Profit attribution to a PE

1. Case laws

(i) Dy Director of Income Tax v SET Satellite Singapore Pte Ltd (Mum - ITAT)

- The concept of Dependent Agent Permanent Establishment ('DAPE') is wholly hypothetical and fictional. Dependent Agent ('DA') and DAPE are two taxable units distinct from each other.

- What is defined as a DAPE is not the dependent agent, per se, but, on the contrary, it is by virtue of an enterprise having a DA that the enterprise is deemed to have a DAPE.

- DAPE must be visualised on the basis of presence of the Foreign Co as projected through the PE, which in turn depends on Functions-Assets-Risks ('FAR') by the Foreign Co in respect of business carried on through a PE.

- The tax liability of the assessee in respect of its DAPE is not extinguished by making an arm's length payment to the DA.

- Discusses the ATO ruling, OECD approach and the IFA Congress approach of profit attribution to DAPE.

- <u>Profit attribution</u>

  Presumptive basis @ 10% as per CBDT Circular No. 742 ⇒
  due to absence of information.

(ii) Nokia/ Motorola Inc v. DCIT (Del SB) 95 ITD 269 [20% of profits]

- <u>Activities undertaken by the PE</u>

  – Network planning;
  – Negotiations in connection with the sale of equipments; and
  – Signing of the supply and installation contracts in India

- <u>Accordingly, 20% profits held attributable to the PE, computed as follows</u>

  – Out of Global net profit, proportionate part attributable to Indian sales treated as total Indian net profit
  – 20% of such total Indian net profit attributed to the PE

- <u>20% arrived at as follows</u>

  – 10% towards network planning and negotiations; and
  – 10% towards signing of the contracts

(iii) DCIT v. Metapath Software International Ltd (Del) 9 SOT 305 [8% of turnover]

- <u>Facts</u>

The assessee was in the business of trading in hardware. The assessee had deputed 2 employees to India for a period of 1 year. Their salaries were borne by the assessee.

- Activities undertaken by the PE in India

These employees did the negotiations of contracts on behalf of the assessee.

- Profit attribution

The deputed employees constituted a service PE in India in terms of the India-UK treaty. Since the assessee traded in hardware and as evidenced by its financial statements, a profit @ 12% of turnover was reasonable from the supply of hardware. As the employees in India were merely doing the negotiations of contracts, the profits attributable to the PE ware held to be 8% of the turnover.

Applied: Rule 10(ii) of the Income Tax Rules, 1962 and Explanation 1 to sec 9(1) of the Income tax Act, 1961.

(iv) CIT v. Bertrams Scott Limited (Cal) 62 CTR 11 [10% of profits]

- Profit attribution

  – While deciding the case, the Tribunal earlier stated – "*Neither the department nor the assessee could give us any relevant particulars. Taking everything into consideration and looking particularly into the large number of items of services in the schedule of the agreement which relate to services to be rendered outside India as compared to the comparatively fewer services that are to be rendered in India, we feel that **10%** of what had been estimated by the Income-tax Officer as net profits of those years would be a proper estimate of the assessee's income that had accrued or arisen in India to be accordingly brought to tax.*"

  – The HC held – "*The findings of the Tribunal as recorded in its judgment noted above have not been challenged by the revenue and they have become final. It appears to us that the Tribunal had materials on record on the basis of which the Tribunal had materials on record on the estimate of the appropriation of profits which would be said to have accrued, arisen and taxable in India. The decision of the Tribunal cannot be said to be improper or illegal and needs no interference.*"

