BEFORE THE AUTHORITY FOR ADVANCE RULINGS
(INCOME TAX)

Friday, 14th February, 2014

PRESENT

Justice Dr. Arijit Pasayat (Chairman)
Mr. T.B.C. Rozara (Member)

A.A.R. Nos. 1018 to 1027 of 2010

Name of the applicants	:	1. Booz & Company (Australia) Pvt. Ltd., Australia (1018) 2. Booz & Co. (N.A.)Inc.,USA(1019) 3. Booz & Co. (U.K.)Ltd.,U.K.(1020) 4. Booz & Co. GmbH, Germany(1021) 5. Booz & Co. (Italia) S.R.L.,Italy(1022) 6. Booz & Co.(Japan) Inc.,Japan(1023) 7. Booz & Co. B.V.,Netherlands (1024) 8. Booz & Co.(Shanghai)Ltd.,China(1025) 9. Booz & Co.(ME)Ltd.,Cayman Islands(1026) 10. Booz & Co.S.A.S.,France (1027)
Present for the applicant	:	Mr. Sunil Moti Lala, CA Mr. Jayesh Kariya, CA Mr. Prashant Maheshwari, CA Mr. Nirmal Nagda, CA Mr. Vyomesh Pathak, CA
Present for the Department	:	Mr. RS Rawal, CIT-DR, AAR,ND Mr. Ranjan kumar Singh, DCIT(IT)(6), Mumbai

RULING

These ten applications involve identical disputes concerning Double Tax Avoidance Agreement (in short DTAA) of different countries, except in case of

the applicant M/s. Booz & Co. (ME) Ltd., Cayman Island in which case no treaty is involved.

The basic features involved, special features of the treaties if any shall be dealt with in the detail infra.

2. In respect of the ten applications which have been filed u/s. 245Q (1) of the Income-tax Act 1961 (in short the "Act") seeking advance ruling, following questions are involved:

(1) Whether, on the facts and circumstances of the case, the payments received/receivable by the Applicant in connection with the provision of services of technical/professional personnel to Booz & Company (India) Private Limited ("Booz India") is chargeable to tax in India as "Fees for Technical Services"(in short"FTS") /Royalty under the provisions of **Article 12 and its sub articles of the relevant India – and the country concerned Double Taxation Avoidance Agreement ("the Tax Treaty") in the absence of Permanent Establishment("PE") in India?(expression supplied)**

(2) Whether, on the facts and circumstances of the case, the payments received/receivable by the Applicant in connection with the provision of services of technical/professional personnel to Booz India is chargeable to tax in India as FTS under section 9(1)(vii) read with section 115A as well as Section 44DA of the Act in the absence of fixed place PE in India?

(3) Whether, on the facts and circumstance of the case, the payments received/receivable by the Applicant towards reimbursement of actual 'out of pocket' expenses incurred by the Applicant for and on behalf of Booz India (as explained in Para B.4 of Annexure I) during the course of provision of services of technical/professional personnel to Booz India is chargeable to tax in India under the provisions of the Act and the Tax Treaty and consequently, whether Booz India is required to withhold tax from such reimbursements?

(4) Whether, on the facts and circumstances of the case at what rate Booz India is required to withhold tax under Section 195 of the Act from payments made/proposed to be made in connection with the transactions as mentioned in question no.1 and 2 above?

However, in the case of Booz & Co. ME Ltd. Cayman Island, the question (2), (3) & (4) above are rechristened as number (1), (2) & (3) respectively.

3. The details of the applicants, the treaty applicable and the questions raised are as follows:

No.	Name of the applicant	Treaty applicable	Questions and Arguments taken by Applicants
1	M/s. Booz & Co. GmbH	India – Germany	i) Amount to be treated as FTS under Article 12(4) read with 12(5)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act.
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12
2.	M/s Booz & Co. SAS Japan	India – Japan	i) Amount to be treated as FTS under Article 12(4) read with 12 (5)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12.
3.	M/s. Booz & Co. NA	India-USA	i) Amount to be treated as FTS under Article 12 (4) read with 12 (6)

