REPORTABLE

IN THE SUPREME COURT OF INDIA

CIVIL APPELLATE JURISDICTION

CIVIL APPEAL NO. 6082 OF 2015

Assistant Director of Income Tax-I, New Delhi …Appellant

Versus

M/s E-Funds IT Solution Inc. … Respondent

WITH

CIVIL APPEAL NO. 2962 OF 2016

CIVIL APPEAL NO. 6087 OF 2015

CIVIL APPEAL NO.6102 OF 2015

CIVIL APPEAL NO. 6084 OF 2015

CIVIL APPEAL NO. 6100 OF 2015

CIVIL APPEAL NO. 6094 OF 2015

CIVIL APPEAL NO. 6083 OF 2015

CIVIL APPEAL NO. 6096 OF 2015

CIVIL APPEAL NO. 6089 OF 2015

CIVIL APPEAL NO. 6104 OF 2015

CIVIL APPEAL NO. 6088 OF 2015

CIVIL APPEAL NO. 6091 OF 2015

CIVIL APPEAL NO. 6103 OF 2015

CIVIL APPEAL NO. 6093 OF 2015

CIVIL APPEAL NO. 6085 OF 2015

CIVIL APPEAL NO. 6090 OF 2015

CIVIL APPEAL NO. 6095 OF 2015

CIVIL APPEAL NO. 6099 OF 2015

CIVIL APPEAL NO. 6092 OF 2015

CIVIL APPEAL NO. 6101 OF 2015

CIVIL APPEAL NO. 6097 OF 2015

AND

CIVIL APPEAL NO. 16958 OF 2017
(@S.L.P.(C) NO.27494 OF 2017 (CC NO.19128 OF 2014)

J U D G M E N T

R.F. Nariman, J.

Leave granted.

1. These appeals are from a judgment of the Delhi High Court disposing off several appeals and cross appeals. They

relate to two American Companies which are the assessees in the present case, namely, e-Funds Corporation, USA (relating to assessment years 2000-01 to 2002-03 and 2004-05 to 2007-08) and e-Funds IT Solutions Group Inc., USA (relating to assessment years 2000-01 to 2002-03 and 2005-06 to 2007-08). The appeals from the Income Tax Appellate Tribunal (ITAT) by the assessees were allowed by the High Court, whereas cross-appeals by the department were rejected. After framing several substantial questions of law, the High Court narrated the undisputed facts as follows:

> "6. Undisputed facts in brief may be first noticed. The assessees are companies incorporated in United States of America (USA, for short) and were residents of the said country. They were assessed and have paid taxes on their global income in USA. e-Fund Corp. was the holding company having almost 100% shares in IDLX Corporation, another company incorporated in USA. IDLX Corporation held almost 100% shares in IDLX International BV, incorporated in Netherlands and later in turn held almost 100% shares in IDLX Holding BV, which was a subsidiary again incorporated in Netherlands. IDLX Holding BV was almost a 100% shareholder of e-Funds International India Private Limited, a company incorporated and resident of India (e-Fund International India Private Limited has been described as 'e-Fund India'). IDLX International BV was also the parent/holding company having almost

100% shares in e-Fund Inc., which as noticed above, was a company incorporated in USA.

7. Both e-Fund Inc. and e-Fund Corp. have entered into international transactions with e-Fund India. The details of these transactions have to be examined in depth and have to be referred below. e-Fund India being a domestic company and resident in India was taxed on the income earned in India as well as its global income in accordance with the provisions of the Act. The international transactions between the assessees and e-Fund India and the income of e-Fund India, it is accepted, were made subject matter of arms length pricing adjudication by the Transfer Pricing Officer (TPO, for short) and the Assessing Officer (AO, for short) in the returns of income filed by e-Fund India. We are not primarily concerned with the merits of the computation of income declared and assessed in the hands of e-Fund India in the present appeals, though the factum that e-Fund India was assessed to tax on its global income as per law or on arms length pricing in relation to associated transactions and the basis of the said computation of income earned by e-Fund India, as noticed below, is a relevant and an important fact. Revenue has not disputed the said legal position. It is the contention of the Revenue that income of the two assessees were attributable to India because the two assessees had PE in India and should be taxed in India, irrespective of whether the said assessees had paid taxes in USA. Income earned and taxed in the hands of e-Fund India was different from the income attributable to the two assessees. Thus the balance or differential amount, i.e., income attributable to the two assessees, which was not included in income earned and taxed in the hands of e-Fund India, should be taxed in India.

> 8. As a principle what is stated and submitted by the Revenue cannot be contested and in fact not contested by the assessees as it is a principle applicable to international taxation. A foreign or a non-resident company can be taxed in the country where it has a subsidiary, which is also a PE on the income attributable to the said PE, even if the subsidiary (in the present case of e-Fund India) is being taxed in the said country. The principle being that subsidiary being an independent and a distinct entity is taxed for its income, whereas the foreign entity, i.e., holding company is taxed for the income earned by the said independent entity attributable to the PE in the country where subsidiary is situated. The income of the subsidiary is not taxed in the hands of the non-resident principal and vice-versa. Thus, there is no double taxation in the hands of the holding company as income of the subsidiary is not taxed as income of foreign holding assessee. The principle is that a subsidiary constitutes an independent legal entity for the purpose of taxation."

2. The assessing authority decided that the assessees had a permanent establishment (hereinafter referred to as PE) as they had a fixed place where they carried on their own business in Delhi, and that, consequently, Article 5 of the India U.S. Double Taxation Avoidance Agreement of 1990 (hereinafter referred to as DTAA) was attracted. Consequently, the assessees were liable to pay tax in respect of what they earned from the aforesaid fixed place PE in India. The CIT (Appeals)

dismissed the appeals of the assessees holding that Article 5 was attracted, not only because there was a fixed place where the assessees carried on their business, but also because they were “service PEs” and “agency PEs” under Article 5. In an appeal to the ITAT, the ITAT held that the CIT (Appeals) was right in holding that a “fixed place PE” and “service PE” had been made out under Article 5, but said nothing about the “agency PE” as that was not argued by the Revenue before the ITAT. However, the ITAT, on a calculation formula different from that of the CIT (Appeals), arrived at a nil figure of income for all the relevant assessment years. The appeal of the assessees to the High Court proved successful and the High Court, by an elaborate judgment, has set aside the findings of all the authorities referred to above, and further dismissed the cross-appeals of the Revenue. Consequently, the Revenue is before us in these appeals.

3. The learned Attorney General, Shri K.K. Venugopal, has argued before us that, under Article 5(1) of the DTAA, a fixed place PE has been made out on the facts of these cases, and

relied heavily upon the United States Securities and Exchange Commission Form 10K of e-Funds Corp. dated 31st March, 2003. According to the learned Attorney General:

- Most of the employees are in India (In fact, the High Court records that 40% of the employees of the entire group are in India).
- eFunds Corp has call centers and software development centers only in India.
- eFunds Corp is essentially doing marketing work only and its contracts with clients are assigned, or sub-contracted to eFunds India.
- The master services agreement between the American and the Indian entity gives complete control to the American entity in regard to personnel employed by the Indian entity.
- It is only through the proprietary database and software of eFunds Corp, that eFunds India carries out its functions for eFunds Corp (The High Court records that the software, intangible data etc is provided free of cost and then states that this is irrelevant).

- The Corporate office of eFunds India houses an 'International Division' comprising the President's office and a sales team servicing EFI and eFunds group entities in the United Kingdom, South East Asia, Australia and Venezuela. The President's office primarily oversees operations of eFunds India and eFunds group entities overseas. The sales team undertakes marketing efforts for affiliate entities also.

