisory activities are rendered in connection to such assembly services?

Conclusion:

Though the installation/assembly activities are undertaken by the subsidiary of F Co., the supervisory activities undertaken by F Co. will not constitute PE as such services are not rendered in connection with installation or assembly project undertaken by the F Co itself.
Case Study I

**FACTS**

1. P Norway and Q UK are wholly owned subsidiary of PQR France. PQR group is in the business of sale of desktops and laptops worldwide.

2. P Norway and Q UK sells desktops and laptops worldwide. In order to sell desktops in India, they have appointed R India as its agent.

3. R India, incorporated in India under the Companies Act, 1956, is an independent company which renders liasoning services to P, Q and other foreign entities in connection with the sale of their products.

4. R India provides liasoning services to P Norway and Q UK in respect of sale of their products in India and receives commission of 5% of the sale price for the following services:
   - **Market research** for P Norway, Q UK and third parties products and report prevailing offers from competitors based on marketing intelligence.
   - **Marketing** P Norway, Q UK and third parties products to existing as well as prospective customers of in India.
   - Provides **after sales services**
   - **Conduct price survey** and provide feedback for change in price
   - **Business development services** in form of liasoning with potential customers to help understand their requirements and communicate the same to principals
   - **Conveying to customer** standard terms of sale by foreign entities which includes prices, delivery terms, mode of payment, delivery time line, etc.
Case Study I

FACTS

• If customer agrees to price and terms and conditions, he fills up order form which is dispatched / communicated to principals for acceptance and confirmation

• Collects payments from customers and remits it to the principals.

5. Goods are delivered directly to customers and payment is made by customers directly to principals.

6. R India also provides abovementioned services to various third parties.

7. Also, P Norway and Q UK sells certain products directly to Indian customers for which no help of R India is taken as below:

<table>
<thead>
<tr>
<th>Commission received from:</th>
<th>Revenue earned by:</th>
</tr>
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<tbody>
<tr>
<td><strong>P Norway</strong> – Rs. 70 crs</td>
<td><strong>P Norway</strong> – 50 crs</td>
</tr>
<tr>
<td><strong>Q UK</strong> – Rs. 50 crs</td>
<td><strong>P UK</strong> – 30 crs</td>
</tr>
<tr>
<td><strong>Third party</strong> – Rs. 10 crs</td>
<td><strong>Situation A – R India’s</strong> revenue consists of only commission income from sale of products</td>
</tr>
<tr>
<td><strong>Total</strong> – Rs. 130 crs</td>
<td><strong>Situation B – R India’s</strong> has commission income and income from other services also</td>
</tr>
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</table>

**In addition** to revenue mentioned in Situation A, **R India also earns** revenue of Rs. 30 crs from providing debtor management services to various third parties.
Case Study I

ISSUES

1. Whether R India can be said to be an agency PE of P Norway and Q UK:
   A. Situation A - R India’s revenue consists of only commission income from sale of products
      Commission received from:
      P Norway – Rs. 70 crs
      Q UK – Rs. 50 crs
      Third party – Rs. 10 crs
      Total Rs. 130 crs
      - R India is not remunerated at ALP
      - R India is remunerated at ALP
   B. Situation B’ - R India’s has commission income and income from other services also
      In addition to revenue mentioned in Situation A, R India also earns revenue of Rs. 30 crs from providing debtor management services to various third parties.

2. Whether R India can be said to be an agency PE of P Norway and Q UK (assuming R India is dependent on P Norway & Q UK)?

3. In case R India is considered as a DAPE of P Norway and Q UK under the DTAA whether revenue of P Norway and P UK from sale of laptops can be said to be attributable to the alleged PE under Article 7 of the respective DTAA.
1. Whether R India can be said to be an agency PE of P Norway and Q UK

Treaty Provision

NORWAY – Article 5(5)
“Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 7 applies - is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:
(a) has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or
(b) has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or
(c) habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control as, that enterprise.”

UNITED KINGDOM – Article 5(4)
“A person acting in a Contracting State for or on behalf of an enterprise of the other contracting State - other than an agent of an independent status to whom paragraph (5) of this Article applies, shall be deemed to be a permanent establishment of that enterprise in the first mentioned State if:
(a) he has, and habitually exercises in that State, an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or
(b) he habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or
(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and the enterprises controlling, controlled by, or subject to the same common control, as that enterprise.”
1. Whether R India can be said to be an agency PE of P Norway and Q UK

As long as the agent is of independent status, the provisions of dependent agent PE under Article 5(5) / 5(4) of Norway and United Kingdom Treaty cannot be invoked.

- Delmas France v ADIT [2012] 14 ITR(Tri) 1 (Mum)
- Delmas France S.A. v ADIT [2013] 141 ITD 67 (Mum)
NORWAY – Article 5(7)

“An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise or on behalf of that enterprise and other enterprises controlling, controlled by, or subject to the same common control as, that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph unless the enterprise can demonstrate that the transactions between the said enterprise and the agent are under arm's length conditions.”

UNITED KINGDOM – Article 5(5)

“An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. However, if the activities of such an agent are carried out wholly or almost wholly for the enterprise (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to same common control) he shall not be considered to be an agent of an independent status for the purposes of this paragraph.”
Whether R India can be said to be independent agent within the meaning of Article 5(7) of Norway Treaty and Article 5(5) of United Kingdom Treaty?

**Conditions under the treaty**

**To apply Article 5(7) of Norway Treaty:**

Independent agent should carry out the activities in its ordinary course of business.

Exception - Not independent if:

• activities of agent are devoted wholly or almost wholly on behalf of that enterprise or on behalf of that enterprise and other enterprises controlling, controlled by, or subject to the same common control as, that enterprise

And

• Transactions are not at arm’s length

**To apply Article 5(5) of United Kingdom Treaty:**

Independent agent should carry out the activities in its ordinary course of business.

Exception - Not independent if:

• activities of agent are devoted wholly or almost wholly on behalf of that enterprise or on behalf of that enterprise and other enterprises controlling, controlled by, or subject to the same common control as, that enterprise
Whether R India can be said to be independent agent within the meaning of Article 5(7) of Norway Treaty and Article 5(5) of United Kingdom Treaty?

**Judicial Precedents**

If an agent provides similar activities to a number of third parties other than the principal it is an independent agent acting in ordinary course of business.