	Inc USA		
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12
4.	M/s Booz & Co. B.V. NETHERLNDS	India - NETHERLNDS	i) Amount to be treated as FTS under Article 12 (5) read with 12 (7)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12
5.	M/s. Booz & Co.(Italy) S.R.L.	India-ITALY	i) Amount to be treated as FTS under Article 13 (4) read with 13 (5)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service

			provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 13
6.	M/s.Booz & Co(ME)Ltd, Cayman Island	No treaty	i) Amount to be treated as FTS u/s 9(1)(vii) r.w.s. 115A & 44DA
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per I.T.Act, 1961
7.	M/s. Booz & Co. (Australia) P.Ltd.	India Australia	i) Amount to be treated as FTS under Article 12 (3) (g) read with 12 (4)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12
8.	M/s. Booz & Co. SAS France	India-France	i) Amount to be treated as FTS under Article 13 (4) read with 13 (6)
			ii) The amount payable would be chargeable to tax as

			FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12
9.	M/s. Booz & Co. (Shanghai) Ltd.	India China	i) Amount to be treated as FTS under Article 12 () read with 12 (5)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.
			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12
10.	M/s. Booz & Co. (UK) Ltd.	India-UK	i) Amount to be treated as FTS under Article 13 (4) read with 13 (6)
			ii) The amount payable would be chargeable to tax as FTS under section 115A read with section 9(1)(vii) of the Act
			iii) The expenses recovered from Booz India being on account of reimbursement of expenses like air ticket cost, freight charges, courier charges, travel expenses, communication expenses, etc. on the personnel deputed to India and borne by the applicant are part of service provisioning and thus do not have any element of income embedded therein.

			iv) Payment by Booz India to the applicant is subject to withholding tax @ 10% as per Article 12

4. In response, the stand of the Revenue is as follows:

"Questions 1 and 2. The basic premise of the applicants is that in the absence of a PE in India, the fee receivable by them from Booz India is not taxable as business income and accordingly, being wholly in the nature of FTS, is taxable @ 10% in terms of 115A of the Act. This proposition is misplaced. The various terms and conditions governing the relationship between the applicants and Booz India, the global character and profile of the Booz Group, the interdependence amongst the various companies of the Booz Group, the nature of the services rendered and exchanged between the companies of the Booz Group and the location of Booz India's office in India combine to give rise to a case for Booz India being a PE in India from multiple angles. Following signature features of the business model of the Booz Group as mentioned in the various applications are listed below which will indicate that Booz India can be simultaneously/alternatively a service PE, an agency PE and also a fixed place PE:

i) The Booz Group is a global network of group companies and in order to optimize the benefits of Booz Group's global business network and expertise, affiliates of Booz Group provide/avail services from each other. (Para B 1.3 of Annexure 1 of the applications)

ii) The entire Booz Group is being catered by a basket of approximately 2200 technically/professionally qualified personnel which is utilized for executing any project won by the group/its affiliates. ((Para A 2.2 of Annexure 1 of the applications)

iii) Booz India would execute the client's project using its own employees and to the extent required, procure services of technical/professional/personnel from the applicant/and other affiliates of the group.)Para B 1.5 of Annexure 1 of the applications) This combine of professionals would work together as one team to execute the projects (third bullet of Para B 2.2 of Annexure 1 of the applications.

iv) The applicants will have the power to recall its technical / professional/ personnel and replace them with other technical / professional / personnel. (Para B 3.3 of Annexure 1 of the applications)

v) The technical/professional/personnel of the applicant will work under the supervision of Booz India with respect to the concerned project. However, the overall control over the technical/professional/personnel shall be with the applicant. (Para B 3.6 of Annexure 1 of the applications).

vi) The technical/professional/personnel will abide by the employment agreement entered into with the applicant. Para B 3.9 of Annexure 1 of the applications)

vii) Any financial and/or other responsibility in respect of any claim made by the third party on Booz India for an actual or alleged infringement of any industrial or other rights of third parties vice versa usage by Booz India of Technical information, data, etc made available by the applicant to Booz India will be borne by the applicant. (Para B 3.16 of Annexure 1 of the applications).

viii) The applicant will also impart on the job training to the employees of India. (Para B 3.17 of Annexure 1 of the applications). This can be treated as one primary contention.

The above terms and conditions and the business model between the applicants and Booz India bring out a strong case of Booz India being a dependant agent of the applicants. This is the primary submission of the Revenue. As it is, the global business model of the group is such that all the entities in the group are interdependent as they cannot attain optimal efficiency without receiving services from each other**.** Booz Group thus has, what in the corporate and taxation parlance is known as, a blurred identity in which the close

intra group interdependence blurs the identity of individual entities to third parties. Thus, the applicant's stand that Booz India is an independent entity does not find support from the business model of the group.

