

Trends in Judicial Tax Treaty Interpretation in India

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1. Introduction

Courts in India have been known worldwide to be a *factory*, regularly churning out large number of decisions on international tax matters of global relevance. Since all judgments are in English and often as detailed as 100-120 pages in length, the judgments are regularly followed all over the world and even referred to in judgments of Courts of other countries.

It is to be noted that the Indian juridical system for tax matters has a particular flow of hierarchy. The 'Income Tax Appellate Tribunal' (ITAT) is a tax court which functions in the major cities in India. Matters from the ITAT may be appealed to the High Court. The various High Courts of the relevant State supersede the decisions of the ITAT. The Supreme Court of India supersedes all matters and decisions of all High Courts and ITATs.

In terms of binding nature, decisions pronounced by one ITAT may have persuasive value in another ITAT, but the latter ITAT is not bound to follow the decisions of the former ITAT. Decisions pronounced by a High Court should be referred to and followed by that High Court and the local ITAT in all matters in relation to the same question of law. However, another state High Court is not bound to follow the decisions taken by the High Court of another state. Those decisions of another state High Court are only persuasive in nature and may be referred to for guidance.

India has 27 ITATs and 24 High Courts.

One can thus imagine that if each ITAT and each High Court has a different view on a matter, then the number of conflicting decisions will be unruly, resulting in very high levels of uncertainty for taxpayers.

It is thus imperative for the Supreme Court to pronounce conclusive decisions on important questions of law, since the decision of a Supreme Court supersedes all other laws of the land and must be followed by all ITATs and High Courts of India.

This article attempts to highlight uniformity or lack thereof in decisions taken by the Courts in matters of important international tax principles and whether there is a predictable clarity or whether it is leaving the taxpayer with more uncertainty.

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2. Treaty Entitlement to Intermediary Holding Companies

A tax treaty³ is entered between two countries to eliminate double taxation that may result from taxation of the same income in the residence and source states, i.e. juridical double taxation. The beneficial provisions of a tax treaty can be availed by a person who is a resident of one of the contracting states who are parties to the tax treaty.

India has signed tax treaties with many countries where certain treaties have more favourable terms than the others. Persons who are not resident of such favourable tax treaty country have used such favourable treaties to reduce their Indian tax costs, by setting up an intermediary company resident in such favourable tax treaty country and routing transactions through such company. This arrangement may be termed as ‘treaty shopping’.

Whether or not such intermediary companies should be entitled to the benefits of the favourable tax treaties has been a matter of substantial litigation.

*Azadi Bachao Andolan (SC 2003)*⁴ – Treaty shopping

In the Azadi Bachao Andolan case, the Supreme Court has ruled on the constitutional validity of Circular No. 789 of 2000 as per which Foreign Institutional Investors which are resident in Mauritius would not be taxable in India on income from capital gains arising in India on sale of shares of Indian companies. The circular was based on the background that India-Mauritius tax treaty defines ‘Resident of Mauritius’ to mean any person who is liable to taxation in Mauritius by reason of his domicile, residence, place of management or other criteria. Once the person is liable to taxation in Mauritius under any criteria, such person qualifies as a resident of Mauritius and should be eligible to the benefits of the treaty.

Jumping straight to the question of the *residence* of the companies in Mauritius, the Supreme Court ruled that it cannot judge the legality of treaty shopping by nationals of a third State merely because one section of thought considers it improper. The question of treaty shopping arises when tax authorities opine on how the law ought to be. However the law is uniform and unless expressly stated, its intendment cannot be assumed. Treaty Shopping may or may not have been intended by the two States at the time of entering into the India-Mauritius tax treaty but many countries encourage it for non-tax reasons.

The Supreme Court further clarified that where a Tax Residency Certificate (TRC) has been issued by the Mauritian government, such certificate shall constitute sufficient evidence for accepting the status of residence and beneficial ownership and the India-Mauritius tax treaty can be applied accordingly. The Supreme Court stated that in the absence of a Limitation of Benefits clause, an entity cannot be denied entitlement to the benefits of the tax treaty.