- The CIT(A) has referred to the Transfer Pricing Report which says that eFunds India provides management support and marketing support services to eFunds Corp group companies outside India. Regarding supervision of personnel rendering the services, the TP Report states as follows:

> *"The President's office manages the operations of eFunds India and eFunds group entities in UK and Australia and accordingly, employees of these entities report to the President. The President's overall reporting is to EFC.*
>
> *Though the personnel rendering marketing services are employees of EFI, they report to overseas group*

entities to the extent that they are engaged in rendering services to such entities."

Applying the above facts, it is submitted that the assessees satisfy the requirements of a fixed place PE. The Supreme Court in the recent judgment in **Formula One World Championship Ltd. v. Commissioner of Income Tax, International Taxation-3, Delhi and others**, (2017) SCC Online SC 474 has held that "it universally accepted that for ascertaining whether there is a fixed place or not, PE must have three characteristics: *stability, productivity and dependence.* Further, fixed place of business connotes existence of a physical location which is at the disposal of the enterprise through which the business is carried on." It was further held that "the physically located premises have to be 'at the disposal' of the enterprise" and that "the place will be treated as 'at the disposal' of the enterprise when the enterprise has right to use the said place and has control thereupon. Consequently, he argued that physically located premises are "at the disposal" of the assessees with the degree of permanence required, namely, the entire year. In addition, he

argued that the High Court was in error in holding that the place of management PE under Article 5(2)(a) was prima facie made out, but since the said provision had not been invoked and requires factual determination, Revenue's argument was dismissed on this score. Further, under Article 5(2)(l) of the DTAA, he argued that a service PE is clearly made out on facts because:

- As per the consolidated Annual Report of eFunds Corp, most of the employees are in India. eFunds Corp has call centers and software development centers only in India.
- eFunds Corp is essentially doing marketing work only and its contracts with clients are assigned, or sub-contracted to eFunds India.
- Regarding supervision of personnel rendering the services, the TP Report states as follows:

> *"The President's office manages the operations of eFunds India and eFunds group entities in UK and Australia and accordingly, employees of these entities report to the President. The President's overall reporting is to EFC.*

Though the personnel rendering marketing services are employees of EFI, they report to overseas group entities to the extent that they are engaged in rendering services to such entities."

- The Master sub-contractor agreement between eFunds Corp and eFunds India discussed in the CIT(A)'s order provides in clause 1.1(a) as follows:

"Subcontractors personnel assigned to work with eFunds IT or Customers located in the United States shall be directed by eFunds IT or by Subcontractors supervisor acting at the direction of eFunds IT. In the event Subcontractors personnel are assigned to perform such services in India, the Subcontractor shall supervise such work, acting at the direction of eFunds IT. eFunds IT shall be the sole judge of performance and capability of each of subcontractors personnel and may request the removal of one or more of Subcontractors personnel from a project covered by any statement of work as follows."

- It is submitted that the personnel engaged in providing these services were ostensibly the employees of eFunds India but were de facto working under the control and supervision of eFunds Corp. In this regard, reference was made to Para 17 of the judgment in **DIT v. Morgan Stanley** (2007) 7 SCC 1, where the Court held:

> "17……It is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or *they continue to have their lien on their jobs with the multinational enterprise, a service PE can emerge."*

- Furthermore, the AO in the Assessment Order has observed that eFunds Corp has seconded two employees to eFunds India and these employees worked as Sr. Director-Technical Services and Country Head-Business Development. The activities of the seconded employees go beyond mere 'stewardship activities' in terms of Morgan Stanley.

- The term ‘Other Personnel’ has to be seen in the context of the facts of this case which show that eFunds India was not an independent subsidiary.

Further, he also argued that a dependent agent PE was made out under Articles 5(4) and 5(5), there being a concurrent finding of facts of the CIT (Appeals) and ITAT in this regard. Also, according to the learned Attorney General, since the assessees failed to furnish information when sought for, an adverse inference was sought to be drawn against them and that, therefore, it is clear that once this inference is drawn, the burden shifts on to the assessees, which they will then have failed to discharge.

4. The learned Attorney General also relied heavily upon an admission made under the mutual agreement procedure (MAP) under Article 27 of the DTAA, in which, for the assessment year 2003-04 qua e-Funds Corp., and assessment years 2003-04 and 2004-05 qua e-Funds IT Solution Inc., the assessees have admitted that income tax will be attributable “to the Indian PEs”

based on a certain ratio and that, therefore, it is clear that this admission would continue to bind the assessees in all subsequent years as there was no change in the factual position.

5. As against this, Shri S. Ganesh, learned senior counsel for the respondents, has argued that the tests for whether there is a fixed place PE have now been settled by the judgment of this Court in **Formula One** (supra), and that it is clear that for a fixed place PE, it must be necessary that the said fixed place must be "at the disposal" of the assessees, which means that the assessees must have a right to use the premises for the purpose of their own business, which has not been made out in the facts of this case. He further argued that, on the facts of this case, both the US companies as well as the Indian company pay income tax, and the Transfer Pricing Officer by his order dated 22nd February, 2006, has specifically held that whatever is paid under various agreements between the US companies and the Indian company are on arm's length pricing and that, this being the case, even if a fixed place PE is found,

once arm's length price is paid, the US companies go out of the dragnet of Indian taxation. He also adverted to Article 5(6) to state that the mere fact that a 100% subsidiary may be carrying on business in India does not by itself means that the holding company would have a PE in India. Further, according to learned counsel, so far as the service PE is concerned, even the assessing officer did not find that such a PE existed. According to him, under Article 5(2)(l), it is necessary that the foreign enterprises must provide services to customers who are in India, which is not Revenue's case as all their customers exist only outside India. Further, according to the learned counsel, the entire personnel engaged in the Indian operations are employed only by the Indian company and the fact that the US companies may indirectly control such employees is only for purposes of protecting their own interest. Ultimately, there are four businesses that the assessees are engaged in, namely, ATM Management Services, Electronic Payment Management, Decision Support and Risk Management and Global Outsourcing and Professional Services. Since all these businesses are carried on outside India and the property

through which these businesses are carried out, namely ATM networks, software solutions and other hardware networks and information technology infrastructure were all located outside India, the activities of e-Funds India are independent business activities on which, as has been noticed by the High Court, independent profits are made and income assessed to tax under the Income Tax Act. According to the learned counsel, "agency PE" was never argued before the assessing officer and even before the ITAT. Therefore, no factual foundation for the same has been laid. Equally, according to the learned counsel, the settlement procedure availed for the assessment years in question cannot be said to be binding for subsequent years as they were without prejudice to the assessees' contention that they have no PE in India. He also relied upon the OECD Commentary, paragraph 3.6 in particular, to demonstrate that the so-called admissions made and relied upon by the three authorities below were correctly overturned by the High Court. Learned counsel also stated that the ground of adverse inference was never argued or put before any of the authorities below, and the only place that it could be found is in the

assessment order for the year 2003-04, which order became non est as it was substituted by the agreement entered into between the parties ending in withdrawal of appeals before the CIT (Appeals). Thus, according to the learned counsel, the view of the High Court is absolutely correct and should not be interfered with. Learned counsel also argued that the cross-appeals of the Revenue were correctly dismissed in that, even though the ITAT decided the case in law against the assessees, yet it found on facts, differing from the calculation formula by the authorities below, that nil tax was payable. This is the only part of the ITAT judgment upheld by the High Court, and should not, therefore, be disturbed in any case.

