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TAX FLASH NEWS

13 December 2017

Indian group company of a U.S. entity does not constitute a PE in India under the India-U.S. tax treaty

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of SPE Networks India Inc[1] (the taxpayer) held that an Indian group company of a U.S. company does not constitute a Permanent Establishment (PE) in India under the India-U.S. tax treaty (tax treaty) since the taxpayer was carrying out its operations from the U.S. and not from India. The activities, i.e., sale of advertisement inventory and distribution of channels were not carried out in India and the taxpayer did not have office premises or fixed place of business in India at its disposal. The Tribunal observed that none of the employees are based in India through whom the taxpayer could render the services in India. Further, the revenue earned by the Indian subsidiary was not on behalf of the taxpayer. It was making payment for the purchases, and it was not subject to any control of the taxpayer as far as conducting of business in India was concerned. Further, the activities of the taxpayer were not devoted wholly or almost wholly for the taxpayer.

Facts of the case

- The taxpayer, a U.S. resident, engaged in the business of operating satellite television channels, marketing, and distribution of the television channels. During the year under consideration, the taxpayer was operating two channels namely ANIMAX and AXN. For the purpose of marketing its channels, the taxpayer had appointed SET India Private Ltd. (SET India) as a non-exclusive advertising and sales agent for canvassing airtime for the taxpayer channel on a principal to principal basis.
- The taxpayer had also granted rights to SET India to distribute TV channels in India for an agreed consideration at 70 per cent of the revenues collected by SET India from the distribution of ANIMAX channel in India with a minimum guarantee and 75 per cent of the revenue collected and the bonus fee in the case of AXN channel.
- The taxpayer had claimed that it did not have a PE in India and therefore the income arising to it was not taxable in India under Article 7 of the tax treaty.
- The Assessing Officer (AO) held that the arrangements between the taxpayer and SET India was not of principal to principal and it was about sharing the actual revenue collected from advertisers and the cable operators. The taxpayer had a business connection in India, and hence, the income attributable to the business operations of the taxpayer was taxable in India. The taxpayer also had a dependent agent PE in India under Article 5(4) of the tax treaty. As per Rule 10 read with Rule 10(iii) of the Income-tax Rules, 1962 (the Rules) the AO estimated the taxpayer's income at 10 per cent of gross advertisements as well as subscription revenue received by SET India on behalf of the taxpayer in India.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

[1] SPE Networks India Inc. v. DCIT (ITA No. 652/Mum/2014) [2017-TII-208-ITAT-MUM-INTL

Tribunal's decision

- From the perusal of the agreements, it becomes clear that the taxpayer was carrying out its operation from U.S. and not from India. Both the activities, i.e., Sale of advertisement inventory and distribution of AXN and ANIMAX channels were not carried out in India. The taxpayer did not have any office premises or a fixed place of business in India at its disposal, and none of its employees were based in India through whom it could render the services in India. Thus, it has been held there was neither fixed base PE nor service PE of the taxpayer in India.

- Though the CIT(A) has endorsed the view of the AO that the taxpayer had agency PE, but nothing has been brought on record to prove that the agreements between the taxpayer and SET India was not on principal to principal basis. SET India had no authority to conclude any contract on behalf of the taxpayer in India.

- On the other hand, while selling the airtime inventory and distributing AXN and ANIMAX channels in India, SET India would act in its own right and not on behalf of the taxpayer. It was not dependent on the taxpayer economically or legally. It is also a fact that SET India also carried out significant marketing and estimation activities for other channels namely Set, Set Max and HBO. Therefore, SET India has to be treated as an independent entity which carried out its own business employing its own capital and bearing connected risks. It cannot be treated an agent, a dependent agent, of the taxpayer. SET India would purchase airtime from the taxpayer and would sell the same in India in its own right, and the taxpayer had no control over it.

- The Tribunal observed that the revenue earned by SET India was not on behalf of the taxpayer. It was making payment to the taxpayer for the purchases made by it. It was not subject to any control of the taxpayer as far as conducting of business in India was concerned. The activities of SET India were not devoted wholly or almost wholly for the taxpayer.

- The Tribunal has also taken note of the facts that the revenue of the taxpayer was not entirely dependent on the earning of SET India. The employees of SET India would work only for SET India and not for any other entity of the group. The lower authorities have not alleged that the transaction between the taxpayer and SET India were not at arm's length. Further, in the Transfer Pricing (TP) orders the TPOs[2] have held that no TP adjustments were required to be made to the income of the taxpayer on account of advertisement revenue or distribution revenue.

- Since the taxpayer did not have business connection India as well as agency PE/fixed base PE and SET India was not an agent of the taxpayer, it has been held that the AO had wrongly invoked the provisions of Rule 10[3] of the Rules.

Our comments

Selling advertisement time through Indian companies is a common practice followed by global channel operating companies. The Mumbai Tribunal in the case of NGC Asia Network LLC[4] held that the Indian group company of a foreign company had been habitually exercising in India an authority to conclude contracts on behalf of the foreign company which are binding on the foreign company. Therefore, the Indian company has been treated as a dependent agent PE in India under the India-U.S. tax treaty. However, the Mumbai Tribunal in the case of B4U International Holdings Ltd.[5] held that the Indian agents of a Mauritian company do not create an agency PE under the India-Mauritius tax treaty since they neither have authority to conclude contracts nor habitually exercise such authority.

The Mumbai Tribunal in the present case held that the Indian group company of the U.S. company did not constitute a PE in India under the India-U.S. tax treaty since the taxpayer was carrying out its operations from the U.S. and not from India. The activities, i.e., sale of advertisement inventory and distribution of channels were not carried out in India, and it did not have office premises or fixed place of business in India at its disposal.

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[2] (AY.s. 2005-06, 2006-07, 2007-08, 2008-09 and 2010-11)

[3] Rule 10 - Where the AO is of the opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or kind cannot be definitely ascertained, the amount of such income for the purpose of assessment to income-tax may be calculated –
(i) at such percentage of the turnover so accruing or arising as the AO may consider to be reasonable, or
(ii) on any amount which bears the same proportion to the total profits and gains of the business of such person, as the receipts so accruing or arising bear to the total receipts of the business, or
(iii) in such other manner as the AO may deem suitable.

[4] NGC Asia Network LLC v. JDIT [2016] 175 TTJ 403 (Mum)

[5] DDIT v. B4U International Holdings Ltd. [2012] 148 TTJ 274 (Mum)

www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur
Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara
iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672