This apart, on facts also Booz India is exclusively dependent on the applicants in various ways. Booz India cannot optimally function without the expertise of the group entities in giving consultancy in the fields in which the group operates, the brand equity the group enjoys, the capabilities the group has developed across the globe and services from the group professionals and experts. Importantly, the group's business is manpower centric in which the only important asset is human resources. In this context, Booz India is exclusively dependent on other group entities in getting the services of appropriate personnel from other entities and job training of these personnel deployed to Booz India. Further, these employees are also under overall control of the applicants. The other group entities are also legally liable in case of third party liabilities. The employees deputed are also contracted by the applicants only. All these inherent and specific dependencies of Booz India make it very clear that it is a dependent agent of the applicants. The assertion of the applicant that no PE exists in the cases is devoid of merit."

The Revenue has submitted that even otherwise the number and high level of qualification of personnel deployed by the applicants to Booz India clearly establishes that Booz India is a service PE. It has been further submitted that there can be no doubt that on the facts of the case i.e. the access given by Booz

India client/Booz India to the technical and professional personnel deployed to work in a given space also renders that place as a fixed place PE.

5. It needs to be noted that by its letter dated 6th May, 2013 the applicants requested this Authority to grant leave to withdraw the question no. 2 in the case of Booz & Company (ME) Ltd. and Q.No.3 in the case of other applicants. Therefore, while dealing with the questions raised we are not expressing any opinion on the aforesaid questions as the applicants have withdrawn the questions and have not sought any ruling from this Authority on the said question.

On a consideration of rival submissions, the basic issues which need to be addressed are (1) whether the amount payable is to be treated as Fees for Technical Services (FTS) or business income? (2) whether the amount payable would be chargeable to tax as FTS u/s. 115A read with section 9(1)(vii) as well as section 44 DA of the Act or as business income? (3) and whether payment by Booz India to the respective applicant is subject to withholding tax @ 10% as per Article 12?

Sections **115A** and Section **44 DA** read as follows:

"[115A. Tax on dividends, royalty and technical service fees in the case of foreign companies –

(1) [Where the total income of -

(a) a non-resident (not being a company) or of a foreign company, includes any income by way of-

(i) dividends [other than dividends referred to in section 115-O]; or

(ii) interest received from Government or an Indian concern on monies borrowed or debt incurred by Government or the Indian concern in foreign currency [not being interest of the nature referred to in sub-clause (iia)]; or sub-clause (iiaa) : or

[(iia) interest received from an infrastructure debt fund referred to in clause (47) of section 10; or]

[iiaa] interest of the nature and extent referred to in section 194LC; or

(iii) income received in respect of units, purchased in foreign currency, of a Mutual Fund specified under clause (23D) of section 10 or of the Unit Trust of India, the income-tax payable shall be aggregate of-

(A) the amount of income-tax calculated on the amount of income by way of dividends [other than dividends referred to in section 115-O], if any, included in the total income, at the rate of twenty per cent ;

(B) the amount of income-tax calculated on the amount of income by way of interest referred to in sub-clause (ii), if any, included in the total income, at the rate of twenty per cent ;

[(BA) the amount of income-tax calculated on the amount of income by way of interest referred to in sub-clause (iia) or sub-clause (iiaa) [or sub-clause (iiab), if any, included in the total income, at the rate of five per cent;]

(C) the amount of income-tax calculated on the income in respect of units referred to in sub-clause (iii), if any, included in the total income, at the rate of twenty per cent ; and

(D) the amount of income-tax with which he or it would have been chargeable had his or its total income been reduced by the amount of income referred to in sub- clause (i), sub-clause (ii) [, sub-clause (iia)] and sub-clause (iii) ;

(b) [a non-resident (not being a company) or a foreign company, includes any income by way of royalty or fees for technical services other than income referred to in sub-section (1) of section 44DA] received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after the 31st day of March, 1976, and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy,

then, subject to the provisions of sub-sections (1A) and (2), the income-tax payable shall be the aggregate of,—