6. Before we deal with the submissions made on both sides, it is necessary to first set out the statutory background. This is contained in Section 90 of the Income Tax Act, before it was amended in 2009. Section 90(1) and 90(2) of the Income Tax Act, as it then stood, read as under:

"**Section 90. Agreement with foreign countries.—**

1) The Central Government may enter into an agreement with the Government of any country outside India—

(a) for the granting of relief in respect of—

(i) income on which have been paid both income-tax under this Act and income-tax in that country; or

(ii) income-tax chargeable under this Act and under the corresponding law in force in that country to promote mutual economic relations, trade and investment, or

(b) for the avoidance of double taxation of income under this Act and under the corresponding law in force in that country, or

(c) for exchange of information for the prevention of evasion or avoidance of income-tax chargeable under this Act or under the corresponding law in force in that country, or investigation of cases of such evasion or avoidance, or

(d) for recovery of income-tax under this Act and under the corresponding law in force in that country,

and may, by notification in the Official Gazette, make such provisions as may be necessary for implementing the agreement.

(2) Where the Central Government has entered into an agreement with the Government of any country outside India under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, the provisions of this Act shall apply to the extent they are more beneficial to that assessee."

7. Under this provision, the India US Double Taxation Avoidance Agreement of 1990 was made. We are directly concerned with Article 5 of the DTAA, which reads as under:

> "**ARTICLE 5 - Permanent establishment –**
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> 1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
>
> 2. The term "permanent establishment" includes especially:
> (a) a place of management;
> (b) a branch;
> (c) an office;
> (d) a factory;
> (e) a workshop;
> (f) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources;
> (g) a warehouse, in relation to a person providing storage facilities for others;
> (h) a farm, plantation or other place where agriculture, forestry, plantation or related activities are carried on;
> (i) a store or premises used as a sales outlet;
> (j) an installation or structure used for the exploration or exploitation of natural resources, but only if so used for a period of more than 120 days in any twelve-month period;
> (k) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, projects or activities, if any) continue for a period of more than 120 days in any twelve-month period;

(l) the furnishing of services, other than included services as defined in Article 12 (Royalties and Fees for Included Services), within a Contracting State by an enterprise through employees or other personnel, but only if:

(i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or

(ii) the services are performed within that State for a related enterprise [within the meaning of paragraph 1 of Article 9 (Associated Enterprises)].

3. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include any one or more of the following:

(a) the use of facilities solely for the purpose of storage, display, or occasional delivery of goods or merchandise belonging to the enterprise;
(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or occasional delivery;
(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;
(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research or for other activities which have a preparatory or auxiliary character, for the enterprise.

4. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 5 applies -

is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if:

(a) he has and habitually exercises in the first-mentioned State an authority to conclude on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;
(b) he has no such authority but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise, and some additional activities conducted in the State on behalf of the enterprise have contributed to the sale of the goods or merchandise; or
(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise and the transactions between the agent and the enterprise are not made under arm's length conditions, he shall not be considered an agent of independent status within the meaning of this paragraph.

> 6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other."

8. Article 7 has also been referred to, by which the profits of an enterprise of a contracting State may be taxed in the other State only to the extent of so much of the business as is attributable to a permanent establishment in the other State. Article 25 was referred to by the learned Attorney General to counter an argument made by Shri Ganesh based upon affidavits filed before this Court stating that if the assessees were made to pay tax in India, there would be double taxation. Article 25 provides for relief from such double taxation, by which the United States shall allow to a resident or citizen of the United States as a credit against US tax on income tax that is paid to India by or on behalf of such citizen in India. Article 27 is also important and reads as under:

"**ARTICLE 27 - Mutual agreement procedure –**

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. This case must be presented within three years of the date of receipt of notice of the action which gives rise to taxation not in accordance with the Convention.

2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.

3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs. The competent authorities, through consultations, shall develop appropriate bilateral procedures, conditions, methods and techniques for the implementation of the mutual agreement procedure provided for in this Article. In addition, a competent authority may

devise appropriate unilateral procedures, conditions, methods and techniques to facilitate the above-mentioned bilateral actions and the implementation of the mutual agreement procedure."

9. This Article must be read with Rule 44H of the Income Tax Rules, 1962, which reads as under:

"**Action by the Competent Authority of India and procedure for giving effect to the decision under the agreement.**

44H. (1) Where a reference has been received from the competent authority of a country outside India under any agreement with that country with regard to any action taken by any income-tax authority in India, the Competent Authority in India shall call for and examine the relevant records with a view to give his response to the competent authority of the country outside India.

(2) The Competent Authority in India shall endeavour to arrive at a resolution of the case in accordance with such agreement.

(3) The resolution arrived at under mutual agreement procedure, in consultation with the competent authority of the country outside India, shall be communicated, wherever necessary, to the Chief Commissioner or the Director-General of Income-tax, as the case may be, in writing.

(4) The effect to the resolution arrived at under mutual agreement procedure shall be given by the Assessing Officer within ninety days of receipt of the same by the Chief Commissioner or the Director-General of Income-tax, if the assessee,—

(*i*) gives his acceptance to the resolution taken under mutual agreement procedure; and

(*ii*) withdraws his appeal, if any, pending on the issue which was the subject matter for adjudication under mutual agreement procedure.

(5) The amount of tax, interest or penalty already determined shall be adjusted after incorporating the decision taken under mutual agreement procedure in the manner provided under the Income-tax Act, 1961 (43 of 1961), or the rules made thereunder to the extent that they are not contrary to the resolution arrived at.

Explanation.—For the purposes of rules 44G and 44H, "Competent Authority of India" shall mean an officer authorised by the Central Government for the purposes of discharging the functions as such."

10. The Income Tax Act, in particular Section 90 thereof, does not speak of the concept of a PE. This is a creation only of the DTAA. By virtue of Article 7(1) of the DTAA, the business income of companies which are incorporated in the US will be taxable only in the US, unless it is found that they were PEs in India, in which event their business income, to the extent to which it is attributable to such PEs, would be taxable in India. Article 5 of the DTAA set out hereinabove provides for

three distinct types of PEs with which we are concerned in the present case: fixed place of business PE under Articles 5(1) and 5(2)(a) to 5(2)(k); service PE under Article 5(2)(l) and agency PE under Article 5(4). Specific and detailed criteria are set out in the aforesaid provisions in order to fulfill the conditions of these PEs existing in India. The burden of proving the fact that a foreign assessee has a PE in India and must, therefore, suffer tax from the business generated from such PE is initially on the Revenue. With these prefatory remarks, let us analyse whether the respondents can be brought within any of the sub-clauses of Article 5.

11. Since the Revenue originally relied on fixed place of business PE, this will be tackled first. Under Article 5(1), a PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on. What is a "fixed place of business" is no longer res integra. In **Formula One** (supra), this Court, after setting out Article 5 of the DTAA, held as follows:

"32. The principal test, in order to ascertain as to whether an establishment has a fixed place of business or not, is that such physically located premises have to be '*at the disposal*' of the enterprise. For this purpose, it is not necessary that the premises are owned or even rented by the enterprise. It will be sufficient if the premises are put at the disposal of the enterprise. However, merely giving access to such a place to the enterprise for the purposes of the project would not suffice. The place would be treated as '*at the disposal*' of the enterprise when the enterprise has right to use the said place and has control thereupon.