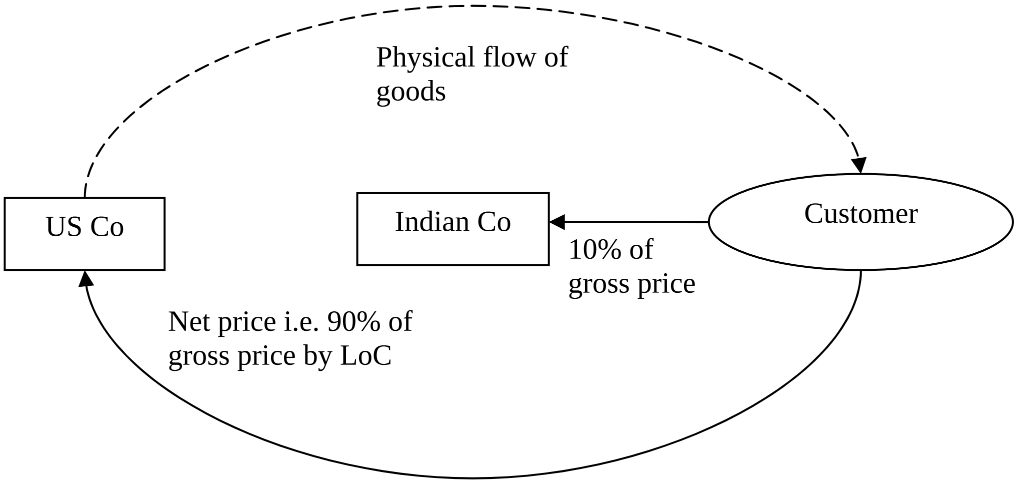
(v) Ingersoll Rand v. ITO (Bom); 4 ITD 654 [10% of profits]

- Facts

The assessee, a US Co, had entered into an agreement with an Indian Co. That agreement described the Indian Co as a 'dealer'. The US Co. would 'sell to the dealer for resale, goods and manufactures as covered by discount sheets' attached to the agreement 'to execute orders for the goods placed by Indian Co, and the US Co would charge Indian Co at net prices and list prices as per price list, less discounts'.

As a matter of practice, the discount allowed to the Indian Co was 10 per cent.

The mechanics were as follows:



The Indian Co was held to be an agent of the US Co.

- Activities undertaken by the PE in India

  Indian Co carried out procurement/ booking of orders and negotiations for purchase with prospective buyers.

- Profit attribution

  – Since procurement of orders and negotiations are the only activities in India, attribution cannot be more than 10%. Since the Indian Co gets a commission of 10%, no liability for Indian taxation for US Co.

  – Reliance placed on CBDT *Circular: No. 23 [F. No. 7A/38/69-IT (A-II)], dated 23-7-1969* which states that –

    "(c) Where a non-resident's sales to Indian customers are secured through the services of an agent in India, the assessment in India of the income arising but of the transaction will be limited to the amount of profit which is attributable to the agent's services, provided that: (a) the non-resident principal's business activities in India are wholly channelled through his agent; (b) the contracts to sell are made outside India; and (c) the sales are made on a principal-to-principal basis. In the assessment of the amount of profit, allowance will be made for the expenses incurred, including the agent's commission, in making the sales. ***If the agent's Commission fully represents the value of the profit attributable to his service, it should prima facie extinguish the assessment****."*

(vi) Anglo French Textiles v. CIT (SC); 23 ITR 101 [10% of profits]

- Held

  It is not every business activity of a manufacturer that comes within the expression "operation". Activities, which are not well defined or are of a casual or isolated character, would not ordinarily fall within the ambit. In a case where there are a few transactions of purchase of raw materials it cannot ordinarily be said that the isolated acts are in their nature "operations".

In this case, the raw materials were purchased systematically and habitually through an established agency having special skill and competency in selecting the goods to be purchased and fixing the time and place of purchase.

There was a regular agency established in British India (taxable territory) for the purchase of the entire raw materials required for the manufacture abroad and the agent was chosen by reason of his skill, reputation and experience in the line of trade. Thus, the agency was an active business connection.

Profits accrue or arise to the appellant from three business processes or operations, those being (1) the purchase of cotton in British India ; (2) its conversion by the process of manufacture in Pondicherry into yarn or cloth; and (3) the sale of the merchantable product, and those have to be apportioned between these three operations.

