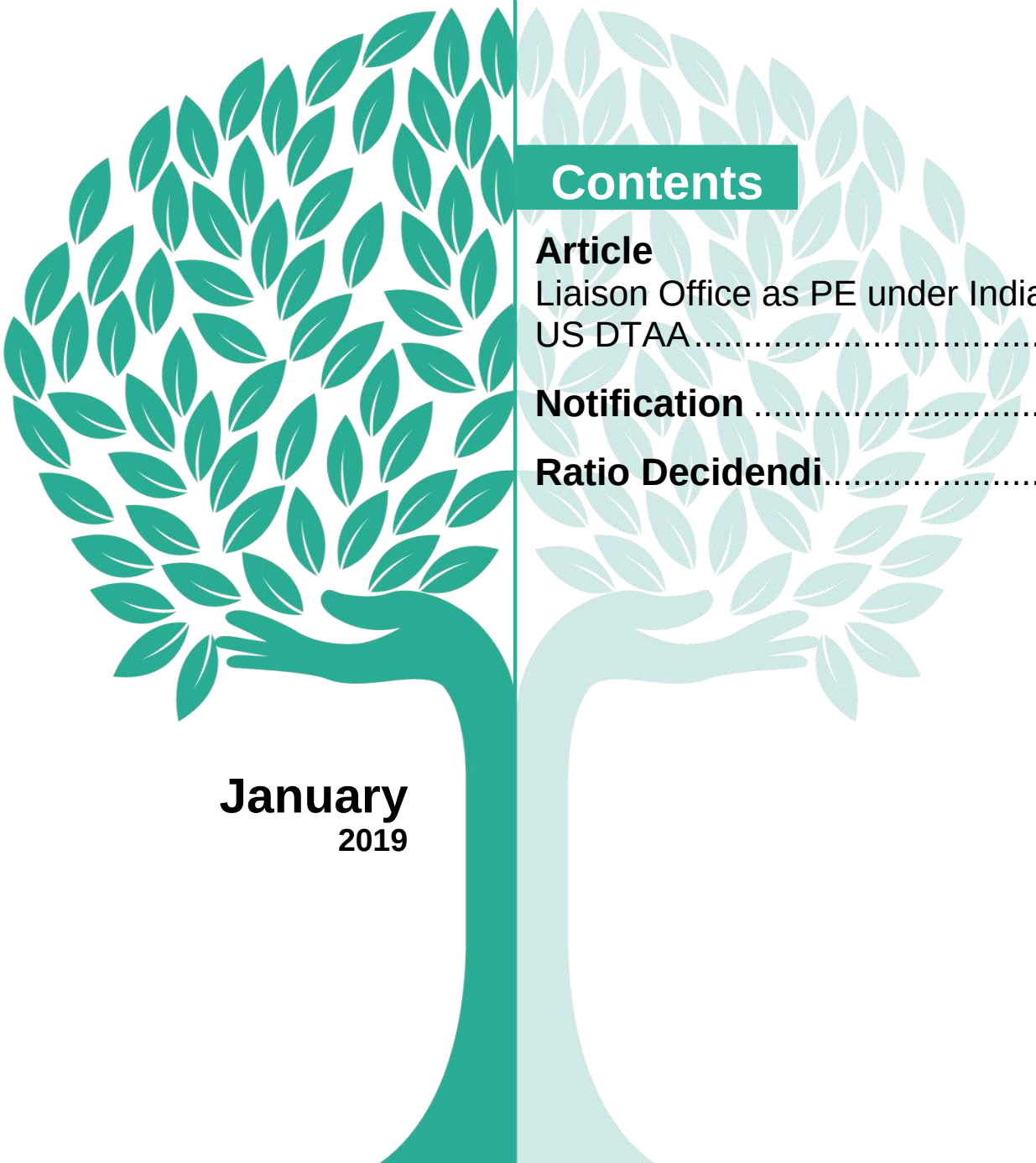
Lakshmikumaran & Sridharan attorneys

Direct Tax

amicus

An e-newsletter from
Lakshmikumaran & Sridharan, India

January 2019 / Issue–52



Contents

January
2019

Article

Liaison Office as PE under India-US DTAA

By **Tanmay Bhatnagar**

A liaison office is defined under the Foreign Exchange Regulations as a place of business, which is meant to merely act as a channel of communication between the Head Office and other entities in India. Such liaison office is not supposed to undertake any commercial /trading/ industrial activity and does not have any independent source of revenue other than inward remittances received from Head Office.