³ Referred to as a Double Tax Avoidance Agreement in the Indian context

⁴ Union of India vs. Azadi Bachao Andolan [2003] 132 Taxman 373 (SC). Azadi Bachao Andolan translates to ‘Save the Freedom Movement’

*E Trade Mauritius Limited (AAR 2010)*⁵ – *Dubious vs. bona fide transactions*

Having placed reliance on the Azadi Bachao Andolan case, the Authority for Advance Rulings (AAR) has further clarified that the Supreme Court appears to have differentiated between treaty shopping and the underlying objective of tax avoidance from the use of a colourable device. Designing transactions for tax avoidance which are within the framework of law are not prohibited. Conduit entities and transactions undertaken by such conduit entities are not illegal or invalid if these were set up for the purpose of treaty shopping.

However, transactions which are not supported by bona fide documents or conceal a different transaction are considered sham or a colourable device. Such dubious transactions can be ignored. The AAR also laid down factors which it considered irrelevant in determining the beneficial ownership of shares - namely the source of funds traced to the holding company, holding company suggesting or negotiating the sale transaction, sale consideration being distributed to the parent, etc. This has been reiterated in the Vodafone Holdings BV case by the SC in 2012. The AAR stated that a TRC can be accepted only as a presumptive evidence of beneficial ownership.

*Aditya Birla Nuvo Limited (HC Bom. 2011)*⁶ – *Beneficial owner*

In another case, a US company AT&T USA entered into a joint venture agreement for investing in an Indian company. AT&T USA subscribed to the shares of the Indian company but its wholly owned subsidiary, AT&T Mauritius was allotted shares in the Indian company as a *permitted transferee* of its US parent. Since it was not the owner of shares, it was not liable to pay for such shares. All the shareholding rights (voting, selling, transfer rights) were vested in the US parent.

Due to lack of adequate documentation evidencing that the Mauritian company had decided on its own to purchase shares in the Indian company and absence of shareholder participation, the High Court held that the Mauritian company were a mere permitted transferee and not the real owner of the shares. The tax treaty between India and Mauritius could not be invoked. Whether AT&T Mauritius held a valid Tax Residency Certificate of Mauritius was considered irrelevant.

*Vodafone International Holdings BV (SC 2012)*⁷ – *Indirect transfers*

The Vodafone case is the most widely and globally discussed case coming out of the Indian stables. It is unavoidable to write about tax planning in India without referring to the Vodafone case.

⁵ E-Trade Mauritius Limited, In Re [2010] 190 Taxman 232 (AAR - New Delhi)

⁶ Aditya Birla Nuvo Limited vs. Deputy Director of Income Tax (International Taxation), 4(2), Mumbai [2011] 12 taxmann.com 141 (Bombay - High Court)

⁷ Vodafone International Holdings B.V. vs. Union of India [2012] 17 taxmann.com 202 (SC)

The matter in the Vodafone case is not directly related to the discussion at hand since in the Vodafone case there was an indirect of transfer of shares of an Indian company due to the multi-tiered holding company structure transferred by way of transfer of shares of a Cayman Islands company.

Thus, the question of tax treaty protection did not arise since the transferor was resident in a country that did not have a tax treaty with India. The argument of the tax authorities in this case was that the multi-tiered holding structure is to be disregarded, the entire corporate veil should be lifted, and that in reality assets in India were being transferred. The Supreme Court has ruled in 2012 that Vodafone has acted within permissible rules of law. However, with a retrospective amendment to the Income Tax Act in 2012, the tax authorities are still pursuing the case.

*AB Mauritius – I (AAR 2018)*⁸ – *Name lender vs. beneficial owner*

In a recent ruling, the AAR accentuated the modus operandi at the time of acquisition of shares of the Indian company by the Mauritian company. To avail the benefit of a tax treaty, the AAR stated that a company must establish that it is acting on its own behalf and the asset which it seeks to alienate should actually belong to the company.