- Fidelity Advisor Series VIII, In re [2004] 271 ITR 1 (AAR)
- Knowrex Education (India) (P) Ltd., In re [2008] 301 ITR 207 (AAR)
- XYZ / ABC Equity Fund, In re [2001] 250 ITR 194 (AAR)

Twin conditions have to be satisfied to deny an agent character of an independent agent i.e. activities are wholly or mostly wholly on behalf of foreign enterprise and the transactions between the two are not made under arm's length conditions. [Norway Treaty]

- Delmas France v ADIT [2012] 14 ITR(Tri) 1 (Mum)
- Delmas France S.A. v ADIT [2013] 141 ITD 67 (Mum)
- DIT v E Funds IT Solution [2014] 266 CTR 1 (Del)
- Varian India (P) Ltd. v ADIT [2013] 142 ITD 692 (Mum)
1. Whether R India can be said to be independent agent within the meaning of Article 5(7) of Norway Treaty and Article 5(5) of United Kingdom Treaty?

**Conclusion – Situation A**

**From P Norway’s perspective:**

Transaction’s not at arms length

- R India carries out the activities in its ordinary course of activities since it provides similar activities to even third parties.

- However, it is not independent agent since:
  - Wholly or almost wholly dependent of P, Norway and Q, UK (subject to common control) for its revenue i.e. 92.3% [70 crs + 50 crs / 130 crs] and
  - Transaction’s are not at arms length

Transaction’s at arms length

- R India carries out the activities in its ordinary course of activities since it provides similar activities to even third party.

- However, it is independent agent since:
  - Even though it is wholly or almost wholly dependent of P, Norway and Q, UK (subject to common control) for its revenue i.e. 92.3% [70 crs + 50 crs / 130 crs], transaction’s are at arms length and hence second condition not satisfied.

**From Q UK’s perspective:**

Transaction’s not at arms length / Transaction’s at arms length

- R India carries out the activities in its ordinary course of activities since it provides similar activities to even third parties.

- However, it is not independent agent since:
  - Wholly or almost wholly dependent of P, Norway and Q, UK (subject to common control) for its revenue i.e. 92.3% [70 crs + 50 crs / 130 crs]
1. Whether R India can be said to be independent agent within the meaning of Article 5(7) of Norway Treaty and Article 5(5) of United Kingdom Treaty?

**Conclusion – Situation B**

_Economic dependence to be tested qua proposed line of services or qua the organisation as a whole?_

- **All activities of taken together (i.e. income from liasoning service as well as debtor management fees)**

There is no evidence to show that the extent of their activities for the assessee, compared to all their activities, is so large that it can be said that they are dependent on the assessee for their earnings or revenues. The agents have not been shown to be economically dependent on the assessee. The agents have their own businesses or activities amounting to business. They are not carrying on the activity for the assessee, as agents, in exclusion of their other businesses or activities. In this situation, just because they are not acting as agents for any other company carrying on money transfer business it cannot be said that their activities are wholly or almost wholly devoted to the assessee. The agent’s activities for the foreign enterprise must constitute a large chunk of all his activities taken together so that it can be said that he is economically dependent largely on the activity.

- **Western Union Financial Services Inc. v ADIT [2006] 101 TTJ 56 (Del)**

- **Activity wise (only income from liasoning services to be considered)**

Where certain specific activities are carried out by the agent only on behalf of one principal, such activities shall be said to be devoted wholly or almost wholly on behalf of one principal, even if agent is carrying out all other activities on behalf of a number of principals

- **Galileo International Inc v DCIT [2008] 19 SOT 257 (DELHI)**
Conclusion

The view taken by Delhi ITAT in Western Union seems correct since:

- Treaty uses the word "activities of agent" which would mean all activity of the agent.
- If agent has sufficient revenues from other service lines it cannot be said to be dependent for its earnings / revenues on the principal.
- Delhi ITAT in Galileo International has not considered the earlier decision of Western Union which is binding.
- As per OECD Commentary 2014,

  “37. A person will come within the scope of paragraph 6, i.e. he will not constitute a permanent establishment of enterprise on whose behalf he acts only if:

  (a) he is independent of the enterprise both legally and economically, and

  (b) he acts in ordinary course of his business when acting on behalf of the enterprise.”

As per US – MTC Technical Explanation 2006

“Another relevant factor in determining whether an agent is economically independent is whether the agent acts exclusively or nearly exclusively for the principal. Such a relationship may indicate that the principal has economic control over the agent. A number of principals acting in concert also may have economic control over an agent. The limited scope of the agent’s activities and the agent’s dependence on a single source of income may indicate that the agent lacks economic independence. It should be borne in mind, however, that exclusivity is not in itself a conclusive test; an agent may be economically independent notwithstanding an exclusive relationship with the principal if it has the capacity to diversify and acquire other clients without substantial modifications to its current business and without substantial harm to its business profits. Thus, exclusivity should be viewed merely as a pointer to further investigation of the relationship between the principal and the agent. Each case must be addressed on the basis of its own facts and circumstances.”

R India is an independent agent within the meaning of Article 5(7) and Article 5(5) of Norway and UK Treaty as the extent of its revenue from P, Norway and Q, UK is only 75% [120 crs / 160 crs] of its total revenue.
Agency PE

2. Whether R India can be said to be an agency PE of P Norway and Q UK (assuming R India is dependent on P Norway & Q UK)?

**Situation A**

All the persons other than agent of independent agent cannot be deemed to be a PE. In order to constitute DAPE the **conditions** specified in para 4 / 5 of Article 5 are to be satisfied viz. (i) **habitually concludes contracts** (Norway) / negotiate and enter into contracts; (ii) **habitually maintains stock of** goods or merchandise; or (iii) **habitually secures orders**. If any of the three conditions are not satisfied, an agent cannot be held to be DAPE.