The failure to comply with the said restriction by a liaison office would not only impact the permission granted by the RBI under the Foreign Exchange Management Act, 1999, but can also lead to tax implications under Income-tax law, since carrying out commercial activities can result in the constitution of a permanent establishment ('PE') as has been envisaged in the various Double Taxation Avoidance Agreements ('DTAAs') entered into by India.

GE Energy Parts Ltd. v. CIT

Questions regarding the activities of a liaison office and whether the same would result in the constitution of a PE under the India -US DTAA arose before the Delhi High Court in the recent case of *GE Energy Parts Ltd. v. CIT: [2019] 101 taxmann.com 142 (Delhi)*. The appellants in this group of appeals were the General Electric group of companies ('GE Overseas'). The ITAT had previously held that GE Overseas had a fixed place PE as well as a dependent agent PE ('DAPE') in India. The findings of the ITAT have been upheld by the High Court on both counts.

Fixed Place PE

On the question of whether the liaison office set-up by GEIOC, a member of GE Overseas, constituted a fixed place PE, the High Court firstly held that GE Overseas had a 'place of business in India since as per Article 5(1) of the India-US DTAA and OECD Model Tax Convention, a 'place of business' means any premises, facilities or installations used for carrying on the business of the enterprise. The Court placed reliance on the decision of the Apex Court in *Formula One World Championship v. Commissioner of Income Tax: [2017] 390 ITR 199* to hold that having certain premises at its disposal for continuous usage, even without any legal right over the same, would also satisfy the 'place of business' requirement.

In this case, the space leased out for the liaison office by GEIOC, though was also being used by the Indian entity, viz. GE India, was at the constant disposal of the GE staff for their work. As such, the liaison office was held to a 'place of business' of GE Overseas in India.

Further, the High Court rejected the appellant's contentions that the presence of GE India employees could not lead to the conclusion that sales were being made from the aforesaid premises. It instead held that the core of the sales activity was done from the leased location and that if the premises were not where the relevant business activities occurred, then the location where they did would likely form the fixed place PE.

The contentions of the appellants were twofold:

(a) The activities being carried out were preparatory or auxiliary in nature and thus excluded under Article 5 (3) of the DTAA;

(b) Only the authority to conclude contracts would result in business activities.

However, the Court rejected both the contentions and held that it if an activity is responsible for the realization of profits it is not preparatory or auxiliary and that there was no mention in Article 5(3) of the DTAA regarding the authority to conclude contracts and it was not a necessary condition for the constitution of a fixed place PE.

The Court concluded that the process of sales and marketing of the appellants' products involved complex processes involving technical specifications, commercial terms, financial terms and other policies of GE, which could only be addressed by highly qualified employees and officials. The said employees were involved in not only information gathering and analysis but also participated in intensive negotiations with respect to change of technical parameters of specific goods and products, which had to be made to suit the customers.

Upon perusal of e-mails, self-appraisals of employees and other evidence collected during survey proceedings, the Court noted that these showed important roles were played by GE India employees in the negotiating process. Even though the Indian office could not take a final decision to conclude contracts, important responsibilities relating to finalization of commercial terms were being carried out by employees of GE India from the premises of the liaison office. Consequently, the liaison office was held to constitute a fixed place PE.

Dependent Agent PE

The second question before the Court was whether the activities carried out by the employees of GE India constituted a DAPE under the India-US DTAA.