It was observed that the decision to purchase shares of the Indian company was not made by the Mauritian company. Instead, the share purchase agreement was signed by the director of the parent of Mauritian company. The Mauritian company had no information of the decision to acquire shares of the Indian company until much after the completion of acquisition, when it was directed by its parent to merely ratify the transaction. Board of directors of the Mauritian company merely reiterated decisions of its parent and had no role in decision making process for acquiring shares of the Indian company. It had also not paid any consideration for purchase of shares. The entire consideration was discharged by the parent with no consideration payable by the Mauritian company as per the SPA.

Thus the Mauritian company was only a name lender and not the beneficial owner of shares and hence not entitled to the benefits of the India-Mauritius tax treaty.

*Skaps Industries India Private Limited (ITAT Ahm. 2018)*⁹ – *TRC requirement*

The ITAT reiterated that entitlement to treaty benefits are available only to the residents of contracting states. As per the India-USA tax treaty, a resident of USA is a person who is liable to tax in the US by reason of his domicile, residence, citizenship, place of management, place of incorporation or any other criteria. Section 90(2) of the Indian Income Tax Act starts with a *non-obstante clause* stipulating that beneficial provisions of a tax treaty shall override other provisions of the Income Tax Act. The ITAT ruled that though section 90(4) of the Indian Income Tax Act requires the furnishing of a Tax Residency Certificate by a non-resident to claim

⁸ AB Mauritius, In Re [2018] 90 taxmann.com 182 (AAR – New Delhi)

⁹ Skaps Industries India (P.) Limited vs. Income Tax Officer, International Taxation, Ahmedabad [2018] 94 taxmann.com 448 (Ahmedabad. Trib.)

treaty benefits, it cannot be treated as a limiting factor for claiming treaty benefits. However, the ITAT confirmed that a reasonable evidence for entitlement to treaty benefits shall always be required, whether in the form of TRC or otherwise.

*JSH Mauritius Limited (HC Bom. 2018)*¹⁰ – *Longevity test*

In this recent case, the Bombay High Court laid emphasis on the fact that shares were held for thirteen years before alienation by the company which was sufficient to conclude that the transaction was bona fide. The utilisation of sale proceeds, i.e. towards reinvestment in another group company, was also held as sufficient evidence that the alienator is not a shell company.

Author Comments

It may be abundantly clear from the above, that the tax authorities have been very active and innovative in disregarding structures that are set up by companies in order to impose tax in India on transactions which would have otherwise been protected by a tax treaty and not taxable in India.

The Courts in India have been consistent in their view on entitlement of treaty benefits to residents of other countries, permitting holding company structures where the sanctity of the intermediary company is maintained and disregarding structures where the intermediary company is improperly interposed as merely a name lender. As long as the transactions are conducted properly by the interposed company itself, the Courts have refrained from disregarding the company and have respected the tax treaty entitlements.

With effect from 2012¹¹, section 90(4) of the Indian Income Tax Act requires that persons not resident in India shall submit a Tax Residency Certificate from the government of the country of which they are resident to claim relief under the tax treaty between India and their country of residence. This was added as an additional layer of procedural protection against treaty abuse.

India has been amending many of its tax treaties and including a Limitation of Benefits (LOB) clause among other amendments, clarifying that benefits of the tax treaties shall not be available to shell or conduit companies. These LOB provisions are being prospectively applied.

With the introduction of LOB for transfer of certain shares, the TRC shall only be an evidence of residence and not a conclusive evidence for beneficial ownership of shares. The beneficial ownership shall be ascertained by applying the principles laid down in the LOB provisions of the treaty.

India has also introduced a General Anti Avoidance Rule (GAAR). The GAAR shall apply to any impermissible avoidance arrangement whose main purpose is to obtain a tax benefit. There

¹⁰ Commissioner of Income Tax (International Taxation)-3, Mumbai vs. JSH (Mauritius) Ltd. [2017] 84 taxmann.com 37 (Bombay - High Court)

¹¹ Added by Finance Act 2012

are threshold limits to the applicability of GAAR and it is expected that a GAAR shall be applied only in rare deserving cases.