Profits can be attributed to purchase of raw material in the taxable territory through a business connection. The SC maintained that 10% of the profits were attributable to that part of the business operations which were carried out in British India.

Applied: Section 42(3) of the Indian Income-tax Act, 1922

(vii) Annamalais Timber Trust v. CIT (Mad); 41 ITR 781 [10% of profits]

- Facts

  – After considerable negotiation, including a conference in which the assessee, a representative of a trading corporation and the Government of India participated, the assessee obtained a contract for the execution of works.

  – The assessee was entitled to some special rights under the contract and the contract provided for close collaboration between the assessee and the Government of India at all stages in the work.

  – The assessee was entitled to 10 per cent of the cost of production as profits which had to be shared with the trading corporation which provided trained personnel to supervise the construction of the works.

  – All the trading operations took place outside the taxable territories. All the profits from the trading operations were realised and received by the assessee outside the taxable territories.

- Activities undertaken within taxable territories

  Negotiation and conclusion of contract.

- Profit attribution

  Taking the special features of the contract into consideration, the High Court held that something more than nominal should be attributable. Accordingly, 10 per cent of the assessee's share of profits of the trading operations was attributable.

  The HC, however, categorically stated as under:

"We should like to guard ourselves at his stage by emphasising that all our observations are only with reference to the contract before us. We are not to be understood as laying down as a proposition of law of general application to all cases where a contract for execution of works takes place within the taxable territories and all the other operations take place outside the taxable territories."

Applied: Section 42(3) of the Indian Income-tax Act, 1922 and *Anglo French Textiles v. CIT (SC)*

(viii) Bikaner Textile Merchants Syndicate Ltd. vs. CIT (Raj); 058 ITR 0169 [20% of profits]

- Facts

  – The company was formed because there was acute scarcity of cloth in the then Bikaner State

  – The quota of cloth allotted to the State of Bikaner by the authorities concerned in British India would be procured by the company. It was stipulated that the company would sell the cloth procured by it to retailers at 12% above the mill price, but that a part of that income would be apportioned under various heads enumerated in the scheme, leaving a net profit of 1% to the company.

  – Tribunal held that there was a business connection. As there was acute scarcity of cloth in the Bikaner State, the profits could be attributable to the assessee's ability to secure the commodity by purchase in British India. The Tribunal took the view that the profits which arose to the assessee could be ascribed to the purchase operations alone, and maintained the order of the Appellate Assistant Commissioner in regard to the rate of 20 per cent.

- Activities undertaken within taxable territories

  Purchase of commodities

- Profit attribution

  The HC held as under:

  "In the instant case, there was an acute shortage of cloth and the assessee had virtually a monopoly for its import and its profits were assured as soon as it procured the cloth under the permits which were granted to it for its import from British India…..

  This is, therefore, a case in which the ***department's assessment of the profits at 20% cannot be said to be improper or arbitrary,*** *for the assessee had no other operations to perform in order to earn the profit once it had procured the cloth from British Indi*a."

  Applied: Section 42(3) of the Indian Income-tax Act, 1922

(ix) Blue Star Engineering Co. (Bombay) (P.) Ltd. vs. CIT (Bom); 073 ITR 0283 [25% of profits]

- Facts

– An assessment was made on the assessee as the agent of a foreign entity M/s. Veerenigde Erstshandel Maatschappij NV (‘VEM’).

– The assessee undertook to study and advise VEM on the possibility of acquisition of iron and manganese ore mines in India and to supervise the execution of contracts concluded by VEM with the Indian exporters of ores as to quantity, quality, time of delivery and transport until FOB steamer.

– The Income-tax Officer estimated the total profits of VEM on the goods imported from India at 10% of their export price and 25% of the said profits as attributable to the purchasing activity in connection with the procurement of raw material in the taxable territories. According to him the assessee's connection extended to the whole of the said purchase activity, and consequently the entire amount of 25% of the total profits estimated by him could be said to be taxable income under section 42 of the Act.

