

**IN THE INCOME TAX APPELLATE TRIBUNAL  
MUMBAI D BENCH, MUMBAI**

**ITA NO 535/MUM/04  
Assessment Year: 1999-2000**

DY DIRECTOR OF INCOME TAX  
International Taxation, Range 2(1)  
Scindia House, 1st Floor  
Ballard Estate, Mumbai - 400038

Vs

SET SATELLITE (SINGAPORE) PTE LTD  
C/O RSM & Co., Chartered Accountants  
Ambit RSM House, 449, Senapati Bapat Marg  
Lower Parel, Mumbai - 400013

**ITA NO 205/MUM/04  
Assessment Year: 1999-2000**

SET SATELLITE (SINGAPORE) PTE LTD  
C/O RSM & Co., Chartered Accountants  
Ambit RSM House, 449, Senapati Bapat Marg  
Lower Parel, Mumbai - 400013

Vs

DY DIRECTOR OF INCOME TAX  
InterNational Taxation, Range 2(1)  
Scindia House, 1st Floor  
Ballard Estate, Mumbai - 400038

Shri Pramod Kumar, AM and Smt P Madhavi Devi, JM

Dated: April 20, 2007

Appellant Rep. by : Shri Rahul Navin, and Arvind Pinto

Respondent Rep. by : Shri S E Dastur, S.M. Lala and Nilesh Joshi

ORDER

Per: Pramod Kumar, A.M.:

1. These cross appeals are directed against the order dated 15th October 2003 passed by the Commissioner (Appeals) in the matter of assessment under

section 143(3) of the Income Tax Act, 1961, for the assessment year 1999-2000. As both of these appeals pertain to the same assessee, involve interconnected issues and were heard together, we are disposing of both of these appeals by way of this consolidated order.

2. We will first take up the ITA No. 535/Mum/04, i.e. the appeal filed by the Assessing Officer.

3. The grievances of the Assessing Officer were articulated by way of following grounds of appeal set out in the memorandum of appeal :

1. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that since the agent i.e. SET India Pvt Ltd has a good profitability record, it can be said that the assessee has remunerated the agent on an arms length basis, and based on the provisions of Article 7(2), the OECD Commentary on the subject, and the other contentions made, no further profits should be taxed in India, in respect of advertisement revenues from its own channel ignoring the facts ;

(i) that the assessee has dependent agency P& in india in the form of SET India Pvt Ltd; and

(ii) that the assessee's income is assessable as business income within the meanings of Article 7 of the India Singapore DTAA.

2. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that advertisement revenue pertaining to AXN channel are not taxable in India on the ground that the assessee has paid an arms length price for services rendered by its agent i.e. SET India Pvt Ltd, and based on the provisions of Section 9(1 )(i) of the Act, Article 7(1) of the DTAA, and the ratio of circular No. 23 dated 23/7/69, no income in respect thereof is taxable in India, ignoring the fact that:

(i) though the purchase and sale of airtime is effected in Singapore, the receipt in respect of broadcasting advertisement is in the territory of India;

(ii) the income in respect of, or in connection with the relay of, advertisements, accrues in India;

(iii) the assessee has a PE in India in the form of SET India Pvt Ltd, and, therefore, advertisement revenue from AXN channel is taxable in India as business income.

3. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that the assessee being a non resident and the entire income being subject to tax deduction at source under section 195 of the Income Tax Act, 1961, no liability under section 234 B and 234 C will arise, ignoring the fact:

(i) that since the tax deducted at source was not adequate to meet the entire tax liability, it was obligation on the part of the assessee to make the deficit good by making the payment towards the advance tax;

(ii) that since the assessee failed to pay the advance tax, the Assessing Officer was right in charging interest under section 234 B and 234 C of the Income Tax Act, 1961

4. In the course of hearing of this appeal, we noticed that first ground of appeal, as reproduced above, is not property worded inasmuch as it does not correctly bring out the controversy requiring our adjudication in appeal.

When we pointed this out to the parties and suggested that the ground be reframed to bring out the actual controversy, learned senior counsel strongly objected to any reframing of the ground of appeal and submitted that such an action will amount to changing the very complexion of the grievance of the Assessing Officer. He also submitted that at this stage, it cannot be open to the

Assessing Officer to modify the ground of appeal as the hearing of appeal is in progress, and that the modification in the grounds of appeal, subject to the permission of the Tribunal, can at best be done before the hearing actually commences. In response to our suggestion that the ground can be reframed by the Tribunal, in exercise of the powers vested in us under proviso to Rule 11, learned senior counsel stated such a reframing of the ground of appeal, which goes beyond the controversy actually raised by the Assessing Officer, is contrary to the scheme of the Act. We are, however, not persuaded by the objections of the learned counsel. These objections proceed on the fallacious assumption. Firstly, we do not think that by reframing the ground before us, there is any enlargement of the subject matter of appeal. The reframing of ground has been considered desirable not with a view to enlarge the scope of the appeal, but only with a view to provided clarity to the real controversy. Secondly, Rule 11 of the Appellate Tribunal Rules 1963 specifically provides that "the Tribunal, in deciding the appeal, shall not be confined to the grounds set forth in the memorandum of appeal..." as long as "the party who may be affected thereby has had a sufficient opportunity of being heard on that ground". This rule is in conformity of the powers of the Tribunal laid down under section 254(1) of the Act. This sub section provides that the "Tribunal may, after giving both the parties an opportunity of being heard, pass such orders thereon as it thinks fit". We do not see how our reframing of grounds of appeal comes in conflict with the scheme of the Act. In any event, while learned counsel did submit that such an action on our part will amount to functioning of the Tribunal contrary to the scheme of the Act, he did not set out, even after taking note of the suggested reframed ground of appeal, any specific propositions in respect of the same, or elaborate any further on this issue. In view of the foregoing discussions, and bearing in all the related facts, we deem it fit and proper to overrule the objection of the learned senior counsel, and proceed with reframing the ground of appeal to bring out true controversy requiring our adjudication.

5. The first ground of appeal, having regard to the facts and pleadings on record, rival submissions before us, suggestions of the parties on the reframing the ground of appeal, as well as our understanding of the core issue requiring our adjudication, is reframed as follows :

On the facts and circumstances of the case, the learned CIT (A) erred in holding that since the assessee has remunerated agent on 'arms' length price" (ALP), no further profits of assessee could be taxed in India other than the profits so earned by the 'dependent agent' (DA).

The outcome of this ground of appeal, as learned representatives agree, will solely depend on the interpretation of the provisions of the applicable tax treaty. This reframed ground of appeal was conveyed to the parties during the course of hearing itself, and both the parties have been heard at length on this ground of appeal, it is this ground of appeal which constitutes main issue in the cross appeals before us.

6. The core issue requiring our adjudication in this case, therefore, is whether or not once a 'dependent agent' (DA, in short) is paid an arms length price for the services rendered by him to the foreign company, any further income, other than the income so earned by the dependent agent, can be said to be attributed to the 'dependent agent permanent establishment' (DAPE, in short), and, accordingly, be brought to tax in the PE State. This question is in the context of India Singapore Double Taxation Avoidance Agreement [(1994) 209 ITR (Statue)] - the tax treaty, in short.