Considering the judicial rulings, the changes to the laws & procedures and the changing international tax planning landscape in the wake of BEPS, it is safe to say there is considerable certainty in Indian judiciaries' approach to the use of intermediary holding companies for investments into India.

3. Treatment of fiscally transparent entities

Eligibility to claim benefits of a tax treaty by fiscally transparent entities has been the subject matter of litigation time and again, especially in the context of the India-UK tax treaty.

Partnerships are opaque in India but fiscally transparent entities in the UK, leading to economic double taxation whereby the same income is taxed twice in the hands of different persons i.e. in the hands of the partnership firm in India without giving tax treaty benefits and the partners in the UK as residents of UK.

*Linklaters LLP (ITAT Mum. 2010)*¹²

The question whether a partnership being a “*fiscally transparent entity*” is entitled to the benefits under the tax treaty was raised for the first time by the Tribunal suo moto and not by the tax authorities. The Court asked whether the assessee, being a fiscally transparent entity which is not a taxable entity under the laws of UK, can be treated as a ‘resident of the United Kingdom within the meaning of that term under the India UK tax treaty, and whether, in this view of the matter, the assessee is entitled to the benefits of the tax treaty at all. The Court laid down that the controversy on residence is to be decided on the concept of ‘liable to taxation (in UK)’.

Residence is based on whether a “person” is “liable to tax” in either State owing to residence, domicile, place of management, etc. The residence definition is modelled around a principle as per which what matters from a country perspective is whether treaty protection is being sought in respect of income which is taxed in the treaty partner country or not. Thus in a situation where the entire income of a partnership firm is taxed in the UK – whether in its own hands or the hands of its resident partners individually, treaty benefits cannot be declined.

*Schellenberg Wittmer (AAR 2012)*¹³

A view contrary to the above has been taken by the AAR wherein the assessee partnership firm has been denied benefits of the India-Switzerland tax treaty. The assessee was a fiscally transparent entity in Switzerland and all its partners were residents of Switzerland itself.

¹² Linklaters LLP vs. Income Tax Officer, International Taxation, Ward 1(1)(2), Mumbai [2011] 9 ITR(T) 217 (Mumbai – Trib.)

¹³ Schellenberg Wittmer, In Re [2012] 24 taxmann.com 299 (AAR – New Delhi)

The AAR has laid emphasis on the term “person” used in the definition of “resident” under the tax treaty. As per the tax treaty, person *includes* among other things, body of individuals or entities which are taxable under the laws in force of either Contracting State. According to the AAR, unless the body of individuals or entity is taxable in the concerned State, it will not be a person. Since the assessee partnership is formed in Switzerland, it should be seen whether it is a taxable entity under the Swiss law. A partnership firm is not a taxable entity in Switzerland. Unlike the definition of person u/s 2(31) in the Indian Income Tax Act, 1961 which explicitly includes partnership firms within its ambit, the Swiss law does not have a corresponding definition of person. Thus the AAR held that even though the definition of person in the treaty is inclusive, it cannot be deemed to apply to partnership firms.

Thus the AAR ruled against the assessee because the partnership firm does not satisfy the prerequisite of being a person, and consequently it cannot be entitled to the benefits of the tax treaty. This position taken by AAR stands to differ from the conclusions arrived at in Linklaters LLP and P&O Nedlloyd Ltd. cases where the ITAT and Supreme Court have considered it sufficient for partnerships to be taxable units in India to qualify as persons even if they are not taxable units in UK in those cases.

It further ruled that, in situations where fiscally transparent entities are denied benefits under a tax treaty, the partners shall not be entitled to benefits under their respective tax treaties on their share of income from partnership. It should be noted that the AAR ruling is not in line with the OECD report on partnerships as per which partners should be entitled to tax treaty benefits in such cases.

