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Advertisement collection agent of a foreign telecasting company does not create a PE; arm's length remuneration to agents extinguishes further attribution to PE

In brief

In a recent case of B4U International Holdings Ltd. [1] (the assessee), the Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) held that assessee's advertisement collecting agents in India do not create a dependent agent permanent establishment (DAPE) under the Double Taxation Avoidance Agreement between India and Mauritius (the tax treaty). The Tribunal further held that the India agents neither had the authority to conclude contracts nor habitually exercised such authority. The Tribunal relied on the rulings of Set Satellite (Singapore) Pte Ltd[2], BBC Worldwide[3] and Morgan Stanley[4] to hold that even if there existed a permanent establishment (PE), since the agents have been remunerated at arm's length basis, nothing further remains to be attributed to the deemed PE.

[1] DDIT (IT) *v.* B4U International Holdings Ltd. [TS-358-ITAT-2012 (Mum)]

[2] SET Satellite (Singapore) Pte Ltd. *v.* DDIT [2008] 307 ITR 205 (Mum)

[3] BBC Worldwide *v.* DCIT [2011] 203 Taxman 554 (Del)

[4] DIT *v.* Morgan Stanley [2007] 292 ITR 416 (SC)

Facts

- The assessee is a foreign company incorporated in Mauritius and engaged in the business of telecasting TV channels such as B4U Music, MCM, etc.
- A copy of tax residency certificate was filed with the assessing officer (AO).
- The assessee, appointed B4U Multimedia International Ltd. and B4U Broad Band Ltd. (B4U India) as its advertisement collecting agents in India during the assessment year 2001-02.
- The assessee contended that:
  - It does not have a PE in India, and hence its income is not taxable under the provisions of the tax treaty.
  - Circular No. 23 of 1969 issued by Central Board of Direct Taxes (CBDT) was applicable in its case as B4U India was remunerated on an arm's length basis.
  - CBDT's Circular No. 742 was not applicable in its case as it had prepared countrywide accounts.

AO's order

- The AO held that the assessee has a DAPE in India and made the following observations:
  - Since the channels broadcasted by the assessee in India were all 'free to air' channels, the only source of revenue was from the sale of advertisement slots. Thus, the activities and duties of B4U India was the most important function for the business of the assessee.
  - The assessee did not have any facility or infrastructure in Mauritius which could be used for generation or maximisation of advertisement revenue. Thus, in the form of B4U India, the assessee extended its physical presence in India.
  - Since the assessee had business operations outside India also, it was difficult to ascertain the profits with respect to its India operations. AO applied CBDT's Circular No. 742, and determined profit at the rate of 10% after allowing commission payable to the advertising agent and other parties.
- The AO also rejected the contention that if an agent is paid an arm's length price (ALP), the non-resident is not liable to tax in India for the following reasons:
  - The payment to B4U India and the profit of the assessee from business operations in India are two separate things that cannot be compared.
  - This hypothesis is applicable only in the case of independent agents where no asset or capital of a non-resident is used, no further risk is assumed and no other activity is carried out by the non-resident in India.
  - CBDT's Circular No. 1 of 2004 also provides that when the core activities of the business of the assessee are outsourced, there would be substantial profits of the principal which would be the income of the non-resident taxable in India.
  - There has been undue reliance on one line in the circular No. 23 of 1969 without referring to entire context.
  - It would make principles of the force of attraction inapplicable in India.

CIT(A)'s order

- The CIT(A) held that the assessee carried out its entire activities from Mauritius and all the contracts were concluded there.
- The only activity carried out in India is incidental, auxiliary or preparatory in nature, carried out in a routine manner as per the direction of the principal. Hence, B4U is not a dependent agent of the assessee.

- As merely 4.69% of the total income of B4U India is on account of commission/service income received from the assessee, it cannot be treated as a dependent agent of the assessee.

- On the alternative contention, the CIT(A) held that the assessee and B4U India were dealing with each other on an arm's length basis and a 15% service fee is supported by CBDT's Circular No. 742. Thus, no further profits should be taxed in the hands of the assessee.

Issues before the Tribunal

- Whether B4U India is a DAPE of the assessee.

- If the dependent agent is paid remuneration at an arm's length, can further profits be attributed to such a PE in India.

Revenue's contentions

- Whether B4U India is a dependent agent of the assessee or not has to be viewed from the perspective of non-resident assessee and not from the perspective of B4U India. As the assessee carried out entire operations through its agents, the agent is a dependent agent. For this proposition reliance was placed on the Mumbai Tribunal's judgment in the case of DHL Operations B.V [5] wherein the issue was decided in favour of the revenue and a special bench was constituted on the issue.

- The authority to conclude contracts does not confine to the application of Article 5(4) of the tax treaty to the agents who enter into contract literally in the name of the enterprises, but it also applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of enterprise. As B4U India had power to conclude contracts, the issue falls within Article 5(4) of the Treaty and therefore constituted a PE of the assessee.