- DIT v E Funds IT Solution [2014] 266 CTR 1 (Del)
- Golf In Dubai, LLC, In re [2008] 306 ITR 374 (AAR)
- WSA Shipping (Bombay) P Ltd v ADIT [2011] 48 SOT 551 (Mum)
- Ebay International AG v ADIT [2013] 140 ITD 20 (Mum)
- Varian India (P) Ltd. v ADIT [2013] 142 ITD 692 (Mum)
- Galileo International Inc v DCIT [2008] 19 SOT 257 (DELHI)
First condition:

Has and habitually exercises in that State authority to conclude contracts (Norway) / negotiate and enter into contracts (UK)

- Ebay International AG v. ADIT [2012] 140 ITD 20 (Mumbai)

  “As per clause (i) of para 5 of the DTA a dependent agent will be treated as a permanent establishment of the enterprise if he has and habitually exercises authority to negotiate and to enter into contract for or on behalf of the enterprise…. Simply by providing marketing services to the assessee or making collection from the customers and forwarding the same to eBay AG, it cannot be said that eBay India entered into contracts on behalf of the assessee. Neither there is any mention in the assessment order nor the ld. DR has specifically invited our attention towards any contract entered into by eBay India or eBay Motors, during the discharge of their functions or otherwise, for or on behalf of the assessee. Thus the test laid down as per clause (i) of para 5 of Article 5 of the DTA also fail in the present case. “

- Varian India (P) Ltd. v ADIT [2013] 142 ITD 692 (Mum)

  “From the Various other obligations which are enumerated in Para-4 of the D.R. Agreement, it is seen that they are mostly in the nature of promotion of the products, maintaining sales and service organization, providing customer support, product inquiries assist in delivery, schedules, administrative support, functions such as order processing, customer credit review and host of other services….. Regarding the first condition as to whether the assessee is a habitually exercising the authority to conclude contracts on behalf of the VGCs, it was held that indent sale orders booked through the assessee are not binding on the VGCs as they may accept or reject the orders completely at their own discretion. From the D.R. agreement, it is seen that the assessee has no authority and also cannot negotiate or conclude contracts on behalf of the VGCs. It only provides marketing support liaising activity for pre-sale and incidental and ancillary post-sale activities…”

Agent cannot be said to be concluding contracts on behalf of principal, since acceptance of the contract is solely done by the principal and none of the orders booked through the agent is not binding on the foreign enterprise.

- Knowrex Education (India) (P) Ltd., In re [2008] 301 ITR 207 (AAR)
Second condition:

Habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise

In instant case no stock of goods is maintained by the Indian company, hence this condition is not applicable.

Third Condition:

Habitually secures orders for the enterprise

- DDIT v Daimler Chrysler A.G. [2010] 133 TTJ 766 (Mum)

“Further the Department has not established that DCIL actively canvasses orders for CBUs of assessee or is actively engaged in negotiating and concluding contracts. If and when clients approach DCIL or their agents evidencing interest to buy CBUs from the appellant DCIL passes on communication both sides. Negotiations of price, specifications etc. were concluded by the appellant. … Thus, DCIL had no role to play from the sale or in any activity in promoting the sale of the assessee directly to the customers in India. They are only collection of information and activities of preparatory or auxiliary in nature. The prices offered to the clients are as per the list price notified by the assessee. DCIL has no authority to conclude any deal. Thus the mere acting as post office between the assessee and the client will not render DCIL as a dependent agent. DCIL cannot be considered as habitually procuring orders for the assessee.."
Varian India (P) Ltd. v ADIT [2013] 142 ITD 692 (Mum)
“The third condition whether the person habitually secures orders wholly or almost wholly for the enterprise. In assessee’s case, the order relating to indent sale are only introduced and liaised by the assessee and not secure by it. The sale orders are not binding on the VGCs until accepted by them. The assessee has no authority to accept orders on behalf of any of the VGCs.”

**Conclusion**

R India cannot be said to be an dependent agent of P Norway and Q UK within the meaning of Article 5(5) / 5(4) of the Treaty since:

- R India is **not concluding or negotiating contracts** but only passing on the orders from the customers which is subject to final acceptance by P Norway and Q UK.
- R India is **not maintaining stock of goods** or merchandise for or on behalf of P Norway and Q UK
- R India is **not securing any orders** for P Norway and Q UK but the orders are only introduced and liaised by it and it merely acts as a communication link between the customers and the principals.
3. In case R India is considered as a DAPE of P Norway and Q UK under the DTAA whether revenue of P Norway and P UK from sale of laptops and televisions can be said to be attributable to the alleged PE under Article 7 of the DTAA?

Treaty Provision

**NORWAY – Article 7(1)**

“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.”

**UNITED KINGDOM – Article 7(2)**

“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 directly or indirectly attributable to that permanent establishment.

……

3. Where a permanent establishment takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, notwithstanding that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the permanent establishment to those transactions bears to that of the enterprise as a whole shall be treated for the purpose of paragraph 1 of this Article as being the profits indirectly attributable to that permanent establishment.”
Attribution of profits

Whether the profits earned by P Norway from sale of laptops in India can be attributable to the DAPE (R India) created due to sale of desktops?

As per the provision of the Norway treaty only so much of the **profits as attributable to the PE** can be taxed. It does not incorporate force of attraction rule.

**Judicial Precedent:**

   
   “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 the DTAA the taxation liability in respect of overseas services would not arise in India. (Para 67)

   ……..

   *Article 7 of the DTAA is applicable in this case, and it limits the tax on business profits to that arising from the operations of the permanent establishment.”*


   “The phrase ‘attributable to PE’ evidently means that there must be direct correlation between the activities of PE and the income generated thereby. What is not attributable to PE cannot be taxed at all in India (Para 10)”
3. ACIT v. Epcos AG, Germany (2009) 28 SOT 412 (Pune ITAT)

“Article 7(1) restricts the scope of taxability of business profits of an enterprise in the source country to only such profits as are attributable to the PE. Therefore, to bring any income to taxability under Article 7 in the source country, the first thing to be satisfied under Article 7(1) is that the income being sought to be taxed is only such as is attributable to the PE. Just because there is a PE in the source country, one cannot infer that entire income from the source country is attributable to the PE and liable to be taxed in the source country for that reason. [Para 44]”

4. DIT v. LG Cable Ltd (2011) 197 Taxman 100 (Del HC)

“There was neither any material to show that accrual of such income was attributable to any operations carried out in India nor any material to show that the PE of the assessee had any role to play in the offshore supply of the equipments.)”

Conclusion:

Since R India does not play any role in respect of sale of laptops by P Norway, the profits earned by P Norway from sale of laptops in India cannot be said to be attributable to the DAPE (R India).
Whether the profits earned by P UK from sale of laptops in India can be attributable to the DAPE (R India) created due to sale of desktops?