The contention of the appellant regarding the same was that the OECD Commentary on Model Tax Convention states that mere participation in negotiation would not lead to the implication that there exists an authority to conclude contracts. However, the same was rejected by the Court since other parts of the commentary took a contrary view in that lack of active involvement by an enterprise/principal in transactions may be indicative of a grant of authority to an agent.

Furthermore, reliance was placed by the Court on the decision of an Italian Court in *Ministry of Finance (Tax Office) v. Philip Morris (GmBH): Corte Suprema di Cassazione No. 7682/02* wherein it was held that participation of employees of a resident company "*in a phase of the conclusion of a contract between a foreign company and another resident entity may fall within the concept of authority to conclude contracts in the name of the foreign company.*"

The Court came to the conclusion that the term 'authority to conclude' did not mean all elements and details, since that would make other portion of the clause redundant and therefore, only meant that the activity needed to be core in nature.

The Court subsequently observed that the activities of GE Overseas were such that the employees of GE India had to involve themselves in contract negotiation, which included core or "key" areas, modification of technical specifications and the negotiations for it, to fulfill local needs and regulatory requirements, complex price negotiation, etc. The Court thus held, that such activities were core activities of the business and not merely auxiliary in character.

Interpreting Articles 5(1) and 5(3) of the DTAA, the Court held that considering the nature of activities carried out by employees of GE India, it was clear that there existed authority to conclude contracts on behalf of GE Overseas.

Therefore, by focusing on the nature of activities carried out of the liaison office and by the employees of GE India, the Court held that both a fixed place PE and DAPE were constituted on behalf of GE Overseas in India.

[The author is an Associate, Direct Tax Team, Lakshmikumaran & Sridharan, Delhi]

Notifications

Recognised start-up to get CBDT approval for issue of shares at premium, within prescribed time

The Department of Industrial Policy and Promotion has issued notification dated 16-1-2019 to partly modify the notification dated 11-4-2018 in terms of which start-ups may be able to obtain approval from CBDT for purposes of Section 56(2)(viib) of the Income Tax Act, 1961. The earlier notification to seek approval of CBDT for issue of shares at a premium, required the start-up to apply to the CBDT, to obtain a report from a merchant banker regarding the fair market value of shares and did not provide any time frame within which CBDT granted or declined approval. The notification now states that CBDT may grant or decline approval within a period of 45 days from date of receipt of the application from DIPP which will forward the application of the recognised start-ups. However, if the start-up has already issued shares and the assessment order has been passed for the relevant financial year, the start-up cannot apply for such approval. Further the condition as to obtaining report from merchant banker has been removed.

Ratio Decidendi

Profits from hedging contracts on raw materials are 'derived from' industrial activity

The assessee claimed deduction of profit arising from hedging contracts in respect of raw material contending that such profits were derived from its manufacturing activity/industrial undertaking of manufacturing Lmethnol. The revenue department argued that the income from speculation business could not form part of profit derived from manufacturing business. However, the High Court agreed with the reasoning of the assessee that the hedging contracts had been entered to avoid the effect of high price fluctuation and to ensure predictability in profits derived from it's business and that any loss/reduction in profit due to high price of raw materials would have qualified as business loss. Thus, the fact that profit arose from a hedging

contract would not detract it from being 'derived from' industrial activity. [*Pr CIT* v. *Jindal Drugs Ltd*. - 2019- TIOL-34-HC-Mum-IT]

Reopening of assessment is justified where it is based on findings of the Tribunal in another assessee's case

In the assessment of assessee's son, the AO had treated certain investment as unexplained investment and made addition thereon. On appeal, the Tribunal had deleted such addition on the ground that the assessee and her son, were first and second holder respectively, of such investments and the addition as an unexplained investment, if any, should have been made in the hands of assessee being the first holder and not in the hands of son who was the second holder of such investment.