- Profit attribution

The HC held as under:

*“**25%**, no doubt, is some guess-work done by the Income-tax Officer, but substituting it by 10% again would be nothing more than indulging in further guesswork. There is no material before us which would show the total extent of the business activity of the non-resident. We do not know whether its business activity consisted of merely purchasing of ore in markets; whether it could profitably purchase and sell it in other markets, where it could be sold at a profit, or whether the ore procured by it from the taxable territories was for the purpose of manufacture of goods and the manufacture and the sale of the finished goods were also parts of its business activity. We also do not know the entire extent of the business of the non-resident. If the assessee had supplied proper material before the income-tax authorities on the basis of which a more definite and certain apportionment could have been made, the position would have been different.”*

Applied: Section 42(3) of the Indian Income-tax Act, 1922

(x) CIT vs. Indian Textile Engineers Pvt. Ltd. (Bom); 141 ITR 0069

- Facts

– The assessee-company is a selling agent of Platt Bros (Sales) Ltd in India. Platt Bros (Sales) Ltd is in turn a subsidiary of Textile Machinery Makers Ltd. Both these companies are registered in UK.

– Section 20 of the Finance Act, 1953, of the UK makes a provision for a subvention payment to one associated company, in respect of losses that may be incurred by it, by other associated companies. Accordingly, Textile Machinery Makers Ltd entered into an agreement with its subsidiaries for making subvention payments

– Platt Bros (Sales) Ltd accordingly received certain subvention payments. While determining its Indian tax liability, the ITO and the AAC treated this receipt as part of its income. However, the Tribunal held that it could not be treated as an income in the hands of that company.

- Profit attribution

  – The subvention payment is intrinsically linked with the loss suffered by the company on account of bad debts. If this loss is not to be considered as a trading loss for the purpose of income-tax, then the receipt also cannot be considered as a trade receipt, because the receipt is by way of reimbursement of that loss. The receipt, therefore, is de hors the trading activity of the company as far as the provisions of the IT Act are concerned. Such a receipt cannot be considered as a receipt by way of income.

  – The HC also commented that - *"To ascertain the world income of the assessee, one must necessarily take into account receipts and outgoings outside India. They cannot be ignored. It is possible that in a given case a non-resident company may carry on diverse business activities which are separable and in respect of which it has kept separate accounts. Out of its several businesses, it may carry on only one business in India. In such a case, if an activity is carried on wholly outside India, it may be ignored while arriving at the calculation of the profits of the non-resident in India ; for example, if a company carries on the business of manufacturing shoes as well as armaments and it keeps separate accounts in respect of both these activities, then if such a company only carries on the activity of manufacturing shoes in India, it may be possible to say that for the purpose of r. 10(ii) the activity of manufacturing armaments may be ignored for arriving at the income of the company in India."*

  – Applied: Section 9 of the Indian Income-tax Act, 1961 read with Rule 10(ii) of the IT Rules, 1962

(xi) Hukam Chand Mills Ltd. vs. CIT (SC); 103 ITR 0548

- Facts

  – The appellant company manufactured textiles in its mills at Indore outside British India and sold its goods to merchants in British India during 1941, 1942 and 1944 to 1946. The sales were of four categories:

    (a) Sales pursuant to business canvassed by appellant's representatives in British India;

    - The assessee's paid representatives at Bombay canvassed the sales, on behalf of the assessee, to merchants in British India.
    - The orders were sent by British Indian merchants to the assessee at Indore.
    - The assessee accepted the orders at Indore, prepared the contracts and signed them at Indore and forwarded the same to customers in British India.
    - The customers signed the contracts in British India.
    - The contracts were signed on the company's forms.
    - The contracts bore British Indian stamps.

(b) Sales through brokers and agents in British India;

- The brokers in British India, described as freelance brokers, transmitted the offers to the company at Indore.
- The offers were made to the company on the brokers' own forms.
- The brokers were not engaged by the assessee-company and such orders were placed by the brokers in the normal course of their business.
- The customers signed the contracts in British India.

(c) and (d) sales to British Indian merchants or their brokers during their visit at Indore.

