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What's New

Tax Insights

5 May 2023

Supreme Court affirms High Court's decision that attribution of profit is essentially a question of fact

In brief

The Supreme Court[1] dismissed the Revenue's appeal and *inter-alia* held that the question of what proportion of profits can be reasonably attributed to the operations in India is a question of fact; therefore, the Income-tax Appellate Tribunal's (Tribunal) ruling and High Court's decision calls for no interference.

In detail

Facts

- The taxpayer company is engaged in providing electronic global distribution services to airlines through a Computerised Reservation System (CRS). This system is connected to airlines servers, to and from which data is continuously sent and obtained regarding flight schedules, seat availability, etc.
- There is no dispute on the fact that the taxpayer earns an amount of USD3 or EURO3 per booking made in India for providing CRS services.
- The taxpayer has entered into a distribution agreement with the Indian entity to market and distribute the CRS services to the travel agent in India, for which it pays an amount ranging from 33.33% to about 60% of their total earnings.
- During the assessment proceedings, the Tax Officer concluded that income was earned through the hardware installed in the premises of the travel agents; therefore, the total income of USD3 or EURO3 is taxable.
- According to the Tribunal the taxpayer company constituted a fixed place and dependent agent permanent establishment (PE). With respect to the attribution to the PE in India, 15% of the total revenue was assessed as the income accruing or arising in India based on the functions performed, assets used and risks undertaken (FAR).
- The Revenue filed miscellaneous applications, but the Tribunal dismissed these, clarifying that after apportioning the revenue, no further income was taxable in India, as the remuneration paid to the agent in India exceeded the apportioned revenues.

[1] Civil Appeal Nos. 6511-6518/2010

- On further appeal by the Revenue before the Delhi High Court, the court dismissed the appeals on the ground that there is no question of law; as far as attribution is concerned, the Tribunal had adopted a reasonable approach.

Revenue's contentions

- Revenue submitted that the computers placed in the premises of the travel agents and the nodes or leased lines form a fixed place PE of the taxpayer in India.
- The Revenue contended that the attribution of only 15% of the revenue as income accruing or arising in India within the meaning of section 9(1)(i) of the Income-tax Act, 1961 (the Act) read with Article 7 of the India-US Double Taxation Avoidance Agreement (DTAA) is entirely incorrect.

Supreme Court's decision

- The Supreme Court observed that the Tribunal has arrived at the taxpayer's quantum of revenue in India based on the FAR analysis.
- The Supreme Court further observed that the commission paid to the distribution agents by the taxpayer was more than twice the amount of attribution, and this had already been taxed. Consequently, the Supreme Court held that the Tribunal has rightly concluded that the same had extinguished the assessment.
- Moreover, the court held that the question as to what proportion of profits arose or accrued in India is essentially one of the facts and concurrent orders of the Tribunal, and the High Court does not call for any interference.
- The Supreme Court dismissed the Revenue's contention of taxing the entire income of the taxpayer as per the DTAA based on section 9(1) of the Act, which confines the taxable income to the attributable to the operations carried out in India.

The takeaways

This Supreme Court decision affirms the principle that the attribution of profits in relation to the operations carried out in India is essentially a question of fact. Consequently, the Tribunal's finding on the issue of attribution, as the last fact-finding authority, would be very critical for the taxpayer.

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