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34. According to Philip Baker, the aforesaid illustrations confirm that the fixed place of business need not be owned or leased by the foreign enterprise, provided that is at the disposal of the enterprise in the sense of having some right to use the premises for the purposes of its business and not solely for the purposes of the project undertaken on behalf of the owner of the premises.

35. Interpreting the OECD Article 5 pertaining to PE, Klaus Vogel has remarked that insofar as the term '*business*' is concerned, it is broad, vague and of little relevance for the PE definition. According to him, the crucial element is the term '*place*'. Importance of the term '*place*' is explained by him in the following manner:

> "In conjunction with the attribute 'fixed', the requirement of a place reflects the strong link between the land and the taxing powers of the State. This territorial link serves as the basis not

only for the distributive rules which are tied to the existence of PE but also for a considerable number of other distributive rules and, above all, for the assignment of a person to either Contracting State on the basis of residence (Article 1, read in conjunction with Article 4 OECD and UN MC)."

36. We would also like to extract below the definition to the expression '*place*' by Vogel, which is as under:

> "A place is a certain amount of space within the soil or on the soil. This understanding of place as a three-dimensional zone rather than a single point on the earth can be derived from the French Version ('installation fixe') as well as the term 'establishment'. As a rule, this zone is based on a certain area in, on, or above the surface of the earth. Rooms or technical equipment above the soil may qualify as a PE only if they are fixed on the soil. This requirement, however, stems from the term 'fixed' rather than the term 'place', given that a place (or space) does not necessarily consist of a piece of land. On the contrary, the term 'establishment' makes clear that it is not the soil as such which is the PE but that the PE is constituted by a tangible facility as distinct from the soil. This is particularly evident from the French version of Article 5(1) OECD MC which uses the term 'installation' instead of 'place'.
>
> The term 'place' is used to define the term 'establishment'. Therefore, 'place'

includes all tangible assets used for carrying on the business, but one such tangible asset can be sufficient. The characterization of such assets under private law as real property rather than personal property (in common law countries) or immovable rather than movable property (in civil law countries) is not authoritative. It is rather the context (including, above all, the terms 'fixed'/'fixe'), as well as the object and purpose of Article 5 OECD and UN MC itself, in the light of which the term 'place' needs to be interpreted. This approach, which follows from the general rules on treaty interpretation, gives a certain leeway for including movable property in the understanding of 'place' and, therefore, we assume a PE once such property has been 'fixed' to the soil.

For example, a work bench in a caravan, restaurants on permanently anchored river boats, steady oil rigs, or a transformator or generator on board a former railway wagon qualify as places (and may also be 'fixed').

In contrast, purely intangible property cannot qualify in any case. In particular, rights such as participations in a corporation, claims, bundles of claims (like bank accounts), any other type of intangible property (patents, software, trademarks etc.) or intangible economic assets (a regular clientele or the goodwill of an enterprise) do not in themselves constitute a PE. They can only form part of PE constituted

otherwise. Likewise, an internet website (being a combination of software and other electronic data) does not constitute tangible property and, therefore, does not constitute a PE.

Neither does the mere incorporation of a company in a Contracting State in itself constitute a PE of the company in that State. Where a company has its seat, according to its by-laws and/or registration, in State A while the POEM is situated in State B, this company will usually be liable to tax on the basis of its worldwide income in both Contracting States under their respective domestic tax law. Under the A-B treaty, however, the company will be regarded as a resident of State B only (Article 4(3) OECD and UN MC). In the absence of both actual facilities and a dependent agent in State A, income of this company will be taxable only in State B under the 1st sentence of Article 7(1) OECD and UN MC.

There is no minimum size of the piece of land. Where the qualifying business activities consist (in full or in part) of human activities by the taxpayer, his employees or representatives, the mere space needed for the physical presence of these individuals is not sufficient (if it were sufficient, Article 5(5) OECD MC and Article 5(5)(a) UN MC and the notion of agent PEs were superfluous). This can be illustrated by the example of a salesman who regularly visits a major customer to take orders, and conducts meetings in the purchasing director's

> office. The OECD MC Comm. has convincingly denied the existence of a PE, based on the implicit understanding that the relevant geographical unit is not just the chair where the salesman sits, but the entire office of the customer, and the office is not at the disposal of the enterprise for which the salesman is working."

37. Taking cue from the word '*through*' in the Article, Vogel has also emphasised that the place of business qualifies only if the place is '*at the disposal*' of the enterprise. According to him, the enterprise will not be able to use the place of business as an instrument for carrying on its business unless it controls the place of business to a considerable extent. He hastens to add that there are no absolute standards for the modalities and intensity of control. Rather, the standards depend on the type of business activity at issue. According to him, '*disposal*' is the power (or a certain fraction thereof) to use the place of business directly. Some of the instances given by Vogel in this behalf, of relative standards of control, are as under:

> "The degree of control depends on the type of business activity that the taxpayer carries on. It is therefore not necessary that the taxpayer is able to exclude others from entering or using the POB.
>
> The painter example in the OECD MC Comm. (no. 4.5 OECD MC Comm. on Article 5) (however questionable it might be with regard to the functional integration test) suggests that the type and extent of control need not exceed the level of what is required for the

specific type of activity which is determined by the concrete business.

By contrast, in the case of a self-employed engineer who had free access to his customer's premises to perform the services required by his contract, the Canadian Federal Court of Appeal ruled that the engineer had no control because he had access only during the customer's regular office hours and was not entitled to carry on businesses of his own on the premises.

Similarly, a Special Bench of Delhi's Income Tax Appellate Tribunal denied the existence of a PE in the case of *Ericsson*. The Tribunal held that it was not sufficient that Ericsson's employees had access to the premises of Indian mobile phone providers to deliver the hardware, software and know-how required for operating a network. By contrast, in the case of a competing enterprise, the Bench did assume an Indian PE because the employees of that enterprise (unlike Ericsson's) had exercised other businesses of their employer.

The OECD view can hardly be reconciled with the two court cases. All three examples do indeed shed some light onto the method how the relative standards for the control threshold should be designed. While the OECD MC Comm. suggests that it is sufficient to require not more than the type and extent of control necessary for the specific business activity which the taxpayer wants to exercise in the source

State, the Canadian and Indian decisions advocate for stricter standards for the control threshold.

The OECD MC shows a paramount tendency (though no strict rule) that PEs should be treated like subsidiaries (cf. Article 24(3) OECD and UN MC), and that facilities of a subsidiary would rarely been unusable outside the office hours of one of its customers (i.e. a third person), the view of the two courts is still more convincing.

Along these lines, a POB will usually exist only where the taxpayer is free to use the POB:

- at any time of his own choice;

- for work relating to more than one customer; and

- for his internal administrative and bureaucratic work.

In all, the taxpayer will usually be regarded as controlling the POB only where he can employ it at his discretion. This does not imply that the standards of the control test should not be flexible and adaptive. Generally, the less invasive the activities are, and the more they allow a parallel use of the same POB by other persons, the lower are the requirements under the control test. There are, however, a number of traditional PEs which by their nature require an exclusive use of the POB by only one taxpayer and/or his personnel. A small workshop (cf. Article 5(2)(e) OECD and UN MC) of 10 or 12 square

meters can hardly be used by more than one person. The same holds true for a room where the taxpayer runs a noisy machine."

38. OECD commentary on Model Tax Convention mentions that a general definition of the term 'PE' brings out its essential characteristics, i.e. a distinct "*situs*", a "*fixed place of business*". This definition, therefore, contains the following conditions:

- the existence of a "place of business", i.e. a facility such as premises or, in certain instances, machinery or equipment;

- this place of business must be "fixed", i.e. it must be established at a distinct place with a certain degree of permanence;

- the carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated."