As per the provision of the United Kingdom treaty so much of the profits as is directly or indirectly attributable to the PE can be taxed in source State.

Whether the phrase “indirectly attributable” used in the treaty incorporates force of attraction rule as embedded in Article 7(1)(b) & 7(1)(c) UN Model so as to tax even the profits arising out of sale of similar goods in Source State without involvement of PE which are same or similar to those effected through the PE?

**Article 7 of UN Model Convention**

“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 that 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 that other State of the same or similar kind as those effected through that permanent establishment.”

**ADVERSE VIEW:**

- Linklaters LLP v ITO (International Taxation) [2010] 132 TTJ 20 (Mum)

“The extension of taxability of profits of PE by including profits directly or indirectly attributable, is akin to the provisions of arts. 7(1)(b) and 7(1)(c) of the UN Model Convention which provides that in addition to the "profits attributable to the PE" the taxability of PE profits will also extend to "(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that PE; or (c) other business activities carried on in that other State of the same or similar kind as those effected through that PE". In our considered view, the connotations of "profits indirectly attributable to PE" will extend to these two categories.”
Attribution of profits

Judicial Precedents:

Favourable Precedents:

For profits to be attributable “directly or indirectly”, the PE should be involved in the activity giving rise to profits and profits derived independently of the PE are excluded. In other words the usage of these words “directly or indirectly” does not result in application of any specific or implied FOA rule as embedded in Article 7(1)(b) & 7(1)(c) UN Model.

• Ishikawajima – Harima Heavy Industries Ltd. v DIT [2007] 288 ITR 408 (SC)
  “It is stated that the term ‘directly or indirectly attributable’ indicates the income that shall be regarded on the basis of the extent appropriate to the part played by the permanent establishment in those transactions. The permanent establishment here has had no role to play in the transaction that is sought to be taxed, since the transaction took place abroad.”

• ADIT (International Taxation) v Clifford Chance [2013] 154 TTJ 537 (Mum)(SB)
  “...What is indirectly attributable to the PE for the purpose of Article 7(1) is explained in Article 7(3) of the India-UK Treaty DTAA which clearly provides that where a PE takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, notwithstanding that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the PE to those transactions bears that of the enterprise as a whole shall be treated for the purposes of para (1) of this Article as being the profits indirectly attributable to that PE.....
Attribution of profits

…In our opinion, when the connotations of "profits indirectly attributable to permanent establishment" are defined specifically in Article 7(3) of the India-UK DTAA which clearly explains the scope and ambit of the profits indirectly attributable to the PE and the provisions of said article being unambiguous and capable of giving a definite meaning, there is really no need to refer to the provisions of Article 7(1) of UN Model Convention which are materially different from the provisions of Article 7(1) of the India-UK DTAA read with Article 7(3) thereof. The reliance of the Division Bench of this Tribunal on the provisions of Article 7(1)(b) and 7(1)(c) of the UN Model Convention as well as on the UN Model Convention Commentary to come to a conclusion in the case of Linklaters LLP (supra) that the connotations of "profits indirectly attributable to permanent establishment" used in Article 7(1) of the Indo-UK treaty incorporates a force of attraction rule thereby bringing an enterprise having a PE in another country 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 their PE or not - is clearly misplaced and we are unable to subscribe to this proposition.”

Conclusion:

Thus the profits earned by P UK from sale of laptops in India cannot be attributable to the DAPE since there is no involvement of R India in sale of such laptops even though it is same or similar to sale of desktops which are sold through the involvement of DAPE.
Case Study IV

1. Employees of US Co. visit India to provide services directly at its client’s place.

2. Procures services from I Co. to provide services to its clients, (if expertise not available with it).

3. Employees of overseas entities visit India to review quality of work and standard checks (in relation to part of service executed by I Co.).

4. Employees of I Co. provide services to the clients of US Co., which are reviewed by employees of US Co.

4. Employees of I Co. provide services to the clients of UK Co., which are reviewed by employees of UK Co.

5. Employees of UK Co. visit India to provide services directly at its client’s place.
Case Study IV

FACTS:

1. MNC Group is in the business of global management and technology consultancy services. It provides consultancy in General Management, Marketing, Research and Development, Distribution and Transportation, Manufacturing and Operations, Finance and Control, Personal and other Special Services.

2. I Co., a wholly owned subsidiary of US Co., is also in the same business. I Co. is a non-exclusive service provider with respect to such business.

3. US Co and UK Co. have entered into contracts directly with Indian clients to provide consultancy services without any involvement of I Co., direct or indirect.

4. Technical / professional personnel of US Co. and UK Co. visit India to render services to the Indian clients in pursuant to contacts entered into by them directly. The duration of stay in India of the said personnel is 100 days for US Co. and 120 days for UK Co.

5. These personnel make available methodologies, process, modules, technical information, proprietary data / information specifications, good practices, control sheets, experience, skills, knowledge, data, business information, global experience of executing similar project to employees of its clients.

6. These employees render services at the premises of its client. Further, the clients are not under an obligation to earmark or provide a dedicated office or other space to the personnel. A prior notice is also required to be given by the said employees before entering the premises of the clients.

7. At times, US Co. and UK Co. may not have the required expertise and experience to execute a project and accordingly, they may procure services of technical / professional personnel from I Co. having the requisite expertise for execution of the projects.
FACTS:

8. I Co. executes the contracts through its own employees, duration of which is **150 days**. The said employees are exclusively under the supervision and control of the I Co.

9. Provision of services of technical / professional is on a principal – to – principal basis.

10. US Co. and UK Co., in order to protect their interests, for ensuring quality and confidentiality, send its employees for short term visits to man and review the services rendered by the Indian company and they were not involved in any day to day management or any specific services.

11. Such visits lasted for 7 days and 12 days for USA & UK entity respectively. Further, there is no demarcated space in the premise of I Co. for the employees of the foreign entities.
Case Study IV

ISSUES:

Fixed Place PE

1. Whether US Co. & UK Co. have a PE in India under Article 5(1) of the India-USA & India – UK Double Tax Avoidance Agreement (‘DTAAs’), particularly whether:
   a. Premises of I Co. can be considered as a Fixed Place PE of the overseas entities?
   b. Since employees of US Co. & UK Co. provide services to clients at their place, whether such place of the client can be considered as fixed place PE of the overseas entities?