7. Let us first briefly set out the scheme of the tax treaty which requires our interpretation. India and Singapore have entered into a tax treaty for avoidance of double taxation, titled as India Singapore Double Taxation Avoidance Agreement [(1994) 209 ITR (Statue)]. Since the dispute before us essentially concerns the correct interpretation of this tax treaty, it is essential to set out some of the relevant provisions of the treaty, and to appreciate the connotations and scope of certain technical expressions used therein. We consider it appropriate to first of all take up the provisions of Article 5 and Article 7 of the tax treaty. These articles are set out below for ready reference:

#### **Article 5 - Permanent Establishment**

1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources,'

(g) a warehouse in relation to a person providing storage facilities for others;

(h) a farm, plantation or other place where agriculture , forestry, plantation or related activities are carried on;

(i) a premises used as a sales outlet or for soliciting and receiving orders;

(j) an installation or structure used for the exploration or exploitation of natural resources but only if so used for a period of more than 120 days in any fiscal year.

3. A building site or construction, installation or assembly project constitutes a permanent establishment only if it continues for a period of more than 183 days in any fiscal year.

4. 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 carries on supervisory activities in that Contracting State for a period of more than 183 days in any fiscal year in connection with a building site or construction, installation or assembly project which is being undertaken in that Contracting State.

5. Notwithstanding the-provisions of paragraphs 3 and 4, 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 that Contracting State for a period of more than 183 days in any fiscal year in connection with the exploration, exploitation or extraction of mineral oils in that Contracting State.

6. An enterprise shall be deemed to have 2 permanent establishment in a Contracting State if it furnishes services, other than services referred to in paragraphs 4 and 5 of this Article and technical services as defined in Article 12, within a Contracting State through employees or other personnel but only if:

(a) activities of that nature continue within that Contracting State for a period or periods aggregating to more than 90 days in any fiscal year; or

(b) activities are performed for a related enterprise (within the meaning of Article 9 of this Agreement) for a period or periods aggregating to more than 30 days in any fiscal year.

7. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

(a) the use of facilities solely for the purpose of storage, display, or occasional delivery of goods or merchandise belonging to the enterprise;

(b) the maintenance of stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or occasional delivery;

(c) maintenance of stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.

However, the provisions of sub-paragraphs (a) to (e) shall not be applicable where the enterprise maintains any other fixed place of business in the other Contracting State through which the business of the enterprise is wholly or partly carried on.

8. Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 9 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 State, if, -

(a) he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise;

(b) he 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) he 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.

9. An enterprise of a Contracting States 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, 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, itself or on behalf of thai 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.

10. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other Contracting State (whether through a permanent establishment or otherwise), shall not, of itself, constitute either company a permanent establishment of the other.

#### **Article 7 - Business Profits**

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.

2. Subject to the provisions of paragraph 3, where an enterprise of 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 separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. 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.

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 executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the (imitations of the taxation laws of that State.

4. Insofar as it has been customary in the Contracting State to determine the profits to be attributed to a permanent establishment on the basis of an apportionment of the total profits of the enterprise to its various parts, nothing in paragraph 2 shall preclude that Contracting State from determining the profits to be taxed by such an apportionment as may be customary; the method of apportionment adopted shall, however, be such that the result shall be in accordance with the principles contained in this Article.

5. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

6. For the purpose of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

7. Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article.

8. For the purpose of paragraph 1, the term "directly or indirectly attributable to the permanent establishment" includes profits arising from transactions in which the permanent establishment has been involved and such profits shall be regarded as attributable to the permanent establishment to the extent

appropriate to the part played by the permanent establishment in those transactions, even if those transactions are made or placed directly with the overseas head office of the enterprise rather than with the permanent establishment

8. A plain reading of Article 5(1) makes it clear that permanent establishment implies "a fixed place of business through which the business of an enterprise is wholly or partly carried on". Article 5(2) describes as to what could "constitute a fixed place of business and, being illustrative in nature in that respect, it sets out a whole list of things which could possibly be construed as fixed place of business. It includes a place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a warehouse in relation to a person providing storage facilities for others, a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on, a premises used as a sales outlet or for soliciting and receiving orders, an installation or structure used for the exploration or exploitation of natural resources . The common thread in all these things is that an enterprise can carry on business through these establishments. Generally, therefore, enterprise of a contracting state is said to have a permanent establishment in the other contracting state when such an enterprise has a fixed place of business in that other contracting state through which business of the enterprise is wholly or partly carried on. However, in the modern age where a business is not always carried on, particularly outside national frontiers of an enterprise, through a fixed place of business of its own as is the lowest common denominator in all the situations visualized in Article 5(2), there is a deeming provision in Article 5(8) which deals with a situation when an enterprise carries on business through an agent in the other contracting state. This refers to a deeming fiction whereby even in cases where the enterprise does not have a fixed place of business in the other contracting state, of the nature described in Article 5(2) or otherwise, the enterprise will still be deemed to have a permanent establishment. Article 5(8) provides that where an agent, other than an independent agent to which Article 5(9) applies, satisfies one of the conditions set out in Article 5(8)(a), 5(8)(b) or 5(8)(c), "the enterprise shall be deemed to have permanent establishment" in the

other contracting state. In simple terms, therefore, when an enterprise acts in the other contracting state through a 'dependent agent' who satisfies at least one of the tests set out in Article 5(8), such an enterprise is deemed to have a permanent establishment in the other contracting state. This deemed PE, for the sake of convenience, we shall refer as 'Dependent Agent PE' (DAPE, in short). It is wholly hypothetical and fictional, because, in strict sense of the word, there is no PE at all. How can one have a permanent or even non permanent establishment, when there is no establishment at all. It is, however, important to note that what is defined as a permanent agent is not the dependent agent per se, but, on the contrary, it is by the virtue of an enterprise having a dependent agent that the enterprise is "deemed to have a permanent establishment". A dependent agent cannot, strictly speaking, be termed as PE because neither the Dependent Agent belongs to the PE, nor can one have something as a result of having the same thing, i.e. if a dependent agent is itself a PE, one cannot have a PE as a result of having a dependent agent. In such a case, the treaty could have simply stated that a dependent agent or agency shall be deemed to be PE of the enterprise; there was no need to say, as has actually been said, that an enterprise shall be deemed to have a PE by the virtue of having a dependent agent and meeting one of tests set out in the relevant sub article. Dependent Agent and the Dependent Agent PE, therefore, cannot be one and the same thing. Though at the cost of repetition, we consider it necessary to reproduce the provisions of Article 5(8) which deal with this provision.

8. Notwithstanding the provisions of paragraphs 1 and 2, where a person - other than an agent of an independent status to whom paragraph 9 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 State, if, -

(a) he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise;

(b) he 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) he 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.