12. Thus, it is clear that there must exist a fixed place of business in India, which is at the disposal of the US companies, through which they carry on their own business. There is, in fact, no specific finding in the assessment order or the appellate orders that applying the aforesaid tests, any fixed place of business has been put at the disposal of these companies. The assessing officer, CIT (Appeals) and the ITAT have essentially

adopted a fundamentally erroneous approach in saying that they were contracting with a 100% subsidiary and were outsourcing business to such subsidiary, which resulted in the creation of a PE. The High Court has dealt with this aspect in some detail in which it held:

> "49. The Assessing Officer, Commissioner (Appeals) and the tribunal have primarily relied upon the close association between e-Fund India and the two assessees and applied functions performed, assets used and risk assumed, criteria to determine whether or not the assessee has fixed place of business. This is not a proper and appropriate test to determine location PE. The fixed place of business PE test is different. Therefore, the fact that e-Fund India provides various services to the assessee and was dependent for its earning upon the two assessees is not the relevant test to determine and decide location PE. The allegation that e-Fund India did not bear sufficient risk is irrelevant when deciding whether location PE exists. The fact that e-Fund India was reimbursed the cost of the call centre operations plus 16% basis or the basis of margin fixation was not known, is not relevant for determining location or fixed place PE. Similarly what were the direct or indirect costs and corporate allocations in software development centre or BPO does not help or determine location PE. Assignment or sub-contract to e-Fund India is not a factor or rule which is to be applied to determine applicability of Article 5(1). Further whether or not any provisions for intangible software was made or had been supplied free of cost is not the relevant criteria/test. e-Fund India was/is a

> separate entity and was/is entitled to provide services to the assessees who were/are independent separate taxpayers. Indian entity i.e. subsidiary company will not become location PE under Article 5(1) merely because there is interaction or cross transactions between the Indian subsidiary and the foreign Principal under Article 5(1). Even if the foreign entities have saved and reduced their expenditure by transferring business or back office operations to the Indian subsidiary, it would not by itself create a fixed place or location PE. The manner and mode of the payment of royalty or associated transactions is not a test which can be applied to determine, whether fixed place PE exists."

13. It further went on to hold that the ITAT's finding that the assessees were a joint venture or sort of partnership with the Indian subsidiary was wholly incorrect. Also, none of these arguments have been invoked by the Revenue and such a finding would, therefore, be perverse. After citing *Klaus Vogel on Double Taxation Conventions*, *Arvid A. Skaar in Permanent Establishment: Erosion of a Tax Treaty Principle* and **Bollinger vs. Commissioner**, 108 S.Ct. 1173, the High Court found against the Revenue, holding that there is no fixed place PE on the facts of the present case. We agree with the findings of the High Court in this regard.

14. Reliance placed by the Revenue on the United States Securities and Exchange Commission Form 10K Report, as has been correctly pointed out by the High Court, is also misplaced. It is clear that the report speaks of the e-Funds group of companies worldwide as a whole, which is evident not only from going through the said report, but also from the consolidated financial statements appended to the report, which show the assets of the group worldwide.

15. Also, Shri Ganesh has pointed out that the two American companies have four main business activities which are: ATM Management Services, Electronic Payment Management, Decision Support and Risk Management and Global Outsourcing and Professional Services. He was at great pains to point out the report of Deloitte Haskins and Sells dated 13th March, 2009, produced before the CIT (Appeals), in which, on behalf of their American clients, the said firm of Chartered Accountants stated:

> "2. The nature of business under each of the above verticals is detailed below:
>
> **a) ATM Management Services**

eFunds US's ATM Management Services ("ATM Services") segment covers the business of ATM deployment, management and branding services. eFunds US is an independent provider of ATMs and it places ATMs in convenience, grocery, general merchandise, and drug stores as well as gas stations located throughout the United States and Canada. The ATMs run on an operating software which is generally owned by the original ATM manufacturer whereas the datacentre, to which such ATMs are connected, operate on the software platforms such as 'Connex' which have been developed and maintained by eFunds US.

Services provided by eFunds US: eFunds US provided the processing for over 11,000 of the ATM machines in its network. Most of the ATMs were owned by the Appellant and its associate companies. All these ATMs were installed outside India and mainly in United States.

Services provided by eFunds India: The only involvement of eFunds India was responding to queries raised by the customers, if they faced any difficulty in operation of their transaction which was part of activity (d) referred above.

b) Electronic Payment Management

eFunds US's Electronic Payment Management segment provides products and services in two broad categories: Payment Processing Software and Electronic Payment Processing Services. The business involves processing transactions for regional automated teller machine or ATM networks in the United States and also transaction processing for retail point-of-sale terminals that accept payments from debit cards and paper cheques that have been converted into electronic transactions.

Processing Services: eFunds US processes transactions for regional ATM networks in the United States. They also provide transaction processing for retail point of sale ("POS") terminals that accept payments from debit cards and paper cheques that have been converted into electronic transactions. Transaction processing involves electronically transferring money from a person's checking or savings account according to his or her instructions. To carry out the tasks required, each ATM or POS device is typically connected to several computer networks. None of these networks is installed in India. These networks include private networks that connect the devices of a single owner, shared networks that serve several device owners in a region, and national shared networks that provide access to devices across regions. Each shared network has numerous financial institution members. eFunds US provides its Customers with access across multiple networks.

eFunds US's Government services EBT (Electronic Benefits Transfer) business was started in response to federal mandates that require state and local Governmental agencies to convert to electronic payment methods for the distribution of benefits under entitlement programs, primarily food stamps and Transitional Aid to Needy Families. The EBT processing system manages, supports, and controls the electronic payment and distribution of cash benefits to program participants through ATMs and POS networks. As mentioned earlier, these are mostly located in USA. In any case, none was located in India.

Software Products: eFunds US develops and sells electronic funds transfer software, Connex and Architect, used in electronic payment services to in-

house processors and regional networks in 23 foreign countries and in the United States. None of the software products of eFunds US was licensed or installed in India. This software runs on IBM and Tandem computing platforms. eFunds US also provides software maintenance and support services as part of its Global Outsourcing business. eFunds US has developed various other software/solutions.

Services provided by eFunds US: eFunds US was responsible for Customer Interface and customization of products and services as per the dictates of the Customer. Agreement/contracts with the Customer were entered into by eFunds US. All risks and responsibilities for performance of the Contract at all times were of eFunds US only. All Software's/solutions are developed by eFunds US. Software writing and conceptualization of ideas were done by eFunds US. All Networks and Infrastructure for this category of services is owned by eFunds US only. Connex was developed by a company acquired by eFunds US. eFunds US's associate company in United Kingdom has developed and owns the Architect software which is middleware used primarily by financial institutions in Europe (there is one customer in Chicago). This software runs on IBM and Tandem computing platforms. All of them were located outside India.

In accordance with the terms of the contract with Government Agencies, eFunds US is responsible for management, support and control of the electronic payment band distribution of cash benefits to program participants through its ATM and point of sale network.

Services provided by eFunds India: eFunds India provided testing, bug fixing and other related

software development support services to eFunds US for various software/software based solutions developed by eFunds US. Such services are required by eFunds US in the course of development of software/software based solutions and their use in providing services to customers. The process of development of software/solutions involves testing the same with sample data to determine the workability of the software. Further, certain errors or bugs may be found in the software/solutions at such eFunds US avails the services of eFunds India for bug fixing.