[(A) the amount of income-tax calculated on the income by way of royalty, if any, included in the total income, at the rate of thirty per cent if such royalty is received in pursuance of an agreement made on or before the 31st day of May, 1997 and twenty per cent where such royalty is received in pursuance of an agreement made after the 31st day of May, 1997 [but before the 1st day of June, 2005];

[(AA) the amount of income-tax calculated on the income by way of royalty, if any, included in the total income, at the rate of ten per cent if such royalty is received in pursuance of an agreement made on or after the 1st day of June, 2005;]

(B) the amount of income-tax calculated on the income by way of fees for technical services, if any, included in the total income, at the rate of thirty per cent if such fees for technical services are received in pursuance of an agreement made on or before the 31st day of May, 1997 and twenty per cent where such fees for technical services are received in pursuance of an agreement made after the 31st day of May, 1997 [but before the 1st day of June, 2005] ; and]

[(BB) the amount of income-tax calculated on the income by way of fees for technical services, if any, included in the total income, at the rate of ten per cent if such fees for technical services are received in pursuance of an agreement made on or after the 1st day of June, 2005; and]

(C) the amount of income-tax with which it would have been chargeable had its total income been reduced by the amount of income by way of royalty and fees for technical services.

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) "foreign currency" shall have the same meaning as in the Explanation below item (g) of sub-clause (iv) of clause (15) of section 10 ;

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

(d) "Unit Trust of India" means the Unit Trust of India established under the Unit Trust of India Act, 1963 (52 of 1963).]

[(1A) Where the royalty referred to in clause (b) of sub-section (1) is in consideration for the transfer of all or any rights (including the granting of a licence) in respect of copyright in any book to an Indian concern [or in respect of any computer software to a person resident in India], the provisions of sub-section (1) shall apply in relation to such royalty as if the words [the agreement is approved by the Central Government or where it relates to a matter] included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy] occurring in the said clause had been omitted :

Provided that such book is on a subject, the books on which are permitted, according to the Import Trade Control Policy of the Government of India for the period commencing from the 1st day of April, 1977, and ending with the 31st day of March, 1978, to be imported into India under an Open General Licence :

[Provided further that such computer software is permitted according to the Import Trade Control Policy of the Government of India for the time being in force to be imported into India under an Open General Licence.]

[Explanation 1]. - In this sub-section, "Open General Licence" means an Open General Licence issued by the Central Government in pursuance of the Imports (Control) Order, 1955.]

[Explanation 2. - In this sub-section, the expression "computer software" shall have the meaning assigned to it in clause (b) of the Explanation to section 80HHE.]

(2) Nothing contained in sub-section (1) shall apply in relation to any income by way of royalty received by a foreign company from an Indian concern in pursuance of an agreement made by it with the Indian concern after the 31st day of March, 1976, if such agreement is deemed, for the [purposes of the [first] proviso] to clause (vi) of sub-section (1) of section 9, to have been made before the 1st day of April, 1976; and the provisions of the annual Finance Act for calculating, charging, deducting or computing income-tax shall apply in relation to such income as if such income had been received in pursuance of an agreement made before the 1st day of April, 1976.]

[(3) No deduction in respect of any expenditure or allowance shall be allowed to the assessee under sections 28 to 44C and section 57 in computing his or its income referred to in sub-section (1).

(4) Where in the case of an assessee referred to in sub-section (1), -

(a) the gross total income consists only of the income referred to in clause (a) of that sub-section, no deduction shall be allowed to him or it under Chapter VIA;

(b) the gross total income includes any income referred to in clause (a) of that sub-section, the gross total income shall be reduced by the amount of such income and the deduction under Chapter VIA shall be allowed as if the gross total income as so reduced were the gross total income of the assessee.

(5) It shall not be necessary for an assessee referred to in sub-section (1) to furnish under sub-section (1) of section 139 a return of his or its income if -

(a) his or its total income in respect of which he or it is assessable under this Act during the previous year consisted only of income referred to in clause (a) of sub-section (1); and

(b) the tax deductible at source under the provisions of Chapter XVII-B has been deducted from such income.]"

"44DA.Special provision for computing income by way of royalties, etc., in case of non-residents – (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 from 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 Explanation 2 to clause (vi) of sub-section (1) of section 9;

(c) “permanent establishment” shall have the same meaning as in clause (iiia) of section 92F.”