General Electric Pension Trust (AAR 2006)¹⁴

The matter of treatment of trusts under tax treaties came up before the AAR. Apart from partnerships, also trusts are fiscally transparent entities. The AAR has analysed the term “resident” as given in the India-USA tax treaty and as per Article 4 of the treaty, “Residents of USA” shall be those persons who are *liable to tax* in USA subject to the provisos given in the Article. As per proviso (b), for income derived by a trust among other specified entities, the term resident shall apply only to the extent such income of the trust is *subject to tax* in USA either in the hands of the trust or its beneficiaries. Thus while for persons other than specified entities, it is sufficient that they are liable to taxation in USA irrespective of actual taxation, it is not so for specified entities like trusts. Trusts or their beneficiaries shall be subject to actual taxation and not be exempted from tax in USA. In the event of such exemption, trusts are not considered as residents of USA and consequently not entitled to claim benefits under the tax treaty.

Chiron Behring GmbH & Co. (HC Bom. 2013)¹⁵

¹⁴ General Electric Pension Trust, In Re [2006] 150 Taxman 545 (AAR – New Delhi)

¹⁵ Director of Income Tax (International Taxation) vs. Chiron Behring GmbH & Co. [2013] 29 taxmann.com 199 (Bombay – High Court)

The Mumbai High Court held that benefits of the India-Germany tax treaty cannot be denied to limited partnerships that paid trade tax covered by the treaty and possessed a TRC issued by the German government evidencing that the partnership was a taxable unit in Germany.

As per the treaty, a person includes any taxable unit in Germany. The TRC issued by the German government was considered as sufficient evidence of the firm being a taxable unit in Germany. Further, a resident is a person who is liable to tax under the laws of Germany by reason of domicile, residence, place of management, etc. The limited liability partnership was filing a trade tax return in Germany which was a tax covered under the tax treaty thereby making the firm a resident of Germany.

It was held that while the OECD commentary does not allow fiscally transparent entities such as partnership firms to treaty entitlement, the benefit prescribed under a specific tax treaty cannot be denied on the basis of the OECD commentary. The specific provisions shall prevail to that extent.

*P&O Nedlloyd Limited (SC 2016 and HC 2014)*¹⁶

Emphasis of this case was on ascertaining whether the LLP was a “person” eligible to claim treaty benefits. While, a LLP is not a taxable unit in UK and hence not a person under the laws of UK, LLPs are considered as firms in India and firms are included in the definition of persons in the Indian Income Tax Act, 1961. As per the Indian Income Tax Act, a firm shall have the meaning assigned to it in the Indian Partnership Act, 1932 and shall include a limited liability partnership as defined in the Limited Liability Partnership Act, 2008.

Since a UK LLP was a person for the purposes of the Income Tax Act, and further, by attempting to bring the income to tax in the hands of the LLP, the tax authorities were inadvertently *themselves* treating the LLP as a person, the tax authorities could not then argue that the UK LLP was not a person for the purposes of the India UK tax treaty. Thus the UK LLP was entitled to be covered by the provisions of the India UK tax treaty.

Author Comments

By way of a protocol¹⁷ and a clarification by the CBDT¹⁸ to the India UK tax treaty, the definition of ‘person’ was amended to delete the exclusion of UK partnerships. Also the term ‘resident’ was amended to include partnership firms, estates or trusts to the extent the income is subject to tax in that country either in its hands or in the hands of its partners or beneficiaries.

Until recently, the applicability of tax treaties to fiscally transparent entities was being assumed in transactions and tax treaty provisions were applied without being questioned. That is now

¹⁶ P&O Nedlloyd Ltd. vs. Assistant Director of Income Tax, International Taxation –II, Kolkata [2014] 52 taxamnn.com 468 (Calcutta – High Court)

¹⁷ Notification No. 10/2014, dated 10 February 2014

¹⁸ Circular No. 2/2016, dated 25 February 2016

becoming an important consideration for taxpayers and tax authorities alike, especially due to the tax treatment arbitrage between nations.

Divergent views in fiscally transparent entities involving different countries is expected due to the emphasis on the nature of the fiscally transparent entity with reference to non-tax laws too, as was seen in the P&O Nedlloyd and Linklaters LLP cases.

Besides non-tax laws to determine treatment of fiscally transparent entities as *persons*, emphasis is certainly to be laid on *subject to tax* and not just on *liable to tax*, in order to determine the residence and eligibility of tax treaty benefits.