The work performed by eFunds India for eFunds Government Services Business (EBT Processing) was limited to responding to the inbound calls made to its call centre for enquiry on non-acceptance of cheques and opening of accounts.

c) Decision Support & Risk Management

eFunds' US Decision Support & Risk Management ("Risk Management") segment provides risk management-based data and other products to financial institutions, retailers and other businesses that assist in detecting fraud and assessing the risk of opening a new account or accepting a cheque. This segment offers products and services that help determine the likelihood of account fraud and identity manipulation and assess the overall risks involved in opening new accounts or accepting payment transactions.

SCAN: SCAN or Shared Cheque Authorization Network, helps retailers reduce the risk of write-offs for dishonoured cheques due to insufficient funds and other forms of account fraud or identity manipulation. When a cheque is presented as payment at the point-of-sale, SCAN members run

the cheque through a scanner. The information on the cheque is then compared to the SCAN database to determine whether there have been payment problems with the cheque writer or his or her account. SCAN then reports any issues to the retailer and the merchant decides whether or not to accept the cheque.

ChexSystems: The ChexSystems business is a provider of new account applicant verification services for financial institutions. ChexSystems provides access to more than 17 million closed-for-cause account histories and has recorded 124 million new account enquiries. An account is considered closed-for-cause when, for example, a consumer refuses to pay the account fee and the bank closes the account. ChexSystems helps financial institutions immediately assess the risks involved in opening an account for a new customer by supporting real-time enquiries to its database of consumer debit account performance. ChexSystems' database includes account history data provided by or purchased from financial institutions and other data purchased from third parties including driver's license data, deceased person's records and suspect address lists. All such data base relates to the persons located in the US and the customers of this data base were banks and retailers located in the US.

Services provided by eFunds US: eFunds US was responsible for Customer interface and agreement/contracts with the customers were entered into by eFunds US. All risks and responsibilities for performance of contracts at all times were of eFunds US only. All eFunds risk management services are based on, or enhanced by eFunds' proprietary DebitBureau database, which is located in data centres of the group

situated in USA. DebitBureau contains over three billion records and includes data form eFunds ChexSystemsSM and SCANSM databases and other sources. The data in DebitBureau is used to screen for potentially incorrect, inconsistent, or fraudulent social security numbers, home addresses, telephone numbers, driver license information, and other indicators of possible identity manipulation. Using this data, eFunds US can perform various tests to validate a consumer's identity and assess and rank the risk of fraud associated with opening an account for or accepting a payment from that consumer. eFunds US software development centers in the United States, as well as in the U.S. data centers and remotely at the customers' sites develop and maintain software for these service offerings.

Services provided by eFunds India: The work performed by eFunds India involved responding to the inbound calls made by the customers located outside India to customer support center of eFunds US. These calls were routed to eFunds India for enquiry on non-acceptance of cheques and opening of accounts.

eFunds India also provided software support services for SCAN and Chex process. eFunds India was only involved in bug fixing and software maintenance.

d) **Global Outsourcing Services & Professional Services**

eFunds US provide its clients with information technology and business process outsourcing services to complement and support its electronic payments business. Its business process management and outsourcing services focus on both back-office and customer support business

processes, such as accounting operations, help desk, account management, transaction processing and call center operations. It consists of providing information technology services including maintenance of hardware and networks, installation of eFunds US electronic payment products and the integration of these products within the customer's existing information technology infrastructure. All of these hardwares, networks and information technology infrastructure were located outside India. Professional services include customizing standard eFunds US products and developing new applications for clients who want additional features and functionality and help clients test and refine eFunds US products in their information technology environments. In addition, it also covers providing on-site user training on eFunds US products and solutions for the information technology, operations and management staff of clients.

Services provided by eFunds US: eFunds US was responsible for Customer Interface and customization of products and services as per the dictates of the Customer. Agreement/ contracts with the customers were entered into by eFunds US. All risks and responsibilities for performance of the contracts at all times were of eFunds US only.

Services provided by eFunds India: eFunds US subcontracted part of its responsibilities under professional services contract with some of its customers to eFunds India which involve the following:

- Data Processing Services including making outbound calls to collate data;
- Making soft outbound calls to customers of eFunds US clients to follow up payment; and
- Responding to inbound calls from customers from dealers/customers of telecom services

providers (who are customers of eFunds US), to check on the status of applications made for new connections, change in billing plans etc.

Note: Logica Global, an independent company, had received an order from the Reserve Bank of India for development and implementation of certain software. A part of this work was subcontracted to eFunds India directly by Logica Global. The Appellant had nothing to do with this contract."

16. This report would show that no part of the main business and revenue earning activity of the two American companies is carried on through a fixed business place in India which has been put at their disposal. It is clear from the above that the Indian company only renders support services which enable the assessees in turn to render services to their clients abroad. This outsourcing of work to India would not give rise to a fixed place PE and the High Court judgment is, therefore, correct on this score.

17. Insofar as a service PE is concerned, the requirement of Article 5(2)(l) of the DTAA is that an enterprise must furnish services "within India" through employees or other personnel. In this regard, this Court has held, in **Morgan Stanley** (supra), as follows:

“16. Article 5(2)(*l*) of DTAA applies in cases where MNE furnishes services within India and those services are furnished through its employees. In the present case we are concerned with two activities, namely, stewardship activities and the work to be performed by deputationists in India as employees of MSAS. A customer like MSCo who has worldwide operations is entitled to insist on quality control and confidentiality from the service provider. For example in the case of software PE a server stores the data which may require confidentiality. A service provider may also be required to act according to the quality control specifications imposed by its customer. It may be required to maintain confidentiality. Stewardship activities involve briefing of the MSAS staff to ensure that the output meets the requirements of MSCo. These activities include monitoring of the outsourcing operations at MSAS. The object is to protect the interest of MSCo. These stewards are not involved in day-to-day management or in any specific services to be undertaken by MSAS. The stewardship activity is basically to protect the interest of the customer. In the present case as held hereinabove MSAS is a service PE. It is in a sense a service provider. A customer is entitled to protect its interest both in terms of confidentiality and in terms of quality control. In such a case it cannot be said that MSCo has been rendering the services to MSAS. In our view MSCo is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of MSAS services. We do not agree with the ruling of AAR that the stewardship activity would fall under Article 5(2)(*l*). To this extent we find

merit in the civil appeal filed by the appellant (MSCo) and accordingly its appeal to that extent stands partly allowed.

17. As regards the question of deputation, we are of the view that an employee of MSCo when deputed to MSAS does not become an employee of MSAS. A deputationist has a lien on his employment with MSCo. As long as the lien remains with MSCo the said company retains control over the deputationist's terms and employment. The concept of a service PE finds place in the UN Convention. It is constituted if the multinational enterprise renders services through its employees in India provided the services are rendered for a specified period. In this case, it extends to two years on the request of MSAS. It is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service PE can emerge.