6. During pendency of the proceedings the Revenue sought for some details as detailed in the letter dated 11/12/2012. The learned counsel of the applicants states that these details have been supplied.

7. We shall first deal with the aspect “Permanent Establishment”

Under the Double Tax Conventions, *right of the contracting States to tax the business profits of an enterprise of other contracting State arises only if the enterprise carries on its business in the first mentioned State through a “Permanent Establishment” (‘PE’) situated therein.* PE is generally classified into five categories:

i. Fixed place PE;

ii. Construction PE;

iii. Installation PE;

iv. Service PE:

v. Dependent Agency PE

One of the *sine qua non* of a fixed place PE is that the fixed place of business through which the business is carried on should be ‘at the disposal’ of the taxpayer which is called the “disposal test”.

It is of significance, that Organisation for Economic Co-operation and Development (in short “OECD’) does not expressly define what constitutes the place to be ‘at the disposal’ of the taxpayer and instead gives examples wherein it may or may not tantamount to ‘right of disposal’. Conducting trading operations

generally require a fixed place which the taxpayer uses on a continuous basis. However, taxpayers rendering service usually do not require a place to be at their constant disposal and therefore application of 'disposal test' is generally more complex in such cases. In some jurisdictions the 'disposal test' is satisfied by the mere fact of using a place. In some other jurisdictions it is stressed that something more is required than a mere fact of use of place.

In the case of *Rolls Royce* Plc v. DIT (2011)339 ITR 147 the taxpayer (RRPlc) supplied aero engines and spare parts to Indian customers. The taxpayer had a UK incorporated subsidiary. Rolls Royce India Limited (RRIL) having office in India, which provided support services to RRPlc. RRPlc reimbursed RRIL for all of the costs incurred in India in the provision of its support services, *including but not limited to the salaries and expenses of its employees, the cost of operating its office premises.* RRIL received service fees from RRPlc in the amount of a fixed percentage of the reimbursed expenses. RRPlc's employees visited India frequently and occupied and used RRIL's premises during these visits. It was held on the facts of the case that RRPlc had a fixed place PE in India *because RRIL's premises were 'available' to all of RRPlc's employees and RRPlc paid all of RRIL's expenses in maintaining its premises.*

In the case of *Seagate Singapore International Headquarters Pvt. Ltd.,* in re. (2010) 322 ITR 650 (AAR) Seagate was engaged in the business of manufacture and supply of Hard Disk Drive (HDD) to Original Equipment Manufacturers (OEM). Seagate entered into an agreement with Independent

Service Provider (ISP) to stock HDD on Seagate's behalf and deliver the same to the OEM on a 'Just-in Time' basis. On the receipt of purchase order from OEM, Seagate supplied HDD to ISP who in turn supplied the goods to OEM. The payment for the supply of HDD was directly made by OEM to Seagate, and the services rendered by the ISP were remunerated by Seagate on an arm's length basis. In the aforesaid factual scenario, this Authority ruled *that Seagate's restricted right to access the premises of the independent service providers satisfied the requirement of* "disposal test".

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.*

How a factual distinction can bring about a different approach is highlighted below.

In *Motorola Inc.* vs. DCIT Motorola and Ericsson carried out certain telecommunications work in India through its Indian subsidiary. In each case the parent, from time to time as required, sent employees to India, where they used the subsidiary's Indian offices. In *Ericsson* appeal, the Special Bench of the Delhi Income-tax Appellate Tribunal held that mere use of the subsidiary's offices by the parent's employees, without anything more, was not sufficient to create a fixed PE, because the employees did not have any right of disposal over the subsidiary's space – *that is, they had no right to enter the space at will, and could do so only with the subsidiary's permission. However,* Same Bench reached the opposite conclusion in the Motorola's appeal on the ground that the parent's

employees worked for parent as well as subsidiary and because they worked for the subsidiary, they must have had the right to enter and use the subsidiary's offices. The three appeals were heard and decided by the Special Bench. The decision is reported in (2005) 147 Taxman 39.

In our view various factors have to be taken into account to decide a Fixed place PE which *inter alia includes a right of disposal over the premises.* No strait jacket formula applicable to all cases can be laid down.