9. The rationale for dependent agent permanent establishment is simple. A foreign enterprise may chose between performing business activity itself, and having it done through a domestic agent. In case, foreign enterprise prefers to perform the business activity through a domestic agent, he does not need to depend on the right to use a fixed place of business. The business activity is carried out through an agent, and a dependent agent at that. However, taxation would infringe neutrality in the event the tax position of a foreign enterprise is to depend on whether the business activity is carried out by the foreign agent directly or whether the foreign enterprise conducts business activity through an agent - who, being a dependent agent, is integrated into principal's business to a large extent. In case the tax position is to vary based only on whether or not the business activities are carried out directly or through an agent, it would be a bit too easy to circumvent the PE taxation if no PE taxation is to be applied to the dependent agent permanent establishment. Whether one carries on the business directly or through the dependent agent, the profit attributable to such business continue to be taxable in the source country. This is the unmistakable underlying principle behind the dependent agent permanent establishment clause in the treaties. This next issue is then how do you compute the profits of this fictional or hypothetical PE.

10. Article 7 (1) provides that when an enterprise has a PE in the other contracting state, profits of the enterprise shall be taxed in that other state but "only so much of them as is directly or indirectly attributable to that permanent establishment" This expression in fact narrows down the scope of taxability in that other contracting state by excluding profits derived by such enterprise in

the source state independently of the permanent establishment. There is no scope of the application of any specific or implied force of attraction rule, as, for example, embedded in Article 7 of the UN Model Convention. The basic philosophy underlying a force of attraction rule is that when an enterprise sets up a permanent establishment in another country, it brings itself 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 through the PE or not. Therefore, under the force of attraction rule, mere existence of PE in another country, leads all profits, which can be said to be derived from that another country, being treated as taxable of that another country. That was the classical force of attraction rule but what is in vogue today is a much improvised and subdued form which restricts application of this rule to few specified areas. Even this subdued and improvised form of force of attraction rule, however, does not find much favour in the contemporary tax treaties, and particularly in OECD Model Convention on which the present tax treaty, in material respects, is based.

The expression confining taxability of profits to "only so much of them as is directly or indirectly attributable to that permanent establishment" only confirm this paradigm feature. The first step to be taken for computation of profits liable to be taxed in the source country, therefore, is computing profits directly or indirectly attributable to the permanent establishment. Article 7(2) provides the methodology for computation of profits of the PE. This sub article, inter alia, provides that when an enterprise of "one of the contracting states (General Enterprise, or GE in short), carries on the business in the other contracting state through a PE, so much of the profits of the enterprise shall be attributed to the PE as such a PE "might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is permanent establishment". In other words, the profit computations of the PE have to proceed on the basis that the PE is wholly independent of its GE which from a purely accounting and commercial point of view, generally means nothing more than the hypothesis that intra organization transactions are to be taken into account at arms length price. It is important to bear in

mind the fact that in the case of intra organization transactions within an enterprises there are several ways of accounting for the same, e.g. at cost, at transfer price, at arms length price or simply at fair market price. Article 7(2) provides that the arms length price is the criterion for computation of these hypothetical profits. Such profits cannot be determined otherwise than hypothetically and, therefore, no more than approximately, if at all, because in practice there is no such thing as unrelated enterprise available for comparison and satisfying completely all the conditions. The two step process in so computing the profits, therefore, involves identifying the PE, proceedings to compute hypothetical profits of the PE by taking into account PE- GE transactions at an arms length price.

11. The particular difficulty in the case of a dependent agent permanent establishment is that DAPE it self is hypothetical because there is no establishment - permanent or transient- of the G& in the PE state. The hypothetical PE, therefore, must be visualized on the basis of presence of the GE as projected through the PE, which in turn depends on functions performed, assets used and risks assumed by the GE in respect of the business carried on through the PE. The DAPE and DA has to be, therefore, be treated as two distinct taxable units. The former is a hypothetical establishment, taxability of which is on the basis of revenues of the activities of the GE attributable to the PE, in turn based on the FAR analysis of the DAPE, minus the payments attributable in respect of such activities, in simple words, whatever are the revenues generated on account of functional analysis of the DAPE are to be taken into account as hypothetical income of the said DAPE, and deduction is to be provided in respect of all the expenses incurred by the GE to earn such revenues, including, of course, the remuneration paid to the DA. The second taxable unit in this transaction is the DA itself, but this taxability is in respect of the remuneration of the DA. The provisions of the tax treaty are silent on this issue, and rightly so. because the taxability of the DA is quite distinct of the taxability of the enterprise of the contracting state which is in respect of PE of such an enterprise. At the cost of repetition, it is not the DA who constitutes PE of the GE, but it is by the virtue of a DA that the GE is deemed to have a PE, a DAPE though, in the other contracting state. We are of the considered view that

in addition of the taxability of the DA in respect of remuneration earned by him, which is in accordance with the domestic law and which has nothing to do with the taxability of the foreign enterprise of which he is dependent agent, the foreign enterprise is also taxable in India, in terms of the provisions of Article 7 of the tax treaty, in respect of the profits attributable to the dependent agent permanent establishment. As we have elaborated earlier in this order, a dependent agent permanent establishment is distinct from the dependent agent. While computing the profits of this dependent agent permanent establishment, a deduction is to be allowed for the remuneration paid to the dependent agent as that is cost of operation of the dependent agent permanent establishment and as it has been incurred for generating the revenues attributable to such hypothetical permanent establishment. Let us take a very simple example to understand the mechanism of this approach. Let us assume that there is an electronic equipment distributor by the name of Sing Co. based in Singapore. He sources the electronic equipment from all over the globe and sells the same to its customers in India. Instead of having a regular office in India, and instead of carrying out the marketing activity in India, he projects his business in India through an Indian Co by the name of Ind Co. There is no dispute that Ind Co is a dependent agent of the Sing Co. In consideration of the services rendered by Ind Co, Sing Co pays Ind Co commission @ 30% on sales plus reimbursement of expenses. Sing Co, however, procures the electronic equipment from China, shipped directly to India and sells it in India after a mark up of 200%. We further assume that the reasonable handling costs of Sing Co for sourcing the merchandise is 60% on cost. In a particular year. Sing Co sells goods worth \$ 3 million in India. Let us further assume that expenses incurred by Ind Co, to earn the agency remuneration, is \$ 5,99,000. The profits taxable in India, in such a case and based on the treaty provisions before us, should be as follows :

A : Commission earned by Ind Co : \$ 6,00,000

Less : Deductible expenses of Ind Co : \$ 5,99,000

Taxable in the hands of the Ind Co.