4. Fixed Place & Other Permanent Establishments

Presence of a foreign enterprise's Permanent Establishment (PE) in India is relevant for determining taxability of income having nexus to India. Business profits of a non-resident attributable to Indian operations shall be liable to tax in India if it has a PE in India.

Thus, it is of prime importance to determine whether there exists a PE of the foreign enterprise in India. In recent times, a number of landmark judgements and rulings have been pronounced by the Courts and AAR dealing with the many contentious matters associated with PEs. We have discussed a few such decisions which, although not exhaustive, lay down in a consistent manner important principles for determination of a PE in India.

*MasterCard Asia Pacific Pte. Ltd. (AAR 2018)*¹⁹

This is one of the most recent and significant rulings on PE issues in India. The assessee, MasterCard Asia Pacific, is engaged in processing of card payment transactions for Indian customers through the MasterCard Network infrastructure physically located in India, partly owned by its 100% subsidiary in India. The case analyses whether a PE is constituted in India owing to the existence of MasterCard Network and a subsidiary in India. The matter was decided against the taxpayer MasterCard Asia Pacific.

'Fixed Place PE' has been analysed by the AAR with regard to the MasterCard Network, the local banks carrying out the settlement function and the subsidiary in India. To create a Fixed Place PE, the AAR has laid down three tests viz. permanency, a fixed place and disposal. Additionally, it would be necessary to examine whether the activities performed in India are preparatory or auxiliary in character. The AAR states that it is sufficient that the fixed place is at the disposal of the foreign company till the time it is required by the business and permanence does not mean *forever*. The fixed place should be at the disposal of the foreign enterprise; however it need not have a formal or legal right to use it. Merely having control or the right to use such fixed place is sufficient. The space need not be exclusively used by the foreign company. Equipment need not be fixed to the ground but should remain at a particular site to qualify as fixed place PE. To determine whether the work performed is preliminary or auxiliary, it is necessary to see whether the functions performed in India by the foreign company itself or

¹⁹ MasterCard Asia Pacific Pte. Ltd. In Re [2018] 94 taxmann.com 195 (AAR – New Delhi)

on its behalf are important and crucial in the context of the overall functions performed by the company. Having relied upon the commentary by Klaus Vogel, it is clarified that activities done for one self may be preparatory or auxiliary. However, when done for a third party would not be so. The nature of work, clerical or otherwise, amount of fees paid, etc. are irrelevant factors for determining the significance of work done. In view of the above factors, MasterCard Asia Pacific was found to have a Fixed Place PE in India in the form of MasterCard Network infrastructure, settlement banks and its subsidiary.

To create a Service PE, the AAR lays down three principle tests viz. services shall be provided within India, the 90 days threshold as per tax treaty should be crossed, and work carried on by persons shall be in connection with the service in question and not any other work. Services should be performed by either employees or other personnel engaged by the foreign company only. Employees of another organisation (i.e. employees of the settlement bank in India) providing services to the foreign company in their capacity as employees of that other organisation cannot result in the creation of a Service PE. However employees of MasterCard Asia Pacific visiting India for furtherance of business shall fulfil all the conditions of constituting a service PE.

A Dependent Agent PE is also created when a subsidiary is legally and economically dependent on its parent. Subsidiaries that secure orders wholly or almost wholly on behalf of the parent and that too habitually, qualify as dependent agent PEs under the India-Singapore tax treaty. Since the Indian subsidiary was working only for MasterCard Asia Pacific and liaising between MasterCard Asia Pacific and its customers in India for securing orders on its behalf, it constituted a dependent agent PE.

*Nokia Networks OY (ITAT Delhi Special Bench 2018)*²⁰

Although the tests laid down in this decision are similar to the MasterCard case as regards a fixed place PE, the conclusion arrived at by the Tribunal is in favour of the assessee unlike the MasterCard case.