- The sales were made to British Indian merchants who went to Indore to negotiate and place orders.
- The orders were accepted at Indore.
- The contracts bore British Indian stamps.
- The customers signed the contracts in British India.

– The Appellate Tribunal held that in respect of categories (a) and (b) it was just and equitable to apportion 15% of the profits to have accrued or arisen in British India and that in respect of categories (c) and (d) 7.5% could be said to have accrued or arisen in British India.

▪ Held

– The question as to what proportion of the profits of the sales in the several categories arose or accrued in British India was essentially one of fact depending upon the circumstances of the case. In the absence of some statutory or other formula, any finding on the question of proportion involved some element of guess work. The endeavour could only be to be approximate and there could not in the very nature of things be great precision and exactness in the matter. As long as the proportion fixed by the Tribunal is based upon relevant material, it should not be disturbed.

– Based on the facts, that it was just and equitable to apportion 15% of the profits of sales in categories (a) and (b) and 7.5% of the profits of sales in categories (c) and (d) as accruing or arising in British India.

– Applied: Rule 33 of the Indian Income-tax Rules, 1922 (corresponding to Rule 10 of the Income tax Rules, 1962)

(xii) CIT v N K Jain (Del) 206 ITR 0692

▪ Facts

The assessee, a non-resident, carried on business in readymade garments in Japan. He had an arrangement with a commission agent in India to purchase readymade garments on his behalf and export them to him. The agent also purchased dress material on the instructions of the assessee, got them stitched into garments through tailoring establishments in India and exported the garments to the assessee

- Held

  – The case of the assessee was clearly covered by clause (b) of the Explanation to section 9(1)(i). No income shall be deemed to accrue or arise in India to a non-resident which accrued through or from operations which were confined to the purchase of goods in India for the purpose of export.

  – Reliance was also placed on CBDT Circular No. 20 dated July 7, 1964. In the said Circular, it was, inter alia, stated that "*any non-resident will not be liable to tax in India on any income attributable to operations confined to purchase of goods in India for export, even though the non-resident has an office or agency in India for the purpose, or the goods are subjected by him to any manufacturing process before being exported from India* ".

(xiii) CIT vs. Shinwa Kaium Kaisha Ltd. (Cal); 165 ITR 0270

- Facts

  – M/s. Shinwa Kaium Kaisha Ltd., the assessee, is a non-resident shipping company incorporated in Japan.

  – For the assessment year 1971-72, the ITO computed the income received or deemed to be received in India by the assessee under rule 10(ii) of the Income-tax Rules, 1962.

  – The total receipts of the business of the assessee were ascertained at Rs. 46,333,095,484 being only the receipts on account of freight. The receipts accruing or arising in India only on account of freight received or deemed to have been received in India was ascertained at Rs. 4,594,480,546. The proportion of the said two figures was applied to the total profits and gains of the assessee to arrive at the profits and gains assessable in India.

  – The ITO had excluded, inter alia, the additions following the adjustment of foreign currency, compensation received on account of general average and interest earned on discount. It was contended that the said items were included in the world profits of the assessee and held to be incidental to its shipping business and hence, the amounts constituting the said items should also be included in the total business receipts as otherwise the proportion calculated would be prejudicial to the interests of the assessee.

  – The AAC as well as the Tribunal ruled in favour of the assessee and directed the ITO to recompute the income.

- Held

  – The other items like interest on discount, adjustment of currency and general average have obviously arisen in connection with the shipping business of the assessee and have been received or deemed to have been received by the assessee in its business and made assessable to tax.

– The formula laid down by rule 10(ii) is only to determine as to which part of such total income has accrued or has arisen or is received or would be deemed to be received in India within the meaning of section 5. Explanation 2 to section 5(2), in our view, makes the matter absolutely clear.

– The items in dispute which have been held to be included in the total income of the assessee must necessarily be considered to be the receipts of its business.