Generally the establishment must belong to the Employer and involve an element of ownership, management and authority over the establishment. In other words the taxpayer must have the element of ownership, management and *authority over the establishment.*

In the case of *Western Union Financial Services,* Vs. Asstt. DIT (2007) 104 ITD 34 (Delhi) the taxpayer (US parent) engaged in money transfer business, appointed agents in India for liaison and related activities. The agents operated from their premises with the display to demonstrate the agency of Western Union Financial Services. The Delhi Bench of ITAT observed that the taxpayer had a 'business connection' in India. It, however, held that there was no PE of any kind in India because the taxpayer *had no right to enter and make use of the agents' offices.*

In DIT (International Taxation) v. Morgan Stanley and Co. Inc.[2007]292 ITR 0416(SC) inter alia it was held as follows:

"Article 5(2)(l) of the DTAA applies in cases where the MNE furnishes services within India and those services are furnished through its employees. In the present case we are concerned with two activities namely stewardship

activities and the work to be performed by deputationists in India as employees of MSAS. A customer like an MSCo who has world wide operations is entitled to insist on quality control and confidentiality from the service provider. For example in the case of software P.E. a server stores the data which may require confidentiality. A service provider may also be required to act according to the quality control specifications imposed by its customer. It may be required to maintain confidentiality. Stewardship activities involve briefing of the MSAS staff to ensure that the output meets the requirements of the MSCo. These activities include monitoring of the outsourcing operations at MSAS. The object is to protect the interest of the MSCo. These stewards are not involved in day to day management or in any specific services to be undertaken by MSAS. The stewardship activity is basically to protect the interest of the customer. In the present case as held hereinabove the MSAS is a service P.E. It is in a sense a service provider. A customer is entitled to protect its interest both in terms of confidentiality and in terms of quality control. In such a case it cannot be said that MSCo has been rendering the services to MSAS. In our view MSCo is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of MSAS services. We do not agree with the ruling of the AAR that the stewardship activity would fall under Article 5(2)(l). To this extent we find merit in the civil appeal filed by the appellant (MSCo) and accordingly its appeal to that extent stands partly allowed.

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As regards the question of deputation, we are of the view that an employee of MSCo when deputed to MSAS does not become an employee of MSAS. A deputationist has a lien on his employment with MSCo. As long as the lien remains with the MSCo the said company retains control over the deputationist's terms and employment. The concept of a service PE finds place in the U.N. Convention. It is constituted if the multinational enterprise renders services through its employees in India provided the services are rendered for a specified period. In this case, it extends to two years on the request of MSAS. It

is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service PE can emerge. Applying the above tests to the facts of this case we find that on request/requisition from MSAS the applicant deputes its staff. The request comes from MSAS depending upon its requirement. Generally, occasions do arise when MSAS needs the expertise of the staff of MSCo. In such circumstances, generally, MSAS makes a request to MSCo. A deputationist under such circumstances is expected to be experienced in banking and finance. On completion of his tenure he is repatriated to his parent job. He retains his lien when he comes to India. He lends his experience to MSAS in India as an employee of MSCo as he retains his lien and in that sense there is a service PE (MSAS) under Article 5(2)(l). We find no infirmity in the ruling of the ARR on this aspect. In the above situation, MSCo is rendering services through its employees to MSAS. Therefore, the Department is right in its contention that under the above situation there exists a Service PE in India (MSAS). Accordingly, the civil appeal filed by the Department stands partly allowed.

To conclude, we hold that the AAR was right in ruling that MSAS would be a Service PE in India under Article 5(2)(l), though only on account of the services to be performed by the deputationists deployed by MSCo and not on account of stewardship activities. As regards income attributable to the PE (MSAS) we hold that the Transactional Net Margin Method was the appropriate method for determination of the arm's length price in respect of transaction between MSCo and MSAS. We accept as correct the computation of the remuneration based on cost plus mark-up worked out at 29% on the operating costs of MSAS. This position is also accepted by the Assessing Officer in his order dated 29.12.06 (after the impugned ruling) and also by the transfer pricing officer vide order dated 22.9.06. As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the

ruling is correct in principle provided that an associated enterprise (that also constitutes a PE) is remunerated on arm's length basis taking into account all the risk-taking functions of the multinational enterprise. In such a case nothing further would be left to attribute to the PE. The situation would be different if the transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a case, there would be need to attribute profits to the PE for those functions/risks that have not been considered. The entire exercise ultimately is to ascertain whether the service charges payable or paid to the service provider (MSAS in this case) fully represents the value of the profit attributable to his service. In this connection, the Department has also to examine whether the PE has obtained services from the multinational enterprise at lower than the arm's length cost? Therefore, the Department has to determine income, expense or cost allocations having regard to arm's length prices to decide the applicability of the transfer pricing regulations." (Underlined for emphasis)

