Tax Hotline

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MUMBAI TRIBUNAL HOLDS ARM'S LENGTH PAYMENT TO DEPENDENT AGENT DOES NOT EXTINGUISH LIABILITY OF A PERMANENT ESTABLISHMENT

The Mumbai tax tribunal ("**Tribunal**") has recently held in case of SET Satellite (Singapore) Pte. Ltd. ("**SET**") that payment of arm's length price to the dependent agent does not extinguish the tax liability of the foreign company in India. The Tribunal has endorsed the 'dual entity approach' and held that dependent agent Permanent Establishment ("**PE**") is distinct from the dependent agent and both can be taxed separately in India. This means even though arm's length price is paid to a related entity in India by a foreign company, additional tax can be imposed on the foreign company's revenues earned from India. This ruling is likely to increase tax uncertainties in India, thus increasing business risks for foreign companies doing business in India through a dependent agent.

The ruling comes in the middle of a raging controversy on attribution of income to a PE. Recently, the Authority for Advance Rulings had held in the case of Morgan Stanley that if the Indian company is paid an arm's length price, no further attribution can be made to the PE in India. The tax office had appealed to the Supreme Court of India on this issue, and a ruling is expected shortly.

In this case, SET was a telecasting company tax resident in Singapore. SET had appointed an agent in India for marketing airtime slots and the agent constituted a dependent agent PE. SET argued that as it remunerated the Indian agent at an arm's length price, nothing further would be attributable to it in India. In arriving at this position SET relied on Circular no. 23 of 1969 and Circular no. 5 of 2004 (which was a clarification on the taxation in case of outsourcing industry) issued by the Central Board of Direct Taxes.

The Tribunal decided the case against SET holding that the 'dependent agent' and the 'dependent agent PE' were two different tax payers. The income earned from India by the dependent agent PE would be taxable in India and a deduction would be allowed for the payment made to the dependent agent.

In coming to this conclusion the Tribunal relied on the OECD Report on 'Attribution of Profits to PE', and the Australian Tax Office paper on the attribution of profits in case of dependent agent PE. In countering the argument that, as stated in the OECD Report a change in the language of the tax treaty currently in place between India and Singapore would be required in order for the report to be applied, the Tribunal held that the language of the treaty as it currently stands merits this interpretation.
The Tribunal thus seems to have departed from the single tax payer approach thus far followed in India, and adopted the dual tax payer approach advocated by the OECD. It remains to be seen which approach the Supreme Court of India will take with regard to the issue. This decision is likely to impact many foreign companies which are doing business in India through dependent agents.

- **Annapoorna Jayaseelan** & **Shefali Goradia**

Source: ***ITA No. 205 and 535 / Mum / 04***

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