B : Profits attributable to Sing Co's DAPE in India Sales  
consideration : 30,00,000

Less : commission paid to Ind Co : 9,00,000(-)

cost of purchases : 10,00,000(-)

Sing Co's handling charges : 6,00,00(-) : 25,00,000

Profit of the DAPE or, in other words, profits  
Attributable to India operations of the Sing Co, : \$ 5,00,000

As far as 'A' in the above example is concerned, it does not have anything to do with the income of the foreign company. This taxability is in the hands of the domestic dependent agent and is on net basis after taking into account the expenses incurred by the agent for earning of remuneration whether or not the same relates to the business of the foreign company or not. As regards 'B' above, it represents the earnings of the foreign company attributable to the dependent agent permanent establishment, on account of its having a dependent agent in source country. This income is taxable in the hands of the foreign company in the source country and the tax credit in respect of such taxability will be available to the foreign company in residence country. If, in this example, we are to assume that the income of the PE is only the remuneration earned by the agent on net basis, we will end up in a situation that while profits of Sing Co attributable to India operations will be \$ 5,00,000, the taxability of the profits will be confined to only \$ 1,000. What is to be taxed under Article 7 is income of the foreign enterprise attributable to the permanent establishment in the host country. The income attributable to the permanent establishment in the host country is the income attributable to foreign company's operations in the host country, which, in turn, implies the income attributable to the activities carried on the foreign enterprise in the host country. That income, as shown in 'B' above, is the income arrived at by taking into account revenues generated by the PE and deducting therefrom the expenditure incurred by the foreign enterprise to earn those revenues. However, it is open to the foreign enterprise to claim appropriate adjustment for the

foreign enterprise's overheads and even a reasonable charge, on account of activities of the foreign enterprise carried on outside the host country, by treating the foreign enterprises as a fictionally separate entity

11. Learned counsel, however, contends that since the profit attributable to the PE are the profits which the PE "might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is permanent establishment", the taxable profits of the foreign enterprise cannot extend beyond the profit earned by the dependent commission agent. The line of reasoning adopted by the learned counsel is that PE is nothing but the dependent agent, and, the taxability of PE can only, therefore, be in respect of the earnings of the agent. Learned counsel has, with his inimitable oration, erudition and legal skills, woven a complex web of arguments to support this legal proposition. However, as it sometimes happens, the quality of arguments in support of a legal proposition is inversely proportional, proportional if it is, to the merits of the proposition sought to be advanced. This is one such occasion. Let us set out the reasons why we think so, and, in the process, deal with various arguments of the learned counsel one by one,

12. At the outset, we must reiterate that a dependent agent (DA) and a dependent agent permanent establishment (DAPE), in our humble understanding, are two distinct things. As we have stated earlier, it is as a result of existence of a dependent agent that the foreign enterprise is deemed to have a permanent establishment in the country in which dependent agent is situated.

13. Under Article 7 of the treaty, the taxability is of the foreign company. What is taxable under Article 7 is profit earned by the foreign enterprise, as Article 7(1) provides that "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". Agency remuneration paid by the foreign enterprise is not an income of the foreign

enterprise but an expenditure of the foreign enterprise. The taxability of any profit under Article 7 has to be in the hands of the foreign company and not the host company of which dependent agent is resident. Therefore, in it is patently erroneous to suggest that by payment of tax liability by the dependent agent, tax liability of the foreign principal is discharged. So far as Article 7 is concerned, it deals with the taxability of the foreign company.

14. Under the scheme of the Act, the taxable unit is the foreign company, though the quantum of income taxable is such income as may be held to be attributable to the permanent establishment of the foreign company in India. The tax liability of the foreign company and not the Indian dependent agent. However, in case we are to uphold the stand of the learned counsel, we will end up in a situation that taxability of Indian company is to be allowed to extinguish tax liability of the foreign principal.

15. Learned counsel has relied upon the commentaries of various authors including Phillip Baker, Prof Roy Rohtagi and Prof David R Davies. it is contended that according to these distinguished authors, payment of arms length remuneration by a foreign company to its agent extinguishes tax liability of the foreign principal. With respect, and for the reasons we have set out above, we are of the considered view that in the dependent agency permanent establishment situation, this proposition does not hold good. In any event, this approach proceeds on the assumption, which turns out to be fallacious assumption on the facts of the present case, that dependent agent and dependent agent permanent establishment are one and the same thing.

16. Learned counsel has then relied upon the order of this Tribunal in the case of DCIT Vs Roxon OY (103 TTJ 891), which was authored by one of us. This decision, however, did not deal with the peculiarities of a dependent agent permanent establishment. This decision dealt with the taxability of the installation PE, and, the principles dealing with computation of profits of installation PE, in our considered view, do not have any bearing on the computation of profits of the dependent agency PE. We are, therefore, not persuaded by this reasoning either.

17. A reference is then made to the ruling given by the Hon'ble Authority for Advance Ruling in the case of Morgan Stanley & Co Inc. 284 ITR 260. We have perused the ruling, but, with respect, we are not persuaded. It is also well settled in law that these rulings have binding value only on the assessee and on the Commissioner with reference to that particular transaction. In this regard, we deem it necessary to produce the following extracts from the judgment of Hon'ble Supreme Court in the case of Union of India v. Azadi Bachao Andolan [2003] 263 ITR 706, at page 742 wherein Their Lordships of Hon'ble Supreme Court had an occasion to deal with the said AAR ruling :

"The respondents placed great reliance on the decision by the Authority for Advance Ruling constituted under section 245-O of the Income-tax Act, 1961, in Cyril Eugene Pereria's case [1999] 239 ITR 650 (AAR). Section 245S of the Act provides that the Advance Ruling pronounced by the Authority under section 245R will be binding only:

"(a) on the applicant who had sought it;

(b) in respect to the transaction in relation to which the ruling had been sought;

(c) on the Commissioner, and the income-tax authorities subordinate to him, in respect to the applicant and the said transaction."

It is therefore, obvious that, apart from whatever its persuasive value, it would be of no help to us. Having perused the order of the Advance Ruling Authority, we are not persuaded." [Emphasis supplied]

The ruling does not have any binding force on us. Learned counsel submits that he wishes to adopt it as his arguments but then the very line of reasoning which has been approved by the Authority for Advance Ruling in this case, has already been declined our approval for the detailed reasons set out above. We are not persuaded to disturb our conclusions.

18. Learned counsel then refers to the judgment of Hon'ble Supreme Court's judgment in the case of Union of India Vs Azadi Bachao Andolan (263 ITR 743) in support of the proposition that the purpose of the tax treaties is to allocate taxing jurisdiction between the contracting states. We cannot, and do not, dispute this proposition. However, we do not think that this proposition can be of use to advance the case of the assessee which is that the taxability the PE profits in the host country, in the case of the dependent agent PE, is confined to taxability of remuneration received by the dependent agent at arms length price.

19. Learned counsel has then referred to Board Circular No. 5 and 23 but once again these circulars do not deal with the question of taxability of dependent agent PE which is the issue before us. Having perused these circulars carefully, we do not find any relevance of these circulars on the issue requiring our adjudication. We, therefore, reject assessee's reliance on the Board Circulars as wed.

20. We have noticed that there are no specific guidelines on the issue of computation of profits for dependent agent permanent establishment from the tax authorities or in the applicable tax treaty. However, dealing with these treaty provisions, there is some guidance available from the tax rulings abroad and other literature from multilateral bodies like OECD (Organization of Economic Co- Operation and Development. Paris) as also prominent organizations like IFA (international Fiscal Association, Amsterdam) We will briefly deal with these.

