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

May 8, 2015

In brief

In a recent case of a taxpayer, the Bombay High Court (HC) has held that the taxpayer's advertisement collecting agents in India did not create a dependent agent permanent establishment (PE) under the Double Taxation Avoidance Agreement (tax treaty) between India and Mauritius. It has been further held that where an Indian agent has been remunerated at an arm's length price (ALP), nothing further was left to be taxed in the hands of the foreign enterprise. In adjudicating this matter, the HC relied upon the decision of Supreme Court (SC) in the case of Morgan Stanley & Co. and the Bombay HC in the case of SET Satellite (Singapore) Private Limited.

In detail

Facts

- The taxpayer[1] was a foreign company incorporated in Mauritius. It was engaged in the business of broadcasting television channels.
- The taxpayer appointed two Indian companies as its collecting agent in India.
- Its income consisted of collections from time slots given to advertisers from India through its agent.
- The taxpayer filed its tax return claiming that it did not have a PE in India and therefore had no tax liability in India.
- The tax officer rejected the taxpayer's contention and held that affiliate entities were basically extensions of the taxpayer, and constituted PEs of the taxpayer in India.
- The Commissioner of Income-tax (Appeal) [CIT (A)] and Income-tax Appellate Tribunal (Tribunal) noted that the taxpayer carried out all activities from Mauritius, and that all the contracts were concluded in Mauritius. The only activity that was carried out in India was incidental or auxiliary/ preparatory in nature, which was carried out in a routine manner as per the direction of the principal, without application of mind. Hence, the Indian Company was not a dependent agent. It was further held that where the agent was remunerated at ALP, nothing further was left to be taxed in India.
- The Tribunal dismissed the appeal[2] filed by the Revenue authorities against the order of CIT (A).

[1] TS-246-HC-2015(Bombay)

[2] Refer news alert dated 1 June 2012 for further discussion of this issue.

Issues before the Bombay High Court:

Was the Tribunal correct in holding that:

1. Indian companies could not be treated as dependent agents of the taxpayer despite various clauses in the inter-company agreement demonstrating that they were covered under Articles 5(4) and 5(5) of the treaty;
2. Since the agent was remunerated at arm's length, no further profit was attributable;
3. The taxpayer was not obligated to withhold tax under section 195 of the Income-tax Act, 1961 (the Act) on transponder charges, and thus there could be no disallowance under section 40(a)(i) of the Act; and
4. Transfer of telecasting rights was not liable to tax in India, and thus no withholding of tax under section 195 of the Act was warranted?

Revenue's contentions:

- The Tribunal misapplied and misinterpreted the SC decision in Morgan Stanley & Co.[3] Reliance on a circular[2] from the Revenue/ Board would not suffice because transfer pricing (TP) analysis was not submitted by the taxpayer. Where TP analysis did not adequately reflect the functions performed and risks assumed by the agent, further attribution to PE for those functions/ risks was required.

- The Tribunal erroneously assumed that Indian Companies were not dependent agents of the taxpayer, and erroneously held that the taxpayer was paying remuneration at arm's length.

- Transponder charges were a consideration for process in terms of Explanation 6 to section 9 of the Act. Thus, the taxpayer was obliged to withhold tax under section 195 of the Act. Not having done so, disallowance under section 40(a)(i) of the Act applied.

- Telecasting rights were intangible, and costs incurred were royalties as clarified in Explanation 4 & 5 to section 9 of the Act. Thus, the taxpayer was obliged to withhold tax under section 195 of the Act. Not having not done so, disallowance under section 40(a)(i) of the Act applied.

Taxpayer's contentions:

- The Tribunal had held that Indian companies could not be treated as the taxpayer's dependent agents. Assuming they could be so treated, they had been remunerated at arm's length. Therefore, no further profit was attributable.

- On the issue of ALP, 15% commission to agent was the norm for advertising agencies, and also as determined by the circular[4] referred to in the Tribunal order for assessment year 2001-02.

- The Tribunal found, in respect of Questions 3 and 4, that the sums were not taxable in India.

High Court's decision:

- The Tribunal had correctly held, after referring to clauses in the agreement, that the Indian companies were not decision makers, nor did they have the authority to conclude contracts. Hence, Article 5(4) of the tax treaty was not attracted.

- The HC had relied[5] upon the decisions in Morgan Stanley & Co[3] and SET Satellite (Singapore) Pte. Ltd[6] to hold that the Tribunal's conclusion was consistent with the facts, and the principles of law laid down were neither perverse nor vitiated by any error of law.

- The Tribunal had rightly dealt with the Revenue's alternate argument by referring to the CBDT's circular[5] and taking 15% to be the basis for ALP.

- On Questions 3 and 4, the HC held that they did not require to be answered separately, but consistent with the findings of Question 1 and 2. Once consistent with the findings on the main issue, i.e., PE/ dependent agent, even these questions had to be answered on facts, against the Revenue.

- It clarified that the issue as to whether payments referred to in Questions 3 and 4 could be brought within the meaning of the Explanations[7] could be raised and kept open for being concluded in appropriate case.

The takeaways

In the context of taxation of foreign broadcasting companies, the issue of existence of a dependent agent on account of advertisement collection agent has been the subject matter of considerable litigation.

The HC, on the interpretation of the India-Mauritius tax treaty, has held that no dependent agent PE of foreign company existed in India. The judicial precedents laid down in Morgan Stanley[3] and SET Satellite[6] that the arm's length remuneration of the agent

[3] DIT *v.* Morgan Stanley & Co. [2007] 292 ITR 416 (SC)

[4] Circular No. 742 dated 2 May 1996

[5] Circular No. 23 dated 23 July 1969

[6] SET Satellite (Singapore) Pte Limited *v.* DDIT [2008] 307 ITR 205 (BOM)

[7] Explanation 4, 5 and 6 to section 9 of the Act

extinguishes any further taxation in the hands of a non-resident has been applied in this judgment pronounced by the Bombay HC.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

Tax & Regulatory Services – Direct Tax

Shyamal Mukherjee, *Gurgaon*
+91-124 330 6536
shyamal.mukherjee@in.pwc.com

Ketan Dalal, *Mumbai*
+91-22 6689 1422
ketan.dalal@in.pwc.com

Rahul Garg, Gurgaon
+91-124 330 6515
rahul.garg@in.pwc.com

Our Offices

Ahmedabad

President Plaza
1st Floor Plot No 36
Opp Muktidham Derasar
Thaltej Cross Road, SG Highway
Ahmedabad, Gujarat 380054
+91-79 3091 7000

Bangalore

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bangalore 560 008
Phone +91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai 600 006
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Andhra Pradesh
Phone +91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata - 700 091, West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai - 400 050
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City, Gurgaon
Haryana -122002
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006+91-20
4100 4444

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

About PwC

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 195,000 people who are committed to delivering quality in Assurance, Tax and Advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details. Tell us what matters to you and find out more by visiting us at www.pwc.in