Service PE

2. Whether sub-clause (l) & (k) of Article 5(2) of India USA & India UK DTAA respectively, are triggered for furnishing of services at client place by US Co. & UK Co. through its employees, since, such activities continued for a period aggregating more than 90 days in 12 months period?

3. Whether the term ‘employees or other personnel’ in Article 5(2)(l) & 5(2)(k) of the India-USA DTAA & India-UK DTAA respectively, would include Employees of I Co. through which services are rendered and consequently can the Revenue allege that the foreign enterprises are furnishing such services through ‘other personnel’ resulting in a Service PE?

4. Further, short term visits by employees of foreign entities to man and review the services rendered by the Indian company can be considered as PE under sub-clause (l) & (k) of Article 5(2)?
Issue 1. Whether (a) Premises of I Co. (b) Premises of client can be considered as a Fixed Place PE?

Treaty Provisions

Article 5.1 of DTAA: “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.”

Legal Position

• This Article contains the following conditions:

  (i) the **existence of place of business** - at the disposal of the enterprise;
  (ii) the **place** of business must be of a **fixed nature**; and
  (iii) the **business being carried on** is **required to be 'carried on through the place of business'**.

*It is only when these three conditions are satisfied, a PE under the basic rule can be said to have come into existence.*
Fixed Place PE

Judicial Precedents

• Place of Business at the disposal

Place of Group Company (I Co.) / Service Provider:

1. Motorola Inc. (95 ITD 269)(Delhi)(SB) (affirmed by Delhi High Court in 343 ITR 470)

“128. The assessee has no office in India, either owned or leased. The Revenue has failed to establish that ECI had made certain space available to the assessee at its disposal. In other words, there is nothing to indicate that whenever any employee of the assessee visited India, he could straightaway walk into the office of ECI and occupy a space or a table. Merely because ECI allowed the visiting employees to use certain facilities occasionally, it cannot be said that the assessee had at its disposal, as a matter of right, certain space which could be characterized as a fixed place of business. Therefore, it cannot be said that the assessee had a PE in India as envisaged in art. 5.1 of the DTAA.”

2. DIT v. E-Funds IT Solution (42 taxmann.com 50)(Delhi High Court)

“48. ….It has not been adverted to or stated that premises of e-Fund India were at the disposal, legally or otherwise, of the two assessee. … In the absence of any such finding Article 5(1) cannot be invoked and applied…”

Place of Client:

3. Her Majesty The Queen v. William A. Dudney (18 taxmann.com 208)(Federal Court of Canada)

“20. … Although D had access to the offices of PanCan and he had the right to use them, he could do so only during PanCan’s office hours and only for the purpose of performing services for PanCan that were required by his contract. He had no right to use PanCan’s offices as a base for the operation of his own business. He could not and did not use PanCan’s offices as his own…”
24. ...No doubt there are providers of independent personal services who, because of the nature of their skill or the services they provide, require very little in the way of a fixed place of business. Mr. Dudney may be one of those people. However, recognition of that fact does not justify the conclusion that Mr. Dudney must necessarily have a fixed place of business wherever his services are provided. The analogy suggested by counsel for Mr. Dudney is an apt one. A Canadian lawyer does not acquire a fixed place of business in the office of a client in the United States merely by attending to the client’s affairs there, even if the client insists on the lawyer’s personal presence.”

4. NATO’s Case:
The German Federal Court held in NATO’s case (IR 30/07 dated 04 June 2008) that a Dutch enterprise cleaning aircraft on the premises of a NATO air base in Germany is not deemed to have created a permanent establishment in Germany. The Dutch company was a subcontractor for cleaning services and employed several workers who had access to the air base premises (including identification cards and keys to recreation rooms and working space with telephone and fax facilities).

*In this case, the Court held that it is not sufficient to create a permanent establishment if a foreign enterprise is just conducting its business on the premises of a German enterprise when fulfilling its service obligations.*

5. GFA Anlagenbau Gmbh v. ADIT (47 taxmann.com 313)(Hyd)

“12.4 ...Here the assessee is clearly doing the supervision of project of the Indian company and has no fixed place of business... Nothing was brought on record that the technicians are operating from a fixed place in the custody of assessee.”

“4.4 A third example is that of a road transportation enterprise which would use a delivery dock at a customer’s warehouse every day for a number of years for the purpose of delivering goods purchased by that customer. In that case, the presence of the road transportation enterprise at the delivery dock would be so limited that that enterprise could not consider that place as being at its disposal so as to constitute a permanent establishment of that enterprise.”

Other Decisions upholding the TEST OF DISPOSAL:

7. Rolls Royce Plc v. DDIT (113 TTJ 446)(Del) (affirmed by Delhi High Court in 339 ITR 147)
8. Airlines Rotables Ltd. v. JDIT (44 SOT 368)(Mum)
9. Galileo International Inc. v. DCIT (19 SOT 257)(Del)
10. Amadeus Global Travel Distribution SA v. DCIT (113 TTJ 767)(Del)
11. Delmas, France v. ADIT (49 SOT 719) (Mum.)
12. DDIT v. Western Union Financial Services Inc. (104 ITD 34)(Del)

ADVERSE VIEW & SUBMISSIONS VIZ-A-VIZ ADVERSE VIEW:


“A taxpayer who is obliged to perform independent personal services without having a PE of his own, is deemed to have a PE where he performs his services.”
2. OECD Commentary on Article 5 (2010)

“4.5 A fourth example is that of a painter who, for two years, spends three days a week in the large office building of its main client. In that case, the presence of the painter in that office building where he is performing the most important functions of his business (i.e. painting) constitute a permanent establishment of that painter.”