In Aramex International Logistics Pvt.Ltd., 248 ITR 159 (AAR)

Aramex International Pvt.Ltd. (AIPL) is a 100% subsidiary of Aramex International Bermuda. Aramex group has admittedly business in various countries all over the world including India. Its business in India is conducted by it through AIPL. No doubt, AIPL has been formed as a subsidiary and has an identity under the Companies Act, 1956. The fact remains that the business is that of Aramex group and the reputation and appealability is that of the Aramex group.

As far as "inward business" is concerned, Aramex group companies in various parts of the world contact the customers, take delivery of the articles to be delivered to various cities and towns in India and deliver them at a chosen destination. The business is completed by delivery of the consignments to the concerned addressees in India. For that, the Aramex group has created a subsidiary, in India, AIPL. Without the association of AIPL, the business of Aramex group as regards the articles sent to India, cannot be performed. It is the

case of the applicant that the goods are brought to a common destination and delivered to AIPL and AIPL ensures that the articles are delivered to the concerned parties in various parts of India.

Aramex group thus cannot successfully conduct its business of transporting and delivering articles from and in India without AIPL performing its role in India. Does AIPL became a permanent establishment of the applicant because of this, is the question.

What is a permanent establishment? Is it not something which enables a non-resident company to carry on a part of its whole business in a particular country? Without this entity AIPL, Aramex group cannot complete its business or fulfill its obligations to its clients or customers around the world. The Aramex group could have done this through any entity in India by entering into the necessary agreement in that behalf. But then if that entity engaged, is an entity which has no business connection with the Aramex group or which is not a part of the Aramex group, then the question will be whether that entity is constituted an agent exclusively for the business of Aramex or almost exclusively for the business of Aramex. But when that business is got done, not through such an agent, but through a subsidiary created, a wholly owned subsidiary at that, is it not possible, to postulate that the subsidiary entity would be a permanent establishment of the group"? Common sense says, that it would be. After all, a permanent establishment is defined to be a permanent place of business. Which is the permanent establishment of Aramex group in India in this case? It is clearly the location of its subsidiary in India.

When a business cannot be carried on exclusively in so far as it relates to customers in India like in the present case, without intervention of another entity, a subsidiary, normally that entity must be deemed to be the establishment of the group in that particular country. The position may be different when the entity is an independent entity uncontrolled by the group unless it satisfies the other requirements mentioned in Article 5(2) of the DTAC. But in a case where a 100%

subsidiary is created for the purpose of attending to the business of the group in a particular country, here, in India, I am of the view that the Indian subsidiary must be taken to be a permanent establishment of the group in India. It is not pretended that without its part being played by the Indian entity, AIPL, the business of the applicant could be successfully transacted. Thus, AIPL is an essential part of the business of the group now routed through the applicant in India. No doubt, AIPL may have an independent existence as a subsidiary. Clearly, the authority over it of the principal, vertical or persuasive, cannot be in doubt. I am, therefore, satisfied that in a case like the present, the subsidiary must be considered to be a permanent establishment of the group in the concerned country, here, India. (Underlined for emphasis)

On the issue of Agency PE the relevant question is “business connection”.

It would be relevant to quote Section 9(1)(i) of the Act

"9. (1) The following incomes shall be deemed to accrue or arise in India :

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, (*) or through the transfer of a capital asset situate in India.

Explanation : For the purposes of this clause-

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;

(b) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are confined to the purchase of goods in India for the purpose of export;

(c) in the case of a non-resident, being a person engaged in the business of running a news agency or of publishing newspapers, magazines or journals, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the collection of news and views in India for transmission out of India;

(d) in the case of a non-resident, being-

(1) an individual who is not a citizen of India; or

(2) a firm which does not have any partner who is a citizen of India or who is resident in India; or

(3) a company which does not have any shareholder who is a citizen of India or who is resident in India,

no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the shooting of any cinematograph in India;"

A perusal of provisions of Section 9(1)(i), extracted above, shows that all income accruing or arising whether directly or indirectly through or from any business connection in India or from any property in India or through any assets or source of income in India or through transfer of capital assets situated in India, shall be deemed to accrue or arise in India. The mandate contained in Clause (a) of the Explanation is that for the purpose of the aforementioned clause, where the business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India. The other clauses of the Explanation are not relevant.