18. Applying the above tests to the facts of this case we find that on request/requisition from MSAS the applicant deputes its staff. The request comes from MSAS depending upon its requirement. Generally, occasions do arise when MSAS needs the expertise of the staff of MSCo. In such circumstances, generally, MSAS makes a request to MSCo. A deputationist under such circumstances is expected to be experienced in banking and finance. On completion of his tenure he is repatriated to his parent job. He retains his lien when he comes to

> India. He lends his experience to MSAS in India as an employee of MSCo as he retains his lien and in that sense there is a service PE (MSAS) under Article 5(2)(*l*). We find no infirmity in the ruling of ARR on this aspect. In the above situation, MSCo is rendering services through its employees to MSAS. Therefore, the Department is right in its contention that under the above situation there exists a service PE in India (MSAS). Accordingly, the civil appeal filed by the Department stands partly allowed."
>
> (at pages 15-16)

18. It has already been seen that none of the customers of the assessees are located in India or have received any services in India. This being the case, it is clear that the very first ingredient contained in Article 5(2)(l) is not satisfied. However, the learned Attorney General, relying upon paragraph 42.31 of the OECD Commentary, has argued that services have to be furnished within India, which does not mean that they have to be furnished to customers in India. Para 42.31 of the OECD Commentary reads as under:

> "Whether or not the relevant services are furnished to a resident of a state does not matter: what matters is that the services are performed in the State through an individual present in that State."

19. Based upon the said paragraph, Shri Venugopal has argued that in assessment year 2005-06, two employees of the American firm were seconded in India and that, therefore, it is clear that management of the American company through these employees has obviously taken place. The High Court, in dealing with this contention, has found as follows:

> "62. The appellants had pleaded before the authorities and the tribunal that prior to assessment year 2005-06 not even a single employee of the assessee ever visited India even for a short period and in 2005-06, two employees of e-Fund were transferred to e-Fund India and that the entire expenditure for these two employees were borne by e-Fund India. No employees were present in India after 2005-06. Presence of employees in India is relevant under Article 5(2)(l) but the said employees should furnish services within the contracting State. These services should not be mere stewardship services. The Assessing Officer has recorded that employees were seconded to e-Fund India but the functions they performed and whether they performed functions and reported to e-Fund Corp/associated enterprise was not known or ascertained. This was not the correct way of determining and deciding whether service PE existed. Whether the seconded employees were performing stewardship services or were directly involved with the working operations was relevant. It is also not known whether the services were performed related to services provided to an associated enterprise in which case clause 5(2)(l)(ii) would be applicable. In the said situation, the

question of attribution of income etc. would also arise.

63. Two employees of e-Fund Corp were deputed to e-Fund India in the assessment years 2005-06. The case of the assessee and e-Fund India is that they were deputed to look towards development of domestic work in India. Payment of these employees as per the Revenue to the extent of 25% was borne by e-Fund India and balance 75% was borne by e-Fund Corp. The Assessing Officer on this basis has observed that this reduced cost base of e-Fund India as remuneration was paid by e-Fund Corp and the said employees were at liberty to perform functions of e-Fund Corp even while working for e-Fund India. The response of the assessee as quoted in the assessment order was that e-Fund India, apart from export activities had also domestic business in India. This was evident from the return of income filed by e-Fund India where domestic income was computed separately as it was not eligible for deduction under Section 10A of the Act. Copy of the return was furnished. It was further stated that cost of personnel seconded in India was fully borne by e-Fund India i.e. 100% of the salary paid to the said employees seconded to India were debited to profit and loss accounts. 75% of the salary component was paid abroad by e-Fund Corp but the same was reimbursed by e-Fund India. This was in accordance with and permitted under the Indian Exchange Control Regulations. It was further stated that the Assessing Officer was wrong in assuming that the two seconded employees were at liberty to function for e-Fund Corp while they were working for e-Fund India. The seconded employees were working under the control and supervision of e-Fund India. The Assessing Officer thereupon has not commented on the reply of the assessee, though he has recorded comments in

> respect of replies to other issues raised by him (see paragraph 7 of the assessment order). The aforesaid factual assertion made by the assessee, therefore, was not negated or questioned by the Assessing Officer."

20. We entirely agree with the approach of the High Court in this regard. Article 42.31 of the OECD Commentary does not mean that services need not be rendered by the foreign assessees in India. If any customer is rendered a service in India, whether resident in India or outside India, a "service PE" would be established in India. As has been noticed by us hereinabove, no customer, resident or otherwise, receives any service in India from the assessees. All its customers receive services only in locations outside India. Only auxiliary operations that facilitate such services are carried out in India. This being so, it is not necessary to advert to the other ground namely, that "other personnel" would cover personnel employed by the Indian company as well, and that the US companies through such personnel are furnishing services in India. This being the case, it is clear that as the very first part of Article 5(2)(l) is not attracted, the question of going to any other part of

the said Article does not arise. It is perhaps for this reason that the assessing officer did not give any finding on this score.

21. Shri Ganesh has argued before us that the "agency PE" aspect of the case need not be gone into as it was given up before the ITAT. He is right in this submission as no argument on this score is found before the ITAT. However, for the sake of completeness, it is only necessary to agree with the High Court, that it has never been the case of Revenue that e-Funds India was authorized to or exercised any authority to conclude contracts on behalf of the US company, nor was any factual foundation laid to attract any of the said clauses contained in Article 5(4) of the DTAA. This aspect of the case, therefore, need not detain us any further.

22. Shri Ganesh has referred to and relied upon an order of the Additional Taxation Commissioner, who is the Transfer Pricing Officer. The said order is dated 22nd February, 2006 and states as under:

> "The taxpayer company filed its return of income with ACIT Circle 11(1), New Delhi. A reference was received from the Assessing Officer to determine

the ‘arm’s length price’ u/s 92CA(3) in respect of ‘international transactions’ entered into by the assessee during the F.Y. 2002-03. In response to notice u/s 92CA, Shri Vijay Iyer, CA of S.R. Batliboi & Co. Chartered Accountants, authorized representative of the assessee appeared form time to time. The documentation prescribed under Rule 10D of the Income Tax Rules was submitted and placed on record.

The taxpayer company is engaged in providing IT enabled services which include Back office services and Call centre services. It also has a software design center for development of software for call centres.

eFunds International (India) Pvt. Ltd. is a wholly owned subsidiary of IDLX Holdings BV, Netherlands. IDLX is a wholly owned subsidiary of eFunds Corp.

The major international transactions undertaken by the assessee during the year is given below:

S.No	**Description of transaction**	**Method**	**Value (In Rs.)**
1.	Financial Shared Services (Back Office)	TNMM	33.9 Cr.
2.	Call Center Services (Shared Service Centre)	TNMM	88.03 Cr.
3.	Software Development (Off-shore for call centres)	TNMM	57.58 Cr.

> In addition to the above the assessee has also provided software development services to overseas eFunds group entities. The international transactions undertaken by the assessee were examined vis-a-vis the method applied by the assessee for arriving at the arm's length price. The assessee has relied on the Transactional Net Margin Method (TNMM) in respect of all the major international transactions.
>
> After examination of the documentation and discussion with the authorized representative of the assessee, no adverse inference is drawn in respect of the Arm's Length Price (ALP) of the international transactions, as declared by the assessee in Form 3CEB, annexed to the return of the Income."

Shri Ganesh is correct in stating that as the arm's length principle has been satisfied in the present case, no further profits would be attributable even if there exists a PE in India. This was specifically held in **Morgan Stanley** (supra) as follows:

> "32. As regards determination of profits attributable to a PE in India (MSAS) is concerned on the basis of arm's length principle we have quoted Article 7(2) of DTAA. According to AAR where there is an international transaction under which a non-resident compensates a PE at arm's length price, no further profits would be attributable in India. In this connection, AAR has relied upon Circular No. 23 of 1969 issued by CBDT as well as Circular No. 5 of

2004 also issued by CBDT. This is the key question which arises for determination in these civil appeals.