3. DRAFT INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) OF THE OECD MODEL TAX CONVENTION

“13. The Group discussed the meaning of that concept in light of the following example, which was developed in the course of the preparation of the branch reports and general report for the IFA 2009 Congress, of a consultant working at a client's premises for a long period of time:

Consultant working at the client’s premises

Peter, a resident of State R, is an independent consultant who provides computer training services on the use of specialized software. CLIENTCO, a resident of State S, has concluded a contract with Peter under which Peter provides training to CLIENTCO’s staff in State S over a 20 month-long period. During that period, the work is undertaken at CLIENTCO’s headquarters located in a series of office buildings located in a large estate in State S. In these buildings, Peter meets employees in their respective offices and is allowed to use 10 various training rooms, located throughout the complex, where group training sessions take place. When these rooms are not in use, Peter is allowed to use them for preparing his courses (the rooms have internet connection). Peter is given a security card allowing him unrestricted access to the buildings located in the estate during business hours. His contract requires him to use CLIENTCO’s facilities exclusively for the purposes of the contract.
14. Members of the Group who expressed a view on the example concluded that the consultant should be viewed as having a permanent establishment in that case. For some, the fact that the room was available to the consultant for the preparation of his training activities was crucial. Others thought that since training was the core part of the consultant’s business, a place where he did that training was a place through which that business was carried on.

15. During the discussion of the example, the painter's example included in paragraph 4.5 of the Commentary on Article 5 was also discussed.

SUBMISSIONS VIZ-A-VIZ ADVERSE VIEW:

- In respect of the decision of the AAR in case of Booz & Company, with due respect to the view, one can argue the Hon’ble AAR has not concluded which PE [i.e. Fixed Place PE, Dependent Agency PE or Service PE] exists. Further, the AAR’s ruling is contrary to the decision of DIT v E Funds IT Solutions Group Inc. [2014] 42 taxmann.com 50 (Delhi) wherein it was held that Article 5(1) cannot be invoked and applied if the premises are not at the disposal, legally or otherwise of the assessee.

- A writ against the aforesaid Ruling has been admitted by the Hon’ble Bombay High Court (WP. No. 1424 of 2014)

- In respect of para 4.5 of the OECD Commentary and also the Draft Interpretation and Application of Article 5 (Permanent Establishment) of the OECD Model Tax Convention, one may argue that the service provider was furnishing services for a long duration (2 years & 20 months). Therefore, where services are rendered for a short duration, then the same cannot constitute a Fixed Place PE. Further, even a limited right of disposal should not be considered as place of business of an enterprise, as envisaged in para 4.4 on Article 5 of OECD Commentary (2010).
Assuming that US Co. & UK Co. has right to disposal with respect to the premise of I Co., would the said premise of I Co. tantamount a fixed place PE of the overseas entities?

**Duration Test:**

*Though the Article does not make reference to any minimum period for which a PE should be in existence in State S, however, there should be certain reasonable degree of regularity & continuity for a fixed place to exist.*

1. **DCIT v. Subsea Offshore Ltd. (66 ITD 296)(Mum)**
   
   “Assessee’s vessel being in India only for 2-1/2 months cannot be said to be of enduring continuity nor could it be said in this case that there was a virtual projection of the assessee into the soil of India.”

2. **eFunds Corp v. ACIT (134 TTJ 1)(Del)**

3. **OECD COMMENTARY ON ARTICLE 5 (2010)**
   
   “4.3 A second example is that of an employee of a company who, for a long period of time, is allowed to use an office in the headquarters of another company (e.g. a newly acquired subsidiary) in order to ensure that the latter company complies with its obligations under contracts concluded with the former company. In that case, the employee is carrying on activities related to the business of the former company and the office that is at his disposal at the headquarters of the other company will constitute a permanent establishment of his employer, provided that the office is at his disposal for a sufficiently long period of time so as to constitute a “fixed place of business” (see paragraphs 6 to 6.3) and that the activities that are performed there go beyond the activities referred to in paragraph 4 of the Article.”
Less than 6 months may not constitute sufficiently long period for formation of a fixed place PE

4. UN Commentary (2011) para 3;
5. OECD Commentary (2010) para 6;
6. ATO TR 2002/5 (para 33, 38, 42);
7. ATO ID 2006/9;
8. ATO ID 2006/10;
9. ATO ID 2008/150;
10. ATO ID 2008/151;
11. ATO ID 2008/152;
12. IBFD Case No 96/14/0084 (Supreme Administrative Court of Australia);

**Conclusion**

In the present case, as the premise of I Co. as well as the premise of the clients are not at the disposal of the US Co. & UK Co. and also because the employees of the foreign entities are present in India for a short period, it cannot be said that premises of I Co. or that of the clients constitute a Fixed Place PE of US Co. & UK Co. as envisaged under Article 5.1 of the DTAAs.
Issue 2: Whether sub-clause (l) & (k) of Article 5(2) of the India-USA DTAA & India-UK DTAA respectively is triggered for furnishing of services at client place by US Co. & UK Co. through its employees and such activities continued for a period aggregating more than 90 days in 12 months period?

Treaty Provision

Article 5(2)(l) of India-USA DTAA

“The term “permanent establishment” includes especially:

…

(l) The furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or

(ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)].

Article 5(2)(k) of India-UK DTAA

The term “permanent establishment” includes especially:

…

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or

(ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period:
Legal Position

Services covered by Article 12 / 13 on Royalty or FIS / FTS are expressly excluded from clause relating to Service PE. Thus, services to which provisions of Article 12 / 13 are applicable, such services have to be ignored to determine a PE in sub-clause (l) / (k). In other words, by rendering services mentioned in Article 12 / 13 in the source state, one cannot be said to have a Service PE in that state.

Article 12 / 13 of the respective treaties define the term "fees for technical services" as payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which make available technical knowledge, experience, skill, know-how, or processes.

Conclusion

In the present case, since the services rendered by the employees of US Co. & UK Co in India make available technical knowledge, experience, skill, know-how, or processes (see point no. 5 of facts) to the client even though the said personnel renders services in India for a period exceeding 90 days, it would be covered by the provisions of Article 12 & 13 of the respective DTAA. Accordingly, Article 5(2)(l) / 5(2)(k) will not be attracted and therefore, the foreign entities cannot be said to have a Service PE in India.
Service PE

Issue 3: Whether the term ‘employees or other personnel’ in Article 5(2)(l) & 5(2)(k) of the India - USA DTAA & India-UK DTAA respectively, would include Employees of I Co. through which services (assume to be non-FIS) are rendered (for 150 days) and consequently can the Revenue allege that the foreign enterprises are furnishing such services through ‘other personnel’ resulting in a Service PE?