21. This issue, however, has been discussed in one of the recent Australian Tax Office guidelines titled "Attributing Profits to a Dependent Agent Permanent Establishment" (Product ID 14314-09.2005; [www.ato.gov.au](http://www.ato.gov.au)). These guidelines, inter alia, provide as follows:

**"THE TWO-STEP PROCESS**

Taxation Ruling TR 2001/11 states our view that Australia's PE attribution rules use a two-step process to apply an arm's length separate enterprise principle in attributing profits to a PE:

- Step 1: Undertake a functional analysis, which attributes to the PE the functions performed, assets used and risks assumed (FAR) by the enterprise in respect of the business it carries on through the PE.
- Step 2: Undertake a comparability analysis, which determines an arm's length return for the FAR attributed to the PE.

This process applies to all PEs, including dependent agent PEs.

In performing this process, it is critical to properly distinguish between two different taxpayer enterprises with different FAR and, invariably, different taxable profits, that is:

- ForCo (i.e. Foreign company), through its dependent agent PE, and
- SubCo (host jurisdiction company which gives rise to PE of the foreign company), through its agency activities.

The FAR of the dependent agent PE, are the FAR of ForCo, not SubCo, in respect of the agency activity. The dependent agent PE is attributed profit of ForCo, not SubCo, arising from the agency activity. Thus the profit attributable to ForCo's dependent agent PE is not merely an arm's length profit for the agent entity, SubCo. Rather, it is an arm's length profit for the FAR of ForCo in respect of the agency activity performed by SubCo on behalf of ForCo.

The taxable profit of the dependent agent PE is calculated by taking some part of ForCo's income from the activity performed by the agent and deducting the expenses (including the service fee paid to SubCo) ForCo incurs in deriving that income. Accordingly, while an arm's length service fee paid by ForCo to SubCo may be an arm's length reward for the agent's FAR, it does not follow that it also constitutes the arm's length reward for the dependent agent PE's FAR."

The views so expressed by the Australian Tax Office also support the conclusion arrived at by us. Learned counsel has submitted that these views should not be taken as correct and authoritative interpretation of the tax treaties. We have, however, agreed with these views on merits, and not just because these are stated by the Australian Tax Office. We are of the considered view that the views expressed by the ATO are on the right lines and these views meet our approval.

22. We would like to next deal with the views expressed by the OECD in this regard, in a recent report published by the OECD ([www.oecd.org](http://www.oecd.org)), on attribution of profits to the permanent establishment, it has been inter alia observed that in cases where a PE arises from the activities of a dependent agent, the host country will have taxing rights over two different legal entities - the dependent agent enterprise (which is a resident of the PE jurisdiction) and the dependent agent PE (which is a PE of a non-resident enterprise). This also supports the conclusions drawn by us earlier in this order. We may, in this regard, quote some of the relevant extracts from this report:

### **"D-3 Dependent agent PEs**

275. As indicated in Sections B-6 and D-5 in Part I, this Report does not examine the issue of whether a PE exists under Article 5(5) of the OECD Model Tax Convention (a so-called "dependent agent PE") but discusses the consequences of finding that a dependent agent PE exists in terms of the profits that should be attributed to the dependent agent PE, it is worth emphasising at the outset that the discussion below is not predicated on any lowering of the threshold of what constitutes a PE under Article 5, and in particular it should be noted that the performance of key entrepreneurial risk-taking functions by a dependent agent enterprise on behalf of a separate enterprise capital provider is a tool for attributing profits, including the reward for capital, to a PE, not a threshold test for determining the existence of a PE.<sup>14</sup> However, it is a fact that the functions associated with a global

trading business may be undertaken by dependent agents within the meaning of Article 5(5). General guidance on the attribution of profits to dependent agent PEs is contained in Section D-5 of Part I and this section applies that guidance to the specific and commonly occurring factual situation of global trading."

276. In cases where a PE arises from the activities of a dependent agent, the host country will have taxing rights over two different legal entities - the dependent agent enterprise (which is a resident of the PE jurisdiction) and the dependent agent PE (which is a PE of a non-resident enterprise). In respect of transactions between the associated enterprises (the dependent agent enterprise and the non-resident enterprise), Article 9 will be the relevant article in determining whether the transactions between the associated enterprises, for example a volume-based commission, were conducted on an arm's length.

277. In respect of the dependent agent PE, the issue to be addressed is one of determining the profits of the non-resident enterprise which are attributable to its dependent agent PE in the host country (i.e. as a result of activities carried out by the dependent agent enterprise on the non-resident enterprise's behalf). In this situation, Article 7 will be the relevant article. Finally, it is worth stressing that the host country can only tax the profits of the non-resident global trading enterprise where the functions in the host country performed on behalf of the non-resident enterprise meet the PE threshold as defined under Article 5. Further, the quantum of that profit is limited to the business profits attributable to global trading operations performed through the PE in the host country.

278. Where a dependent agent PE is found to exist under Article 5(5), the question arises as to how to attribute profits to the PE. The answer is to follow the same principles as used for other types

of PEs for to do otherwise would be inconsistent with Article 7 and the arm's length principle. Under the first step of the authorised OECD approach a functional and factual analysis determines the functions undertaken by the dependent agent enterprise both on its own account and on behalf of the nonresident enterprise. On the one hand, the dependent agent enterprise will be rewarded for the services it provides to the nonresident enterprise (taking into account its assets and its risks) usually by means of a fee from the non-resident enterprise. On the other hand, the dependent agent PE will have attributed to it the assets and risks of the non-resident enterprise relating to the functions performed on its behalf by the dependent agent enterprise, together with sufficient free capital to support those assets and risks. The authorised OECD approach then attributes profits to the dependent agent PE on the basis of those assets, risks and free capital. The analysts focuses on the nature of the functions carried out by the dependent agent on behalf of the non-resident enterprise and in particular whether it undertakes key entrepreneurial risk-taking functions. In this regard an analysts of the skills and expertise of the employees of the dependent agent enterprise is likely to be instructive, for example in determining whether trading, negotiating or risk management functions are being performed by the dependent agent on behalf of the non-resident enterprise.

279. In calculating the profits attributable to the dependent agent PE it would be necessary to determine and deduct an arm's length reward to the dependent agent enterprise for the services it provides to the non-resident enterprise (taking into account its assets and its risks). Issues arise as to whether there would remain any profits to be attributed to the dependent agent PE after an arm's length reward has been given to the dependent agent enterprise. In accordance with the principles outlined above, the answer is that it depends on the precise facts and circumstances as revealed by the functional and factual analysis.