– Applied: Rule 10(ii) of the Income tax Rules, 1962

(xiv) Ostime (Inspector of Taxes) vs Australian Mutual Provident Society; 1959 (3) All ER 245

Rule 3.(1) Where an assurance company not having its head office in the United Kingdom carries on life assurance business through any branch or agency in the United Kingdom, any income of the company from the investments of its life assurance fund (excluding the annuity fund, if any), wherever received, shall, to the extent provided in this rule, be deemed to be profits comprised in this Schedule and shall be charged under this Case. (2) Such portion only of the income from the investments of the life assurance fund for the year preceding the year of assessment shall be so charged as bears the same proportion to the total income from those investments as the amount of premiums received in that year from policy holders resident in the United Kingdom and from policy holders resident abroad whose proposals were made to the company at or through its office or agency in the United Kingdom bears to the total amount of the premiums received by the company: Provided that in the case of an assurance company having its head office in any British possession, the Commissioners of Inland Revenue may, by regulation, substitute some basis other than that herein prescribed for the purpose of ascertaining the portion of the income from investments to be so charged as being income derived from business carried on in the United Kingdom. (3) Every such charge shall be made by the Special Commissioners as though the company under the provisions of this Act had required the proceedings relating to the charge to be had and taken before those commissioners. (4) Where a company has already been charged to tax, by deduction or otherwise, in respect of its life assurance business, to an amount equal to or exceeding the charge under this rule, no further charge shall be made under this rule, and where a company has already been so charged, but to a less amount, the charge shall be proportionately reduced.

- UK – Australia DTAA

Respondent is an Australian enterprise and, therefore, comes within the regulation of art III (2) that its commercial profits are not to be subject to United Kingdom tax at all unless it is engaged in business here through a permanent establishment here. It is conceded that its branch office is such an establishment and, therefore, the second part of the regulation applies and tax may be imposed on the respondents commercial profits by the United Kingdom, but only on so much of them as is attributable to that establishment. It is not left wholly to the will of the United Kingdom taxing authorities to decide the basis on which that attribution of commercial profits is to be made. Article III (3) provides by its terms for a basis which, in effect, requires the hypothesis that the branch is an independent enterprise dealing as an independent entity at arms length with the head office.

- India – Swiss DTAA

  Article 7 : Business profits - 1. The business profits of an enterprise of a Contracting State, other than the profits from the operation of ships in international traffic, shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment.
  2. Where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

- India – Ireland DTAA

  Article 7 : BUSINESS PROFITS - 1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may also be taxed in the other State but only so much of them as is attributable to that permanent establishment.
  2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

(xv) Ellerman Lines Ltd. vs. CIT (SC); 082 ITR 0913

- Facts

  – The appellant was a non-resident British shipping company whose ships ply in waters all over the world including the Indian waters.

  – The Income-tax Officer computed its total income taxable under the Indian Income-tax Act, 1922 by taking into account the ratio certificates issued by the Chief Inspector of Taxes, UK, which were based on the assessments made on the appellant in UK.

  – The certificates issued by the Chief Inspector contained the percentage ratio of the total world profits of the appellant to its world earnings and similarly the percentage ratio of the wear and tear allowance and the investment allowance to its total world earnings.

  – The ITO computed the Indian income as per Rule 33(ii); but in computing the Indian earnings, he did not include the destination earnings received in India, ie freight received in Indian ports in respect of cargo loaded at non-Indian ports nor did he take into account the investment allowance granted to the appellant in its U. K. assessments.

– The Tribunal ruled in favour of the assessee on both the questions. The HC, however, answered the first question in favour of the assessee and the second in favour of the revenue.

- Held

– The profits of the assessee-company were not computed in accordance with the provisions of the Act. Hence, rule 33(ii) cannot be applied. That being so the computation of the appellant's income had to be made either under the first basis, viz, the calculation of the profits and gains on such percentage of the turnover accruing or arising as the Income-tax Officer may consider to be reasonable or on the third basis, ie, "in such other manner as the Income-tax Officer may deem suitable".