As regards fixed place PE, some important points for consideration have been stated by the ITAT apart from the basic tests which are similar to the MasterCard case. There need not be premises if they are not required or available and simply having a certain amount of space at its disposal can also result in a fixed place of business. Such PE should have characteristics of stability, productivity and dependence and should amount to a virtual projection of the foreign enterprise on the soils of India. Fixed place alludes to some kind of a particular location, physically located premises or some place in physical form. However, telephone, fax or car cannot amount to physically located premises. Moreover business should be carried on through such fixed place to qualify as a PE. Providing assistance to employees of the foreign company visiting India for networking, negotiation and signing of supply contracts in the form of telephone, car or fax cannot be considered as carrying on business through such facilities.

²⁰ Nokia Network OY vs. Joint Commissioner of Income Tax, Non-Resident Circle, New Delhi [2018] 94 taxmann.com 111 (Delhi - Trib.) (SB)

Further as in the case of MasterCard case, the nature of activities carried on in India shall not be preparatory or auxiliary to constitute a PE. Signing the supply contracts, networking and negotiating before the supply of goods are only preparatory and auxiliary activities.

Further, the scope of dependent agent PE has been explained in much detail by the ITAT. A dependent agent carries on activities for the principal which are subject to the principal's instructions and comprehensive control resulting in legal dependence. Dependent agents do not bear any entrepreneurial risk resulting in economic dependence. Such agents must have sufficient authority to bind the principal's participation in the business activities that it is conducting on his behalf. Given the above factors, Nokia India was not reckoned as a dependent agent PE of the foreign company because none of the activities of the foreign company pertaining to supply contracts were carried on by Nokia India. Being a subsidiary, Nokia India may have been in complete control of the foreign company and subject to its instructions. However, the control was not exercised for carrying on the supply functions of the foreign company and thus cannot lead to creation of a dependent agent PE.

*E-Funds IT Solution Inc (SC 2017)*²¹

E-Fund India performed back office operations in respect of ATM management, electronic payments, decision support and risk management services rendered by E-Fund USA to customers located outside India.

This case is different from the MasterCard case in the sense that the ultimate consumers are not located in India but outside India. Thus the single most important ingredient for constituting a service PE, that the enterprise must furnish services 'within India' through employees or other personnel is absent since the customers are located outside India and have received services outside India. Further, as per the OECD commentary what matters is that the services shall be performed in India through an individual present in India. If any customer, resident or otherwise, would have received a service in India, it would be sufficient. However it is not so in the case of E-Funds. Thus no Service PE is created.

The concept of fixed place PE has been well explained in either of the two cases summarised above. In line with them, the E-Fund case also places utmost reliance on the 'disposal' test. However it has been clarified that merely giving access to certain premises without having the right to use it or have control upon it would not lead to creation of a PE in India.

Secondly, *main business and revenue earning activity* should be carried on from the fixed place of business in India which should be at their disposal. Since the Indian subsidiary is only rendering support services, it would not give rise to a fixed place PE.

Further it has been clarified that 100% Indian subsidiaries do not automatically become location PEs if some business is outsourced to them. Even if foreign companies have saved and reduced their expenditure by transferring business of back office operations to the Indian subsidiary, it would itself not create a fixed place or location PE because they are separate and independent

²¹ Assistant Director of Income Tax-1, New Delhi vs. E-funds IT Solution Inc. [2017] 86 taxmann.com 240 (SC)

entities and are entitled to provide services to their parent who are separate taxpayers. The concept of dependent agent PE has been analysed from a different perspective in this case where importance has been placed on the independence of a subsidiary.

*Formula One World Championship Ltd. (SC 2017)*²²

This is the landmark judgement that was pronounced by the Supreme Court and deals exclusively with the creation of a Fixed Place PE. The Court has emphasized that a twin condition needs to be satisfied to constitute a fixed place PE: existence of a fixed place of business; *through* that place, business of the enterprise is wholly or partly carried out.

The Buddh International Circuit was a fixed place owned by Jaypee, an Indian Company. The Formula One Grand Prix was held here, which is the business activity of Formula One World Championship Ltd (FOWC). The question is whether the Buddh Circuit was put at FOWC's disposal for carrying on its business activities.