The reward should provide the appropriate remuneration for the functions performed (taking into account the assets used and risks assumed) by the dependent agent enterprise in its own right. However, a functional analysis of a transaction may show that the ability to assume the risks arising from the transaction is not found in the dependent agent enterprise, for example because it has insufficient capital to support the risks assumed. Rather the ability to assume the risks is generally found in the non-resident enterprise in whose books the transaction - and the resultant risk - appears. The reward for the capital to support those risks clearly belongs to the non-resident enterprise, not the dependent agent enterprise. The question is which part of the non-resident enterprise. The answer is that under the authorised OECD approach, these risks, and therefore the capital needed to support them, will be attributed to the dependent agent PE to the extent that they arise from functions performed by the dependent agent in the host country on behalf of the non-resident enterprise. In short, when attributing profits to the dependent agent PE, there are likely to be profits (or losses) over and above the arm's length reward paid to the dependent agent enterprise. This principle can be illustrated by the following commonly occurring situation where the trades of a broker-dealer in the host country are booked in the accounts of a non-resident enterprise. The analysis applied to the functions performed by the dependent agent for attributing the assets and risks to the dependent agent PE is the same analysis applicable to determining the assumption of risk within a single enterprise as discussed in Section D-1(i)(b).

280. The following illustration is intended to better explain the approach taken under the authorized OECD approach. It is recognised that in practice most situations will be significantly more complex and difficult to deal with. Even where the nonresident enterprise is a special purpose vehicle (as in the example below), and all the trading functions are performed in the

dependent agent enterprise, the special purpose vehicle may have employees of its own to maintain the vehicle's enhanced creditworthiness, or to perform strategic risk management or operational risk management functions. In other cases, where the special purpose vehicle itself does not have employees performing such functions, the functions may be performed either by another company in the group or by a dependent agent PE in a different location from the traders. Similarly the traders in the dependent agent enterprise may be relying on proprietary systems developed elsewhere in the group for which an arm's length reward is due. Finally, there may be traders in more than one location. The objective of the highly simplified example, however, is to illustrate the principle that the host country's taxing rights are not necessarily exhausted by ensuring an arm's length compensation to the dependent agent enterprise under Article 9 (the following example is one where the dependent agent is an associated enterprise).

281. Assume that a special purpose enterprise in Country A, with no employees, has a broker-dealer subsidiary in Country B. For regulatory and other reasons the equity derivatives business of Country B is not booked in the broker-dealer subsidiary, but in the non-resident (special purpose) enterprise. Assume further that all the functions (key entrepreneurial risk-taking and support) in connection with the derivatives business is conducted in the host country by the broker-dealer subsidiary and its employees, who are authorised to conclude contracts in the name of the enterprise in Country A- Assume, finally that the circumstances are such that the broker-dealer is a dependent agent enterprise and that a dependent agent PE is found to exist under Article 5(5). There are two steps to the transfer pricing analysis.

282. Firstly, it is necessary to attribute an arm's length reward to the dependent agent enterprise (the broker-dealer) for the

functions it performs on behalf of the non-resident enterprise. A suitable third party comparable should be used to arrive at an arm's length fee for the service provided by the dependent agent enterprise to the non-resident enterprise. This is because the market credit risk associated with the financial assets created by the dependent agent enterprise do not belong to the dependent agent enterprise, but to the legal owner of the assets -the non-resident enterprise. An arm's length fee paid by the nonresident enterprise would not therefore under Article 9 as discussed in Section C take account of the assumption of these risks nor the return on the capital needed to support those risks. The risks are assumed by the non-resident enterprise and so the reward for capital properly belongs to that non-resident enterprise.

283. The question is whether any of the reward for the assumption of the market and credit risk by the non-resident enterprise should be attributed to its dependent agent PE. On the facts of, the present example the answer would be yes, since the key entrepreneurial risk-taking functions are undertaken, not by the non-resident enterprise itself but by the dependent agent enterprise on behalf of the non-resident enterprise. The reward for the assumption of the market and credit risk, i.e. the return on the associated capital, is therefore attributed to the dependent agent PE. In this highly simplified example the profits attributed to the PE would be the profits of the book as a whole less the amount of the arm's length fee (determined by reference to a suitable comparable) given to the dependent agent enterprise. In more realistic cases, the residual profits attributed to the PE would be the profits of the book less an arm's length reward for one or more of the functions described in paragraph 279.

284. The above outcome, in addition to being technically correct, also gives a commonsense result; if in fact all the key entrepreneurial risk-taking and other functions are performed by

the dependent agent enterprise on behalf of the non-resident enterprise in Country B then it is appropriate that all the profits should be taxed there. This analysis also gives a sensible policy outcome in that it produces the same outcome as performing the same functions in Country B through a branch of Company A. It is worth emphasising that the above analysis is only applicable if a dependent agent PE is found to exist under Article 5(5).

285. An Alternative approach, the "single taxpayer approach", has been suggested by some business commentators, but this was rejected as an authorised OECD approach in Section D-5 of Part I.

286. The danger of overlooking the assets used and risks assumed in the performance of the functions in the PE jurisdiction is minimised if the existence of the dependent agent PE is formally recognised so that it is clear that the host country has taxing rights over two different legal entities - the dependent agent PE and the dependent agent enterprise - and an attribution of profit based on a functional analysis is made to the dependent agent PE on the basis described in this section. This should also ensure that any other tax consequences arising from different rules for PEs and subsidiaries in the PE jurisdiction are taken into account. One way to formally recognise the existence of dependent agent PEs is to require the filing of tax returns for all such PEs. However, nothing in the authorized OECD approach would prevent countries from using administratively convenient ways of recognizing the existence of a dependent agent PE and collecting the appropriate amount of tax relating to the nonresident enterprise resulting from the activity of a dependent agent. For example, where a dependent agent PE is found to exist under Article 5(5), a number of countries actually collect tax only from the dependent agent enterprise even though the amount of tax is calculated by reference to the activities of both the dependent agent enterprise and the dependent agent PE. In practice what

this means is taxing the dependent agent enterprise not only on the profits attributable to the people functions it performs on behalf of the non-resident enterprise (and its own assets and risks assumed), but also on the reward for the free capital which is properly attributable to the PE of the non-resident enterprise. Such administrative matters related to the taxation of dependent agent PEs are for the domestic rules of the host country and not for the authorised OECD approach to address. 15 It follows that the home country with a PE in a host country that operated such an administratively convenient procedure would not be obliged to give relief or be entitled to tax on the basis that there was no dependent agent PE. The taxing rights of the home country are not altered by administratively convenient procedures of the host country.