– Since the ITO had not adopted the first basis, the most appropriate basis was the last basis.

– While adopting that basis, the ITO is not required to rigidly apply the various conditions prescribed in the Act in the matter of granting one or the other of the permissible allowances. He may adopt any equitable basis so long as that basis does not conflict either with rule 33 or with the instructions or directions given by the Board of Revenue. The power given to the ITO under that basis is a very wide power.

– Both questions answered in favour of the assessee.

– Applied: Rule 33(iii) (*" in such other manner as the Income-tax Officer may deem suitable"*) of the Indian Income-tax Rules, 1922 (corresponding to Rule 10 of the Income tax Rules, 1962)

(xvi) ITO v. Intercontinental Hotels (Del); 4 ITD 334 [5% of receipt / profits]

- Facts

The assessee, a US Co entered into membership and service agreements with two Indian hotels. According to the agreement, the Indian hotels would be entitled to, inter alia, use the word "Intercontinental". No business connection was found.

- Profit attribution

Only a small percentage was attributable for the right to use the word "Intercontinental" – 5% of receipts.

2. Australian Tax Office ('ATO') Ruling

- Step 1: Undertake a functional analysis, which attributes to the PE the functions performed, assets used and risks assumed ('FAR') by the enterprise in respect of the business it carries on through the PE.

- Step 2: Undertake a comparability analysis, which determines an arm's length return for the FAR attributed to the PE.

- In performing this process, it is critical to properly distinguish between two different taxpayer enterprises with different FAR and, invariably, different taxable profits, that is:

ForCo, vide its DAPE	SubCo, vide its agency activities
The FAR of the DAPE are the FAR of the ForCo	The FAR of the DA is in respect of the agency activity
Profit attributable to DAPE is an arms' length profit for the FAR of ForCo in respect of agency activity performed by SubCo on behalf of ForCo	Profit attributable to DA is the arms' length profit for SubCo

3. Circulars

Guidelines for the purpose of proper and efficient management work of the assessment of foreign telecasting companies:

It is seen that out of the gross amount of bill raised by a foreign telecasting company, the advertising agent retains commission @ 15% or so. Similarly, the Indian agent of the foreign telecasting company retains his service charges @ 15% or so of the gross amount. The balance amount of approximately 70% is remitted abroad to the foreign company. So far as the income of Indian advertising agent and the agent of the non-resident telecasting company are concerned, the same is liable to tax as per the accounts maintained by them. As regards the foreign telecasting companies which are not having any branch office or permanent establishment in India, tax has to be deducted and paid at source in accordance with the provisions of section 195 by the persons responsible for paying or remitting the amount to them.

In the absence of country-wise accounts and keeping in view the substantial capital cost, installation charges and running expenses, etc., in the initial years of operations, it would be fair and reasonable if the taxable income is computed at 10% of the gross receipts (excluding the amount retained by the advertising agent and the Indian agent of the non-resident foreign telecasting company as their commission/charges) meant for remittance abroad. The Assessing Officer shall accordingly compute the income in the cases of the foreign telecasting companies which are not having any branch office or permanent establishment in India or are not maintaining country-wise accounts by adopting presumptive profit rate of 10% of the gross receipts meant for remittance abroad or the income returned by such companies, whichever is higher and subject the same to tax at the prescribed rate, *i.e.*, 55% at present.

It has also been decided that while assessing the income in the aforesaid manner, penalty proceedings may not be initiated in the cases in which taxes due alongwith the interest are paid voluntarily within 30 days of the date of issue of this circular.

It is clarified that these guidelines would be applicable to all pending cases irrespective of the assessment year involved until 31st March, 1998 after which the position with regard to the reasonableness of the rate of profits of such companies will be reviewed ***- Circular : No. 742, dated 2-5-1996.***

CLARIFICATION ONE

The Central Board of Direct Taxes *vide* Circular No. 742, dated 2-5-1996 (*see* above) had laid down certain guidelines for the computation of profits of FTCs from advertisement payments received by them from India. These guidelines were extended till further orders by Circular No. 765, dated 15-4-1998. The Central Board of Direct Taxes hereby withdraws the above Circular with effect from 31-3-2001.