FOWC entered into a Race Promotion Contract with Jaypee giving it rights to stage, host and promote the event for a consideration. Jaypee had given back all commercial rights to FOWC and its affiliates vide other agreements which were eventually exploited through the actual conduct of the race in India. Omnipresence of FOWC and its tag over the event was loud, clear and firm. As long as the race was conducted in India and the income was generated in India, it is immaterial that the race was conducted only for 3 days in a year as long as the event remains under the control of FOWC throughout its duration. FOWC along with its affiliates had real and dominant control of the event. Thus the Buddh Circuit was put at FOWC's disposal.

The Buddh Circuit was construed as a virtual projection of the foreign enterprise FOWC on the soils of India. The Buddh Circuit possessed all the three characteristics of a PE as stated by Philip Baker: stability, productivity and dependence. Thus it created a Fixed Place PE of FOWC in India.

*Steel Authority of India Limited (ITAT Delhi 2007)*²³

Moving to the other aspects of a PE in India, another highly litigated concept is that of a 'Supervisory PE'. This section shall highlight the conflicting views taken by the Tribunal in the context of Supervisory PE owing to installation projects in India.

In the given ruling, the Tribunal has dealt with the issue of supervisory activities in connection with installation projects constituting a PE in India under the India-Germany tax treaty. It has concluded that supervisory services must be rendered by the foreign company at installation sites in India. However, there is no condition stipulating that activities shall be rendered at sites where

²² Formula One World Championship Ltd. vs. Commissioner of Income Tax. (International Taxation)-3, Delhi [2017] 80 taxmann.com 347 (SC)

²³ Steel Authority of India Ltd. vs. Assistant Commissioner of Income Tax, Circle 23(2), New Delhi [2007] 105 ITD 679 (Delhi – Trib.)

the installation services are also being rendered by such foreign company. The Tribunal further explains that it is in view of this reason, where the building site, construction, assembly project or installation may not belong to the foreign company thereby not giving it control and domain over the premises, that the condition of supervisory activities constituting PE would arise only if they continued for a period of 6 months has been stipulated.

Thus even if the installation or assembly project does not belong to the foreign company, supervisory activities by themselves can constitute a PE if they cross the time period threshold.

*GFA Anlagenbau GmbH (ITAT Delhi 2014)*²⁴

Contrary to the above decision of ITAT, in the instant case under the India-Germany tax treaty, it has held that supervisory activities do not constitute a fixed place of business if the assessee renders services from the project sites of its clients and does not by itself own or operate such sites independently. It is merely providing services under the terms contracted by its clients and has no fixed place of business in India. It has concluded that supervisory activities by themselves cannot constitute a PE as they are to be in connection with a building, construction or activity of the non-resident himself.

Author Comments

It is also pertinent to note that the “disposal test” was of paramount importance in both the cases, MasterCard and Nokia, for analysing a fixed place PE. The Courts have also defined certain parameters to determine when a place of business is at the *disposal* of the foreign enterprise. Varied views have been taken by the Courts on whether any *business was carried on* through the fixed place of business depending on whether certain activities are merely preparatory and auxiliary to the core business of the foreign enterprise or whether the activities carried on in India are part of the core business of the foreign enterprise.

5. Conclusion

The judiciary in India is well known for its meticulous and detailed analysis of questions before it, for guidance referring to the OECD Model, the Commentary to the OECD Model, other OECD reports like the Partnership Report, foreign court judgments, Klaus Vogel on Double Taxation Conventions, renowned global experts on international taxation and even in some cases having foreign experts present in Court as expert witnesses.

Being a Common Law country, the decisions of the Courts are very relevant to the day to day practice of law in India and thus the onus is on the Courts, specially the higher Courts to give clarity to the taxpayer on matters involving diverse interpretation of law.

²⁴ GFA Anlagenbau GmbH vs. Deputy/Assistant Commissioner of Income Tax (International Taxation)-I, Hyderabad [2014] 47 taxmann.com 313 (Hyderabad Trib.)