Treaty Provision

India USA DTAA - Article 5(2)(l) & India UK DTAA - Article 5(2)(k)

“The term “permanent establishment” includes especially:

…

(l) The furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if: …”

Judicial Precedent

• **Other personnel**

1. Lucent Technologies International Inc. v. DCIT (28 SOT 98) (Del)
   “7. …A perusal of article 5(2)(1) clearly shows that it is not only the employees through whom if services are provided the PE is to set to come into existence. It also includes other personnel. Obviously, the term other personnel has to be read with reference to the earlier words as provided in the said article 5(2)(l). The other personnel specified here would be persons over whom the enterprise would be having a control….”
2. DIT v. E-Funds IT Solution (42 taxmann.com 50)(Delhi High Court)

“26. ...Sub-clause (l) would apply only if the foreign enterprise or the two assessees had performed services in India through their employees or personnel, i.e., personnel engaged or appointed by the foreign assessee. Employees of e-Fund India were their employees, i.e. employees of an Indian entity and not employees of the assessee. The employees of e-fund India did not become "other personnel" of the two assessees, once and if the said persons were defacto and dejure employed by the Indian entity/enterprise, i.e., e-Fund India. The words "employees" and "other personnel" have to be read along with the word "through" and furnishing of services by the foreign enterprise within India. Thus the employees and other personnel must be of the non-resident assessee to create a service PE. Any other interpretation or treating employees of the Indian entity, i.e., e-Fund India as "other personnel" of the foreign assessee would lead to incongruities and irrational result, for every subsidiary which engages an employee, would always become a PE of the controlling foreign company. The said submission of the Revenue is misconceived and has to be rejected...

Conclusion

Thus, in a case, where furnishing of services in the source state is under control of another enterprise, the foreign enterprise will not constitute a Service PE. Similarly, if the employees of the another enterprise are furnishing services under control of the foreign enterprise, the foreign enterprise could trigger Service PE. In the present case, the employees of I Co. were defacto and dejure employed by the Indian entity / enterprise and such employees are not under direct control of US Co. & UK Co. and thus cannot be considered as “personnel”. Further, the foreign enterprise are not responsible for the performance of those employees. Therefore, it cannot be said that there exists a service PE of the foreign entities in India.
Issue 4: Further, short term visits by employees of foreign entities to man and review the services rendered by the Indian company can be considered as PE under sub-clause (l) of Article 5(2)?

Judicial Precedents

1. **DIT v. E-Funds IT Solution (42 taxmann.com 50)(Delhi High Court)**

   “27. In respect of stewardship activities by employees of the non-resident assessee, it was observed that the "employees" were not involved in any day-to-day management or any specific services undertaken by the Indian subsidiary and it was basically to protect the interest of the customers, i.e., the third parties. It was also noticed, as in the present case, that the Indian subsidiary therein was a service provider. The aforesaid observations of the Supreme Court affirm our view that the services must be performed in respect of the activities within India. The distinction being activities "within India" and activities "between" the foreign enterprise/assessee and the Indian enterprise, i.e., the resident assessee is relevant. Thus, merely because the non-resident assessee to protect their interest, for ensuring quality and confidentiality has sent its employees to provide stewardship services, will not make the Indian subsidiary or another entity, a PE of the non-resident company. . . .


Conclusion

In the present case, employees of foreign entities visit India to man and review the services rendered by the Indian company in relation to the projects of the foreign entities. It is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality. Nonetheless, while providing stewardship services, there cannot be any service recipient. The foreign entity is merely guarding itself and I Co. cannot be said to have received any service. Therefore, such short visits will not constitute a PE in India of US Co. & UK Co.
Case Study 5

FACTS
1. H Ltd., is a company incorporated in USA and provides services in relation of management of various hotels worldwide through its employees.
2. It entered into a contract with an Indian hotel, I Ltd. to provide services for managing its hotel.
3. The services were provided by the employees of H Ltd. while in India and even from overseas.
4. The stay of employees in India exceeded 100 days.
5. The services rendered by the employees are not FIS under Article 12 of the DTAA but is FTS under the Act.
6. Total contract value is Rs. 100 lakhs.
7. Total man days spent on the contract is 1000 man days out of which 600 man days is spent in India and 400 man days outside India.
8. The total salary cost of employees who rendered services in India is Rs. 50 lakhs.
9. Administrative and general expenses of H Ltd. reasonably allocated to the PE is Rs. 1 lakhs

ISSUES
1. Whether H Ltd has a service PE in India?
2. How profits attributable to the PE is to be computed?
3. Whether administrative and general expenses reasonably allocated to the PE can be disallowed under Section
   I. 44DA?
   II. 44C?
Issue 1. Whether H Ltd has a service PE in India?

Treaty Provision

India USA DTAA - Article 5(2)

“2. The term "permanent establishment" includes especially:

……

(i) the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or

(ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)].”

Conclusion

H Ltd. has a service PE in India since:

• H Ltd. furnishes services in India through its employees

• FTS definition under the Act – Explanation to Section 9(1)(vii) includes services in the nature of managerial, technical and consultancy. In the given case services are managerial in nature and gets squarely covered by the definition of FTS under the Act. However, as per Article 12 of the Treaty, Fees for included services includes only technical and consultancy services. Thus, services in question cannot be said to be in the nature of FIS under Article 12 of the Treaty.

• Services are rendered for a period of more than 90 days i.e. 100 days
Attribution of Profits

Issue 2. How profits attributable to the PE is to be computed?

Treaty Provision

India USA DTAA - Article 7

“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 independent enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly at arm’s length with the enterprise of which it is a permanent establishment and other enterprises controlling, controlled by or subject to the same common control as that enterprise. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis. The estimate adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.”
### Attribution of Profits

#### Estimate on Reasonable Basis

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income attributable to the PE in India.</td>
<td><strong>Rs. 100 lakhs</strong> × 600 (man days spent in India)**</td>
</tr>
<tr>
<td>(Contract value)</td>
<td>---------------------------------</td>
</tr>
<tr>
<td>(Less): Expenses attributable to PE in India</td>
<td><strong>Rs. 60 lakhs</strong></td>
</tr>
<tr>
<td>(Less): Expenses attributable to PE in India</td>
<td><strong>Rs. 50 lakhs</strong></td>
</tr>
<tr>
<td>Net income attributable to PE in India</td>
<td><strong>Rs. 10 lakhs</strong></td>
</tr>
</tbody>
</table>
Issue 3(I). Whether administrative and general expenses reasonably allocated to the PE can be disallowed under Section 44DA?

