

# Tax Hotline

August 23, 2008

## BOMBAY HIGH COURT UNDERScores MORGAN STANLEY'S RULE OF SINGLE ENTITY ATTRIBUTION

The Revenue has time and again tried to challenge the rule laid down in Morgan Stanley. Earlier this year, the Revenue had filed a review petition against the said judgment, which was dismissed by the SC. The judgment of the HC only re-iterates and fortifies the rule that an arm's length relationship between a non-resident enterprise and its PE in India absolves the non-resident enterprise from any tax liability in India.

On Friday, August 22, 2008, a division bench of the Bombay High Court ("**HC**") comprising of Justice Rebello and Justice Mohite set aside the order of the Income Tax Appellate Tribunal ("**Tribunal**") in the case of SET Satellite

(Singapore) Pte. Ltd ("**Appellant**")<sup>1</sup>.

In this case, the Appellant was a telecasting company, which was a tax resident in Singapore. The Appellant had appointed SET India Pvt. Ltd. as an agent ("**Agent**") for marketing airtime slots in India. The Agent constituted a dependent agent PE under Article 5(8) of the Double Tax Avoidance Agreement between India and Singapore ("**Treaty**"). According to the Appellant, it had remunerated the Agent at an arm's length price, and therefore nothing further would be attributable to India. In arriving at this position the Appellant had relied on Circular no. 23 of 1969 and Circular no. 5 of 2004 issued by the Central Board of Direct Taxes.

The Tribunal had earlier held, adopting the dual entity approach, that a foreign company with an Indian dependent agent permanent establishment ("**PE**") would continue to be liable to tax in India even after it remunerated the dependent agent at arm's length. The Tribunal had held that 'dependent agent' and 'dependent agent PE' were two different tax payers, and the remuneration of the former on an arm's length basis did not extinguish the liability of the latter.

The above decision of the Tribunal was in stark contrast to the single entity approach followed in India, which was subsequently confirmed by the Supreme Court of India ("**Supreme Court**") in the case of Morgan Stanley<sup>2</sup>. In Morgan Stanley, which was pending for judgment at the time of the judgment of the Tribunal, the Supreme Court confirmed the single entity approach while ruling that once a transfer pricing analysis is undertaken, there is no further need to attribute profits to a PE.

The HC, relying on the precedent laid down in Morgan Stanley, has now set aside the order of the Tribunal. It has held that if the correct arm's length price is applied and paid, then nothing further would be left to be taxes in the hands of the foreign enterprise. This judgment re-iterates and fortifies the rule that an arm's length relationship between a non-resident enterprise and its Indian PE absolves the non-resident enterprise from any tax liability in India.

- Dhruv Sanghavi & Hariharan Gangadharan

1. [2007] 106 ITD 175

2. (2007) 7 SCC 1

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