Based on the aforesaid findings of the Tribunal in the case of Assessee's Son, the AO reopened the assessment of the assessee and made certain additions thereon. The CIT(A) and the Tribunal confirmed the action of the AO. On further appeal, the High Court whilst upholding the reopening, held that the finding of the Tribunal in the case of Assessee's son that the addition on account of unexplained investment can only be made in the hands of Assessee being the first holder of such investment, amounted to 'cause' or 'justification' for the AO to reason to believe that the income of the Assessee with reference to these unexplained investment, has escaped assessment. [*Smt. S. Rajalakshmi* v. *ITO* - ITA 2517 of 2018, decision dated 25th October 2018 (Bombay High Court)]

No separate transfer pricing adjustment on delayed receipt from AE when operating margin is higher than that of comparables

The assessee received certain payments after the date mentioned in the services agreement with the Associated Enterprise (AE). A transfer pricing adjustment was made on account of delayed receipt of receivables from the AE of the assessee by treating the amounts due as unsecured loan and computing interest on the same based on the bank lending rate. However, the assessee argued that such interest was already built into the price charged and also since the operating profit was found to be acceptable, no separate adjustment for interest on outstanding receivables was required. The Tribunal held that no separate adjustment was required following the ratio laid down in *Kusum Healthcare*, 6814/DEL/2014. As regards the contention of the revenue department that it had preferred as SLP against the judgement, the ITAT held that so long as the operation of the judgment of the High Court in *Kusum Healthcare* had not been stayed, it was binding. [*Orange Business Services India* v. *Dy. C.I.T*. - ITA No. 6751/DEL/2018, ITAT Delhi, decision dated 31-12-2018]

Sale of listed shares off market on commercial consideration when not a colourable device

The assessee had sold shares to a group company off market at a price below market value and claimed loss on the transaction. However, it did not claim it as a set off against any other income. The revenue department contended that the said listed shares could have been sold by the assessee on the stock exchange and the transaction was a colourable device. The assessee however put forth an argument that since it was selling a huge number of shares (about 30 lakhs) it wanted to avoid a glut in the market which would have brought down the price of shares. The assessee also argued that the Income Tax Act did not contain

any provision for valuation of quoted shares and the price declared by it may be accepted. The Tribunal accepted the arguments of the assessee and held that since the revenue has not discharged its onus to prove that the assessee had received some benefit over and above the sales consideration, the transaction could not be treated as a sham transaction. [*Aura Securities P Ltd* v. *DCIT* - ITA No.218/AHD/2016, ITAT, Ahmedabad decision dated 31-12-2018]

Rental income received from unsold portion of property constructed by a real estate developer is assessable to tax as income from house property.

The assessee was engaged in the business of development of real estate projects. During the impugned assessment year, the assessee had earned rental income from unsold portion of properties and offered to tax it as 'income from house property'. The AO assessed the said rental income as 'business income'. The CIT(A) and the Tribunal reversed the action of the AO. On appeal, the Bombay High Court held that the assessee was not engaged into the business of letting out properties and therefore, income arising from such letting out, would be assessable as 'income from house property'. The High Court declined to rely on decisions in the case of *Chennai Properties and Investments Limited* v. *CIT* [(2015) 14 SCC 793 (SC)] and *Rayala Corporation Private Limited* v. *ACIT* [(2016) 15 SCC 201 (SC)] on the ground that the assessees' in those cases, were engaged into the business of letting out properties whereas in the present case, the assessee is not engaged into letting out properties. The High Court relied on the judgement in the case of *CIT* v. *Sane & Doshi Enterprises* [(2015) 377 ITR 165]. [*CIT* v. *Gundecha Builder* - ITA No. 347 of 2016 (Bombay High Court)]

First appellate authority cannot add a new source of income to enhance assessment in appellate proceedings

The assessee had received certain property worth about Rs. 12 crores as part of settlement in a suit it had filed against the land aggregator who had failed to procure the land as per the contract. The assessee had advanced about Rs. 1 crore initially. During the proceedings in appeal before CIT(A), the first appellate authority sought to treat the difference between the advance of Rs. 1 crore and the value of property as income of the assessee. The ITAT however held that the power of enhancement vested in the CIT(A) did not extend to introducing a new source of income. It was opined that the assessing officer had already considered the facts but did not treat it as income and it was not open for the CIT(A) to treat the same as income at appellate stage. [*Radiance Realty Developers India Ltd* v. *DCIT* - 2019 (1) TMI 534 - ITAT Chennai]

Delay in filing of appeal to be condoned where appeal on identical issues for earlier assessment years is pending before High Court.