The total income of FTCs from advertisements hitherto computed on a presumptive basis shall now be determined by the Assessing Officers in accordance with the other provisions of the Income-tax Act, 1961 in relation to assessment year 2002-2003 and subsequent assessment years. In case accounts for Indian operations are not available, the provisions of rule 10 of the Income-tax Rules, 1962 may be invoked. Where an FTC is a resident of a country with whom India has a Double Taxation Avoidance Agreement (DTAA), its business income (including receipts from advertisement) can be taxed only if it has a Permanent Establishment in India. Therefore, the taxability of an FTC in this regard shall be determined on the facts and circumstances of each case. Taxation of FTCs who are residents of countries with whom India does not have a DTAA, shall be governed by the provisions of section 5 read with section 9.

It may be reiterated that the guidelines for computation of profits of FTCs in Circular Nos. 742 and 765 were applicable only to the income stream from advertising. Other kinds of income like subscription charges receivable from cable operators in respect of pay channels and income from the sale or lease of decoders, etc., shall continue to be taxed in accordance with the guidelines stated above ***- Circular No. 6/2001, dated 5-3-2001.***

4. Reference books

(i) *Law relating to transfer pricing – Pradeep Shah & Rajesh Kadakia*

(ii) *Master Guide to Income-Tax Act, 1961 (Finance Acts 2001 and 2002) – Commentary on transfer pricing provisions*

- Definition of "Permanent Establishment" under the Act – refer relevant treaty

(iii) *Transfer pricing – technical position paper*

- Definition of "Permanent Establishment" under the Act – reference to a tax treaty for interpreting the same may be inappropriate.

(iv) *Transfer pricing – Mukesh Butani*

(v) *Law of transfer pricing – D.P. Mittal*

- Where a PE is found to exist, the amount of profit attributable to the PE is normally determined under the rules corresponding to those governing transfer pricing between related companies. (pg 218)

(vi) *Taxation of permanent establishment – Radhakishan Rawal*

- If sales are recognised in the Indian books, the entrepreneurial rewards will come to the Indian PE in terms of the Act. (pg 76)

- Section 9(1) and Article 7 of the DTAA contain the same principle for attribution of profits. (pg 77)

- Sections 44AA, 44AB and 145 of the Income tax Act and sections 594 and 600 of the Companies Act facilitate maintenance of books of accounts in respect of Indian operations. Only if profits cannot be definitely ascertained, Rule 10 can be invoked. Out of the three methods in Rule 10, the proportionate method as per Rule 10(ii) is preferred if world accounts are available.

- Arm's length consideration and profits attributable (pg 201)

  – CBDT Circular No 23 dated 23 July 1969.

  – CBDT Circular No 4 of 1958 dated 24 February 1958.

  – CBDT Circular No 1/2000 dated 2 January 2004.

  – Ingersoll Rand v ITO (Mum ITAT) 4 ITD 654

  – Conclusion – "Arm's length profits" and "profits attributable to the activities in India" refer to the same amount of profits.

- Profit attribution – a guesswork (pg 228). Methods of profit attribution:

  – Resources deployed as a basis of attribution

  – Salaries paid-cost incurred as a basis of attribution

- Outsourcing cost as a basis of attribution
- DTAA method

- A better view seems to be that the presence of employees or presence of dependent agent does not amount to a PE in terms of the existing definition of the Act. (pg 398)

- Although the Act does not so imply, PE and HO are two separate entities as per Circular No 14 of 2001 and DTAA. (pg 407)

- Calculation of profits arising to a PE from its transactions with the HO under the provisions of the Act would be at par with such calculation under the provisions of the DTAA after the introduction of transfer pricing provisions. To the extent there are differences between the two, the one, which is more beneficial to the taxpayer, would prevail in terms of section 90(2) of the Act. (pg 443)