23. Learned counsel submits that it would be inappropriate for us to be guided by this report because this report what the law should be and not what the law is. Our attention is drawn to paragraph 3 of the preface which indicates that the working group was also assigned the task of examining whether, and if so, to what extent, the amendments in the OECD Model Convention and its Commentary are needed. Our attention is then invited to paragraph 9 at page 3 of the report which, inter alia, notes that "the best way to provide administrators and taxpayers with maximum certainty as to profits should be attributed to permanent establishment is to redraft Article 7 in such a way that will remove the potential for different interpretation based on previous practices and existing commentary". It is thus contended that the present provisions do not support the interpretation given in the above report. We are thus urged to ignore this report. We are unable to see merits in this contention either. Just because a particular interpretation can be better supported by more specific provisions does not mean that the provision which exist do not support that interpretation. We have arrived at our independent conclusions but these are the same conclusions as arrived at in this report. We adopt the reasoning taken by this report as well. We particularly agree with the following observations made in the OECD report:

"Whilst superficially attractive 'single taxpayer' approach (as canvassed by the assessee before us) in fact contains a number of fundamental flaws. Firstly, this approach would not result in fair division of taxing rights between host and home jurisdictions as it ignores assets and risks that relate to the activity being carried on in the source jurisdiction simply because those assets and risks belong to the non resident enterprise. Indeed, such an approach would go against one of the fundamental rationales behind the PE concept which is to allow, within certain limits, the taxation of non resident enterprise (including their assets and risks) in respect of their activities in the source jurisdiction. The 'single taxpayer approach simply does not consider that if the risks (and rewards) legally belong to a PE of a non resident enterprise created by the activity of its dependent agent in the host country"

24. We are in considered agreement with the views so expressed in the OECD report on attribution of profits to the permanent establishment. In our considered opinion, these views correctly state the interpretation of the existing Article 7 in the OECD Model Convention which is materially the same as in the India Singapore tax treaty that we are concerned with.

25. We may now briefly deal with a report on the proceedings of the International Fiscal Associations 2006 Congress at Amsterdam. This report is by Professor Phillip Baker, QC, of Gray's Inn Tax Chambers and Dr Richard Collier, of Price Waterhouse Coopers. Learned counsel has invited our attention to the following observations in the said IFA report:

The DD (discussion draft) would, if adopted, lead to significant changes in the current approach and practice in relation to Article 7 (2), whilst there has been a considerable effort expended upon the nature and operation of new approach, the discussions of the consequences of the AOA (Authorized OECD Approach) has been very limited.

(Page 80)

This may be second important conclusion of this General Report; that existing case law and guidance may make it very hard in a number of jurisdictions to adopt the AOA without an explicit change in the working of Article 7

(Page 84)

26. Learned counsel submits that these observations in the IFA report unambiguously show that the OECD report, from which we have quoted earlier in this order does not correspond to the legal position as it exists right now. It is contended that in order that the OECD report is implemented, changes will have to be made in treaty and that right now we are only discussing what the law exists and not what the law should be. We are, therefore, urged to ignore the contents of the OECD report.

27. We are unable to find much substance in this objection of the learned counsel. While we do recognize the significant contribution made by the IFA to the international tax literature and its pivotal position as a body dedicated to the study of inter alia, issues pertaining to the cross border taxation issues, we do not see any support to the assessee's cause by the IFA report. We do attach due importance to the views and guidance of the IFA, but there is nothing to directly support the assessee's case. As far as the observations at page 80, on which learned counsel has relied, immediately after the said observations, the report sets out two example to illustrate the point so made and none of those illustrations pertains to the dependent agent permanent establishment profit attribution. These observations, therefore, cannot be construed to mean that the changes are necessarily required to be made so far as profit attribution for dependent agent permanent establishment is concerned. Unless such is the proposition, there is no reason for us to disturb the conclusion that we have arrived at on merits. Similar is the position is with regard to the second observation relied upon by the learned counsel: Even this does not pertain to the dependent agent permanent establishment situation, and is general in

scope. The objections of the learned counsel, on the basis of IFA report, do not therefore merit acceptance.

28. There are, however, some direct references to the dependent agency permanent establishment profit attribution, in the IFA Congress Report 2006. We may refer to the following observations made in the said report at pages 69-70:

As explained in part I, DDI (2004) has proposed that the correct interpretation of the MTC (Model Tax Convention) is that a profit may be attributed to the DAPE (Dependent Agent Permanent Establishment) over and above arms length reward to the agent enterprise..... .

Branch reporters were asked to speculate as to what they thought the DDI (2004) contentions that there might be a profit attributed to the DAPE over and above the arms length agency fees would be accepted in their jurisdiction. Not all the branch reporters responded to this question. A few indicated that the issue was highly controversial in their jurisdiction.

Of the branch reporters who responded to the issue, five indicated that it was thought that there might be a profit attached to the DAPE. The Australian Report indicated that Australian Tax Office considers that a DAPE might be left in a net profit position. The Australian report mentioned the views of some commentators that a commercial profit might indeed be allocated to DAPE. The Danish report mentions about an unpublished ruling from the Danish Tax Assessment Board which concludes that the income attributed to the DAPE cannot be zero. The Norwegian report indicates that tax authorities seem to take the position that a profit should be allocated to the PE, but accept that PE's profit under these circumstances may be limited. Finally, the Swiss

report states that there may be income and expenses of the DAPE which are not identical to the agent's income and expenses.

By contrast, six branch reports indicate that in their jurisdiction no profit will be allocated to the DAPE. The Czech report notes that, if the dependent agent's remuneration is considered reasonable and based on arms length principle, no additional profit adjustment would be considered necessary by tax administration. The German report considers the difference between employed agent and agent enterprises and concludes that no scope remains for DAPE's own profits except in the case of employee agents). The Italian report states that, to the extent that the costs effectively incurred by the HO for the agent is in line with the market rates, there will be no taxable income attributable to the PE. The Mexican report states that there should be no further profit - over and above the arms length reward -which should be attributed to the PE. The report quotes Mexican IFA branch in support of this view. The Dutch report quotes a 1957 Hoge Raad case in support of the view that taxable profit of the DAPE would be zero. Finally, the New Zealand report states that, in New Zealand, the risk of further profit being attributed to the DAPE will be low if the functional profile of the dependent agent and DAPE will be the same. The dependent agent should be receiving remuneration that is appropriate given the functions it undertakes and risk it assumes in New Zealand,

Finally, three branch reports state that the issue is unclear : that is the position taken by the branch report for Canada, India and the United Kingdom.

What one can say is that this is not a rousing show of support for the DDI (2004) contentions with regard to the DAPE or, put another way, that the adoption of WP6 approach to the DAPE

issue seems unlikely to achieve the broad consensus regarding the interpretation and practical application of Article 7 that it seeks"

29. The above observations clearly show that there is a widely held school of thought, even amongst the tax advisors who tend to take liberal interpretations in favour of the taxpayers and who easily outnumber and outweigh neutral members in bodies like IFA, that there has to be profit attributed to the dependent agent permanent establishment over and above the arms length fees paid to the dependent agent. Having given our careful consideration to the matter, we also subscribe to this school of thought.

30. As a matter of fact, in case the plea of the assessee is to be accepted, the whole concept of agency PE will be rendered meaningless. The profits earned by the dependent agent, or even independent agent, are anyway to be taxed in the host country of which the dependent agent is resident. The existence of the PE is therefore rendered meaningless by the interpretation sought to be canvassed by the assessee. It is well settled that no law or treaty can be interpreted in such a manner so as to make a clause meaningless. The interpretation is required to be made at *res magis valeat quam pereat*, i.e, making it effective rather than making it redundant.