- Further on the issue of ALP, reliance was placed on the decision in the case of Hapag-Lloyd6, and it was submitted that once the assessee has the power to conclude contracts, the decisions in the case of SET Satellite (above) and Morgan Stanley (above) were not applicable.

Assessee's contentions

- As per the terms of agreement B4U India did not have any authority whatsoever to conclude contracts on behalf of the assessee or to bind the assessee by its actions.

- Article 5(4) of the tax treaty applies only if B4U India has or habitually exercised authority to conclude a contract in India. Reliance was placed on the decision in the case of TVM Ltd. [7] wherein it has been held that the term "has" means the legal existence of authority to conclude contract.

- As 96% of the total income of B4U India was not from the assessee, B4U India could not be held as the dependent agent of the assessee.

[5] ACIT *v.* DHL Operations B.V. [2007] 13 SOT 581 (Mum). Issue in this case was whether dependency of an agent is to be seen from the perspective of the agent or the non resident principal.
[6] Hapag-Lloyd *v.* DIT [2009] 20 Taxman 719 (Mum ITAT)
[7] TVM Ltd. *v.* CIT *In re* [1999] 237 ITR 230(AAR)

- High Court has stayed the disposal of appeal by the Special Bench in case of DHL Operations B.V. (above). Further, the decision in this case is contrary to the decisions in the cases of Western Union Finance Services Inc[8] and Daimler Chrysler A.G[9] and hence that decision should not be followed by the Bench. Further, when there are two contrary views on the same issue, view favourable to the assessee should be taken.

- On the second issue of ALP, the assessee relied on CBDT's Circular No. 742 of 1996 to contend that 15% is the industry norm for advertising agency. Further, reliance was placed on the jurisdictional High Court decision in the case of Set Satellite (above) and Galileo International Inc [10] for the proposition that 15% commission is an ALP. It was further submitted that the Transfer Pricing Officer (TPO) also accepted the ALP at 15% in AYs 2002-03 to 2004-05.

- The contention of the assessee was supported by the judgements in the cases of Morgan Stanley, BBC Worldwide Limited and Set Satellite that if agent was remunerated at ALP then nothing further could be attributed to the PE.

Tribunal ruling

- On perusal of the agreement, it was noted that:

  - The decision on pricing was controlled by the assessee.

  - Invoices were raised by the assessee. B4U India only obtained approval from the RBI, collected money and remitted it to the assessee.

  - B4U India only forwarded the advertisement to the assessee who had the right to reject. B4U India had no control.

  - Assessee and B4U India were independent of each other.

- Relying on the AAR ruling in case of TVM Ltd.(above), it held that neither there is legal existence of authority to conclude contracts, nor is there any evidence to prove that the agent has habitually exercised such authority. Hence, Article 5(4) of the tax treaty is not attracted in the current case.

- The Tribunal has held that Article 5(5) of the tax treaty refers to the activities of an agent and its devotion to the non-resident. The perspective should be from the angle of the agent and not of the non-resident as has been held by the AAR in the case of Morgan Stanley (above) as against the decision of the Mumbai Tribunal in the case of DHL Operations BV (above) relied upon by the revenue.

- Receipts from the assessee constituted merely 4.69% of the total income of B4U India for the year under consideration, hence, the latter could not be considered as a dependent agent.

- On the alternative argument, it was held that even if the assessee had a PE in India, the rate of commission of 15%, was accepted as an ALP by the TPO for AYs 2002-03 to 2004-05, which is also the rate mentioned in the CBDT Circular no. 742, and therefore, no further profits were attributable to the PE.

- Relying on the judgements in the cases of BBC Worldwide and SET Satellite (above), which are squarely applicable to the facts of this case, it was held that when the payment to an agent is made at ALP then there is no need to attribute any further profits to the PE for the purpose of India tax.

[8] Western Union Financial Services Inc. *v.* ADIT [2007] 104 ITD 84 (Del) In this ruling, it was held that agents in India to whom payments were made for the purpose of money transfer would not constitute DAPE.
[9] DIT *v.* Daimler Chrysler A.G. [2010] 39 SOT 418 (Mum) In this ruling, it was held that agent who were themselves in the business of manufacturing cars could not be held as DAPE of the assessee for rendering preparatory or auxiliary services to the assessee.
[10] DIT *v.* Galileo International Incorporation [2007] 114 TTJ 289 (Del)

PwC's Observation

- In the context of taxation of foreign telecasting companies, the issue of existence of a DAPE on account of advertisement collection agents has been under considerable deliberation. The precedence set in Morgan Stanley, SET Satellite and BBC Worldwide that the arm's length remuneration of the agent extinguishes any further taxation in the hands of non resident has once again been followed in this case by the Mumbai Tribunal. The Tribunal has discussed at length and held that dependency has to be seen from the perspective of the agent and not the non-resident.

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