The Assessee had filed the appeal before the High Court with condonation of 1662 days delay in filing the appeal. The reason set out for condonation was that the appeals on identical issues for earlier assessment years have already been admitted and are pending for final adjudication before the High Court. The High Court held that from the stage of AO to the Tribunal, the assessee was represented by the professional and merely because identical issues in earlier assessment years were admitted and are pending, would not amount to *bona fide* reasons for condonation of undue delay of 1662 days. On further appeal, the Supreme Court

however held that where identical issues are already pending, the High Court should not resort to technical views for condonation of delay in filing the appeal. The Supreme Court condoned the delay in filing the appeal before the High Court and directed the appeal to be decided on merits. [*Anil Kumar Nehru through his Power of Attorney Ankit Agrawal* v. *ACIT* - Civil Appeal No(s). 11750/2018 (Supreme Court)]

NEW DELHI
5 Link Road, Jangpura Extension,
Opp. Jangpura Metro Station,
New Delhi 110014
Phone : +91-11-4129 9811

B-6/10, Safdarjung Enclave
New Delhi -110 029
Phone : +91-11-4129 9900
E-mail : lsdel@lakshmisri.com

MUMBAI
2nd floor, B&C Wing,
Cnergy IT Park, Appa Saheb Marathe Marg,
(Near Century Bazar)Prabhadevi,
Mumbai - 400025
Phone : +91-22-24392500
E-mail : lsbom@lakshmisri.com

CHENNAI
2, Wallace Garden, 2nd Street
Chennai - 600 006
Phone : +91-44-2833 4700
E-mail : lsmds@lakshmisri.com

BENGALURU
4th floor, World Trade Center
Brigade Gateway Campus
26/1, Dr. Rajkumar Road,
Malleswaram West, Bangalore-560 055.
Ph: +91(80) 49331800
Fax:+91(80) 49331899
E-mail : lsblr@lakshmisri.com

HYDERABAD
'Hastigiri', 5-9-163, Chapel Road
Opp. Methodist Church,
Nampally
Hyderabad - 500 001
Phone : +91-40-2323 4924
E-mail :lshyd@lakshmisri.com

AHMEDABAD
B-334, SAKAR-VII,
Nehru Bridge Corner, Ashram Road,
Ahmedabad - 380 009
Phone : +91-79-4001 4500
E-mail : lsahd@lakshmisri.com

PUNE
607-609, Nucleus, 1 Church Road,
Camp, Pune-411 001.
Phone : +91-20-6680 1900
E-mail :lspune@lakshmisri.com

KOLKATA
2nd Floor, Kanak Building
41, Chowringhee Road,
Kolkatta-700071
Phone : +91-33-4005 5570
E-mail : lskolkata@lakshmisri.com

CHANDIGARH
1st Floor, SCO No. 59,
Sector 26,
Chandigarh -160026
Phone : +91-172-4921700
E-mail :lschd@lakshmisri.com

GURGAON
OS2 & OS3, 5th floor,
Corporate Office Tower,
Ambience Island,
Sector 25-A,
Gurgaon-122001
phone: +91-0124 - 477 1300
Email: lsgurgaon@lakshmisri.com

ALLAHABAD
3/1A/3, (opposite Auto Sales),
Colvin Road, (Lohia Marg),
Allahabad -211001 (U.R)
phone . +91-0532 - 2421037, 2420359
Email:lsallahabad@lakshmisri.com