31. In view of the above discussions above, we are of the considered view that the tax liability of a foreign enterprise, in respect of its dependent agency permanent establishment, is not extinguished by making an arms length payment to the dependent agent. There is no dispute in the present case to the extent that the assessee company has a dependent agent in India, and that the profits of the dependent agency permanent establishment are, therefore, taxable in India. Since the assessee has not produced any details of computation of profits of such DAPE, and had instead accepted the tax liability on presumptive basis @ 10% under CBDT circular No. 742 at the time of filing of income tax return, we are of the considered view that the Assessing Officer had rightly taxed the income of Rs 13,58,43,976 on that basis. The relief given by the Commissioner by holding that the taxability of arms' length remuneration to the

dependent agent extinguishes the tax liability of dependent agent permanent establishment as well, is unjustified and we vacate the same.

32. Ground No. 1 is thus allowed.

33. In the second ground of appeal, the grievance raised by the Assessing Officer is as follows:

On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that advertisement revenue pertaining to AXN channel are not taxable in India on the ground that the assessee has paid an arms length price for services rendered by its agent i.e. SET India Pvt Ltd, and based on the provisions of Section 9(1)(i) of the Act, Article 7(1) of the DTAA, and the ratio of circular No. 23 dated 23/7/69, no income in respect thereof is taxable in India, ignoring the fact that:

(i) though the purchase and sale of airtime is effected in Singapore, the receipt in respect of broadcasting advertisement is in the territory of India;

(ii) the income in respect of, or in connection with the relay of, advertisements, accrues in India;

(iii) the assessee has a PE in India in the form of SET India Pvt Ltd, and, therefore, advertisement revenue from AXN channel is taxable in India as business income.

34. Learned CIT (A) has not given any independent findings for the impugned finding. He has merely followed his stand as he had taken the first ground of appeal before us, and has held that as dependent agent has been paid an arms length consideration for the services rendered, no further profits can be attributed to the DAPEE. As we have reversed the action of the CIT(A) on the first ground of appeal, and as a corollary thereto, we vacate the relief given by

the CIT(A) which is impugned in this appeal by way of second ground of appeal as well. The Assessing Officer succeeds on this ground of appeal as well.

35. Ground No. 2 is also allowed.

36. In the ground of appeal no. 3, the Assessing Officer has raised the following grievance:-

3. On the facts and in the circumstances of the case and in law, the CIT(A) erred in holding that the assessee being a non resident and the entire income being subject to tax deduction at source under section 195 of the Income Tax Act, 1961, no liability under section 234 B and 234 C will arise, ignoring the fact:

(i) that since the tax deducted at source was not adequate to meet the entire tax liability, it was obligation on the part of the assessee to make the deficit good by making the payment towards the advance tax;

(ii) that since the assessee failed to pay the advance tax, the Assessing Officer was right in charging interest under section 234 B and 234 C of the Income Tax Act, 1961

37. Learned representatives fairly agree that the issue in appeal is covered by a number of decisions of the co ordinate benches, viz Sedco Forex International Drilling Inc Vs DCIT (72 ITD 415), Asia Satellite Telecommunication Co. Ltd Vs DCIT (85 ITD 478) and Fisons plc Vs DCIT (91 ITD 450) , as also by the Special Bench decision in the case of Motorola Inc Vs DCIT (96 ITD SB 269). Learned Departmental Representative, however, relied upon the stand of the Assessing Officer.

38. We see no reasons to take any other view of the matter than the view so taken by the co ordinate benches in the cases of Forex International Drilling Inc

(supra), Asia Satellite Telecommunication Co. Ltd Vs DCIT (supra) and Fisons plc Vs DCIT (supra) and the Special bench in Motorla's case (supra). Respectfully following the same, we uphold the relief given by the CIT (A) and decline to interfere in the matter.

39. The appeal filed by the Assessing Officer is thus partly allowed in the terms indicated above.

40. We now take up the appeal filed by the assessee.

41. In the first ground of appeal, the assessee has raised the following grievance:

The learned Commissioner of income Tax (Appeals) erred in holding that as the appellant has offered the advertisement revenue (including those relating to the AXN channel) to tax in the revised return of income, no relief from taxation could be given to the appellant, despite holding that no further profits should be taxed in the hands of the appellant, under Article 7 of the, India Singapore tax treaty, when the remuneration paid to the Indian Agent was paid on arms length basis.

42. As far as this grievance of the assessee is concerned, it is raised in the backdrop of the CIT (A)'s observation that even though the assessee did not have any tax liability in India, since the assessee has accepted the tax liability on his own at the time of filing the return of income, the assessee could not be given any relief from taxation and the CIT (A) had "no reasons to interfere with the income offered to tax by the appellant".

43. However, while adjudicating upon the grievance of the Assessing Officer against CIT (A)'s findings about non taxability of the assessee, we have already reversed the action of the CIT (A) so far as decision on merits is concerned. The grievance of the assessee, against not giving relief from taxation even after holding that the assessee has no tax liability, thus becomes infructuous and

academic. It does not call for any adjudication by us. We, therefore, decline to adjudicate on this ground of appeal.

44. Ground No. 1 is thus dismissed as infructuous.

43. in the second ground of appeal, the assessee has raised the following grievance:-

The learned Commissioner (Appeals) also erred in not confirming that the appellant was not liable to tax in India in respect of advertisement revenues earned (including those relating to AXN channel) under the provisions of the Income Tax Act, 1961.

44. As regards this grievance of the assessee, we find that the CIT(A) has not adjudicated on the assessee's contentions regarding its non taxability under the provisions of the Income Tax Act. We, therefore, deem it fit and proper to remit the matter to the file of the CIT (A) for the limited purposes of adjudication on this aspect of the matter. The CIT (A) shall decide the matter afresh after giving due and fair opportunity of hearing to the assessee, in accordance with the law and by way of a speaking order. We order so.

45. Ground No. 2 is thus allowed for statistical purposes.

46. In ground no. 3, the assessee has raised the following grievance:

The learned Commissioner (Appeals) erred in not appreciating that the information was placed on record indicated that the commission paid to SET India Pvt Ltd fully represented the value of profit attributable to the services rendered by it and, therefore, having regard to Circular No. 23 dated July 23, 1969, the advertisement revenue earned by the appellant was not taxable in India.

47. The aforesaid issue, learned representatives agree, pertains to assessee's contention that the assessee did not have any tax liability in India even under

the provisions of the Indian income Tax Act. That aspect of the matter has not been examined by the CIT (A) in the impugned order.

48. We, therefore, deem fit and proper to remit this issue also to the file of the CIT (A). The CIT (A) shall decide the matter afresh after giving due and fair opportunity of hearing to the assessee, in accordance with the law and by way of a speaking order. The matter thus stands restored to the file of the CIT (A) with directions as above

49. Ground No. 3 is thus allowed for statistical purposes.

50. in the result, the appeal of the assessee is partly allowed for statistical purposes in the terms indicated above.

51. To sum up, the appeal filed by the revenue is partly allowed in the terms indicated above and the appeal filed by the assessee is partly allowed for statistical purposes. In the result, the ITA No. 535/Mum/04 is partly allowed and the ITA No. 205/Mum/04 is partly allowed for statistical purposes. It is so pronounced in the open court today on 20th day of April 2007.