The expression "business connection" was not defined for the purpose of the aforementioned provisions, before 31st March, 2003. By the Finance Act, 2003, two Explanations were inserted after the then existing Explanation which are numbered as Explns. 1 and 2 to Sub-section (1) of Section 9 w.e.f. 1st April, 2004. Explanation 2 which is relevant for our purpose defines the expression thus :

"Explanation 2 : For the removal of doubts, it is hereby declared that 'business connection' shall include any business activity carried out through a person who, acting on behalf of the non-resident,-

(a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or

(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:"

It may be seen that Expln. 2 contains an inclusive definition; it brings in the business activities specified in Clauses (a) to (c), referred to above, within the fold of the expression "business connection" which has to be understood in its ordinary meaning. We shall presently advert to the decisions of the Hon'ble Supreme Court wherein the meaning of that expression has been elucidated.

We may, with advantage, note here the following decisions of the Hon'ble Supreme Court to comprehend the full import of the expression "business connection" :

In CIT v. R.D. Aggarwal & Co. (1965) 56 ITR 20 (SC), the essence of the expression is brought out in the following observation of the Supreme Court :

"The expression 'business connection' postulates a real and intimate relation between the trading activity carried on outside the taxable territories and the trading activities within the territories, the relation between the two contributing to the earning of income by the non-resident in his trading activity".

Hon'ble Mr. Justice Shah (as he then was), for the purpose of Section 42 of the IT Act, 1922, laid down, '"business connection' contemplated by Section 42 involves a relation between a business carried on by a non-resident which yields profits and gains and some activity in the taxable territories which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of non-resident and the activity in the taxable territories, a stray or isolated transaction not being normally regarded as a business connection."

The requirement of continuity of transactions to form 'business connection' between a non-resident and a resident was laid down by the Supreme Court as long back in 1952 in Anglo-French Textile Co. Ltd. v. CIT (1953) 23 ITR 101 (SC). Hon'ble Mr. Justice Mahajan (as he then was), speaking for the Court, observed, "an isolated transaction between a non-resident and a resident in British India without any course of dealings such as might fairly be described as a business connection does not attract the application of Section 42, but when there is a continuity of business relationship between the person in British India who helps to make the profits and the person outside British India who receives or realizes the profits, such relationship does constitute a business connection".

In the light of above discussion, the essential features of "business connection" may be summed up as follows :

(a) a real and intimate relation must exist between the trading activities carried on outside India by a non-resident and the activities within India;

(b) such relation shall contribute, directly or indirectly, to the earning of income by the non-resident in his business;

(c) a course of dealing or continuity of relationship and not a mere isolated or stray nexus between the business of the non-resident outside India and the activity in India, would furnish a strong indication of 'business connection' in India.

Apart from the fact that requirements of Expln. 2, referred to above, are satisfied, the facts of the instant case would also fulfill the aforementioned essential features of business connection.

The factual position as highlighted by the Revenue clearly support the stand taken by it that a PE does exist.

8. Having held that the applicants have Permanent Establishment in India, the incomes received by them from the Indian Company are taxable as business profit under Article 7 of the Tax Agreement of India and the respective countries (except M/s.Booz & Co.(ME) Ltd. Cayman Islands (AAR/1026) with which there is no tax treaty by India, and M/s.Booz & Co.(Italia)S.R.L.,Italy (AAR/1022), whose income will be taxed as per provisions of the Act).

Question No.2 of AAR/1026 / Question No.3 in others; regarding the reimbursement of expenses was withdrawn by the applicants during the course of hearing.

Question No.1 of AAR/1026 / Question Nos.1&2 in others; become irrelevant as we hold that the applicants have Permanent Establishment in India and their incomes are taxable as business profits.

As regards Question No.3 in AAR/1026 / Question No.4 in others; the income being taxable as business profits, the payments by the Indian company to the applicants will be subjected to withholding of tax under section 195 of the Act.

The applications are disposed accordingly.

The ruling is given and pronounced on this day of 14 February, 2014.

(TBC Rozara)
Member

(Arijit Pasayat)
Chairman