Treaty Provisions

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.”
Section 44DA of the Income Tax Act, 1961

(1) The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-resident (not being a company) or a foreign company with Government or the Indian concern after the 31st day of March, 2003, where such non-resident (not being a company) or a foreign company carries on business in India through a permanent establishment situated therein, or performs professional services from a fixed place of profession situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of profession, as the case may be, shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of this Act:

Provided that no deduction shall be allowed,—

(i) in respect of any expenditure or allowance which is not wholly and exclusively incurred for the business of such permanent establishment or fixed place of profession in India; or

(ii) in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to its head office or to any of its other offices:

Provided further that the provisions of section 44BB shall not apply in respect of the income referred to in this section.

(2) Every non-resident (not being a company) or a foreign company shall keep and maintain books of account and other documents in accordance with the provisions contained in section 44AA and get his accounts audited by an accountant as defined in the Explanation below sub-section (2) of section 288 and furnish along with the return of income, the report of such audit in the prescribed form duly signed and verified by such accountant.

Explanation.—For the purposes of this section,—

(a) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of sub-section (1) of section 9;

(b) "royalty" shall have the same meaning as in Explanation 2 to clause (vi) of sub-section (1) of section 9;

(c) "permanent establishment" shall have the same meaning as in clause (iii) of section 92F.
As explained earlier services in question are Fees for technical services under the provision of the Act but not Fees for Included Services under the DTAA.

For computing profits under Article 7 of the DTAA, limitations under the Chapter IVD are to be considered. Section 44DA is one such section.

For the purpose of Section 44DA, FTS has been exhaustively defined in the explanation to mean “FTS as defined in Explanation 2 to Section 9(1)(vii). Since in the given case, the services gets covered within the definition of FTS as given in the Act, Department may apply the provisions of Section 44DA and deny the allowance of general and administrative expenses allocable to the PE in India.

For computing profits under Article 7 of the DTAA, limitations under the Chapter IVD (i.e. Section 28 to Section 44DB) to be considered. However, for the purpose of Section 44D, meaning of FTS to be taken as defined in treaty and not as per the Act by invoking the provisions of section 90(2). Thus, even for the purposes of section 44D/ 44DA, meaning of FTS has to be taken as per the Act or Treaty whichever is more beneficial to the assessee.

- DCIT vs. Boston Consulting Group Pte. Ltd. (2005) 93 TTJ 293 (Mum)
- JCIT vs. Essar Oil Ltd. (2006) 7 SOT 216 (Mum)
- Cray Research India Ltd. vs. JCIT (2011) 136 TTJ 1 (Del)
For computing profits under Article 7 of the DTAA, limitations under the Chapter IVD (i.e. Section 28 to Section 44DB) to be considered. However, for the purpose of Section 44D, meaning of FTS as per Act to be considered.

- DIT vs. Rio Tinto Technical Services (2012) 340 ITR 507 (Del)
- ABC, In Re (1997) 228 ITR 487 (AAR)
- Ericsson Telephone Corporation India AB, In re (1997) 224 ITR 203 (AAR)
- Voith Siemens Hydro Kraftwerkstechnik GMBH & Co. vs. DDIT (2013) 140 ITD 216 (Del)
- Steel Authority of India Ltd. vs. ACIT (2007) 105 ITD 679 (Del)
- DDIT vs. Pipeline Engineering GmbH (2009) 125 TTJ 534 (Mum)

However, the above unfavourable judgments can be distinguished on the following points:
- no plea was taken by the assessee that definition of FTS as per treaty is to be considered
- Treaty involved in the said cases did not have make available clause

Thus, by relying on the favourable cases, it can be said that the 44DA would not apply to the assessee, since the services are not FIS as per the Treaty and accordingly, the limitations in Section 44DA shall not apply to the allowability of general and administrative expenses.
Issue 3(II). Whether administrative and general expenses reasonably allocated to the PE can be disallowed under Section 44DA?

Once the limitations under the provisions of Section 44DA are not applicable, one may have to analyse the implications of section 44C of the Act.


44C. Notwithstanding anything to the contrary contained in sections 28 to 43A, in the case of an assessee, being a non-resident, no allowance shall be made, in computing the income chargeable under the head "Profits and gains of business or profession", in respect of so much of the expenditure in the nature of head office expenditure as is in excess of the amount computed as hereunder, namely:—

(a) an amount equal to five per cent of the adjusted total income; or  
(b) [***]  
(c) the amount of so much of the expenditure in the nature of head office expenditure incurred by the assessee as is attributable to the business or profession of the assessee in India,  
whichever is the least:

Provided that in a case where the adjusted total income of the assessee is a loss, the amount under clause (a) shall be computed at the rate of five per cent of the average adjusted total income of the assessee.

Explanation.—For the purposes of this section,—

(i) "adjusted total income" means the total income computed in accordance with the provisions of this Act, without giving effect to the allowance referred to in this section or in sub-section (2) of section 32 or the deduction referred to in section 32A or section 33 or section 33A or the first proviso to clause (ix) of sub-section (1) of section 36 or any loss carried forward under sub-section (1) of section 72 or sub-section (2) of section 73 or sub-section (1) [or sub-section (3)] of section 74 or sub-section (3) of section 74A or the deductions under Chapter VI-A;
For computing profits under Article 7 of the DTAA, limitations under the Chapter IVD are to be considered. Section 44C is one such section.

As per the mandate of Article 7, the deduction is to be allowed in conformity with the provisions of the Income Tax Act, 1961. Once there is section 44C there can be no escape unless it is proved that the expenses incurred are not covered within the mandate of section 44C of the Act.

- DCIT v Banque Indosuez [2012] 19 ITR (Tri) 463 (Mum)
- ADIT v Dalma Energy LLC [2012] 20 taxmann.com 780 (Mum)

As per Section 44C, deduction of head office expenditure is to be allowed least of:

- 5% of adjusted total income
  5% X 10 lakhs = Rs. 50000

  OR

- Amount of head office expenses attributable to Indian operations
  Rs. 1 lakh

Thus deduction of Rs. 50000 towards head office expenditure is to be allowed for computing profits of the PE.
Questions & Answers
Thank You