(at page 25)

xxx xxx xxx

35. The object behind enactment of transfer pricing regulations is to prevent shifting of profits outside India. Under Article 7(2) not all profits of MSCo would be taxable in India but only those which have economic nexus with PE in India. A foreign enterprise is liable to be taxed in India on so much of its business profit as is attributable to the PE in India. The quantum of taxable income is to be determined in accordance with the provisions of the IT Act. All provisions of the IT Act are applicable, including provisions relating to depreciation, investment losses, deductible expenses, carry-forward and set-off losses, etc. However, deviations are made by DTAA in cases of royalty, interest, etc. Such deviations are also made under the IT Act (for example Sections 44-BB, 44-BBA, etc.).

36. Under the impugned ruling delivered by AAR, remuneration to MSAS was justified by a transfer pricing analysis and, therefore, no further income could be attributed to the PE (MSAS). In other words, the said ruling equates an arm's length analysis (ALA) with attribution of profits. It holds that once a transfer pricing analysis is undertaken, there is no further need to attribute profits to a PE. The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis *taking into account all the risk-taking functions*

> *of the enterprise*. In such cases nothing further would be left to be attributed to PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to PE for those functions/risks that have not been considered. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case. Lastly, it may be added that taxing corporates on the basis of the concept of economic nexus is an important feature of attributable profits (profits attributable to PE)."
>
> (at pages 27-28)

23. As a large portion of Shri Venugopal's argument was in relation to the MAP settlement in the present case, it would be necessary to refer, in some detail, to the documents produced on this account.

24. Resolution dated 23rd April, 2007 passed by the competent authority of India, which was strongly relied upon by Shri Venugopal, is set out hereinbelow:

"**Resolution under Section 90 of Income Tax Act, 1961 read with Article 27 of Indo-USA Double Taxation Avoidance Agreement**

1. The Acting Director (International), Competent Authority of USA initiated Mutual Agreement Procedure in the case of M/s eFunds Corporation and eFunds I.T. Solutions Inc. for the previous year ending 31.03.2003 with the Competent Authority of India under the Double Taxation Avoidance Agreement vide their letter No.SE:LM:IN:T:2:JN dated 8.05.2006. Subsequently, vide letter dated 16.02.2007 Competent Authority of USA initiated Mutual Agreement Procedure for the previous year ending 31.03.2004 in the eFunds I.T. Solution Group Inc. The Competent Authorities of both the countries after having examined the facts of the case and issues involved have arrived at a resolution in terms of Section 90 of Income Tax Act, 1961 read with Article 27 of Indo-USA Double Taxation Avoidance Agreement and Rule 44H of Income Tax Rules, 1962.

2. The Competent Authorities of USA and India have reached an agreement as follows with respect to the tax assessment on M/s eFunds Corporation and eFunds IT Solutions Group Inc.:-

Income will be attributed to the Indian PEs based on the ratio of certain developed and acquired tangible and intangible assets in India and outside India. Out of the total assets for the AY 2003-04, 10.48% of the assets were located in India and accordingly 10.48% of the income would be attributable to India. The percentage attributable to India for the AY ending 2005 was arrived at 11.11%. These percentages will be applied to the base of consolidated gross income as reduced by the income of subsidiary eFunds India Pvt. Ltd. already

reported in India. Thereafter, the total income so attributed will be apportioned between eFunds and IT solutions in the ratio of 85% (to eFunds) and 15% (to IT Solutions) for the AY 2003-04 and 87% (to eFunds and 13% (to IT Solutions) for the AY 2004-05.

In view of the above, the income attributor, as agreed upon is given below:-

	A.Y. 2003-04	A.Y. 2004-05
	Figures in US $ million	Figures in US $ million
Apportionable base income	25.12	30.71
Percentage attributed to India	10.48%	11.11%
Income attributed to India	2.63	3.41
Allocation between IT Solutions and eFunds IT Solutions eFunds	 0.39 (15%) 2.24 (85%)	 0.45(13%) 2.96(87%)

Interest will be chargeable as per provisions of the Income –Tax Act, 1961.

3. The Assessing Officer will give effect to this resolution in terms of clause 4 of Rule 44H of the Income Tax Rules, 1962.

4. Appeals, if any, filed by both the parties will be withdrawn."

25. However, Shri Ganesh stated that this was not the end of the matter as the Department of Treasury in Washington, by a letter dated 7th May, 2007, specifically stated, "although we do not agree on the technical merits that e-Funds and IT Solutions had a PE in India, we reached a mutual agreement with a view to avoid double taxation". Equally the same document states:

> "Effect on Future Years: The competent authority determination made herein is not binding on subsequent years."

26. To the same effect are the letters dated May 14, 2007 written by e-Funds Corp. to the Deputy Director of International Tax Circle in India. Shri Ganesh has also referred to and relied upon paragraph 3.6 of the OECD Manual on MAP Procedure, which reads as follows:

> "**3.6. Competent Authority Agreements**
>
> Competent authority agreements or resolutions are often case and time specific. They are not considered precedents for either the taxpayer or the tax administrations in regard to adjustments or issues relating to subsequent years or for

competent authority discussions on the same issues for other taxpayers. In fact, the letters exchanged between competent authorities to resolve a case often state as much. This is because the competent authorities have reached an agreement that often takes into account the facts of the particular taxpayer, the differences in the provisions of the tax law in each country, as well as the effects of the economic indicators on the particular transactions at the relevant time. Any review or adjustments of subsequent years by a taxpayer or tax administration is best based upon the particular circumstances, facts and documentary evidence existing for those years."

27. However, the learned Attorney General relied upon paragraph 1.3.1 of the OECD Manual and Best Practice No.3, in particular, which reads as under:

"**Best Practice Nº3: Principled approach to resolution of cases**

In the resolution of MAP cases, a competent authority should engage in discussions with other competent authorities in a principled, fair, and objective manner, with each case being decided on its own merits and not by reference to any balance of results in other cases. To the extent applicable, the Commentary to the OECD Model Tax Convention and the OECD Transfer Pricing Guidelines are an appropriate basis for the development of a principled approach. As part of a principled approach to MAP cases, competent authorities should be consistent and reciprocal in the positions they take and not change position on

> an issue from case to case, depending on which side of the issue produces the most revenue. Although a principled approach is paramount, where an agreement is not otherwise achievable, both competent authorities should look for appropriate opportunities for compromise in order to eliminate double taxation. To the extent possible, competent authorities who face significant recurring issues in their bilateral relationship may wish to reach agreement on the consistent treatment of such issues."

A perusal of the above would show that a competent authority should engage in discussion with the other competent authority in a principled, fair and objective manner, with each case being decided on its own merits. It is also specifically observed that where an agreement is not otherwise achievable, then both parties should look for appropriate opportunities for compromise in order to eliminate double taxation on the facts of the case, even though a principled approach is important. The learned Attorney General also relied upon Best Practice No.1 of the said OECD Manual, which requires the publication of mutual agreements reached that may apply to a general category of taxpayers which would then improve guidance for the future. Best Practice No.1 has no application on the facts

of the present case, as the agreement reached applies only to the respondent companies, and not to any general category of taxpayers. It is clear, therefore, that Shri Ganesh is right in relying upon Article 3.6 of the OECD Manual. It is very clear, therefore, that such agreement cannot be considered as a precedent for subsequent years, and the High Court's conclusion on this aspect is also correct.

28. The learned Attorney General has also laid great emphasis on non-disclosure of documents and has relied upon a long list of documents that the assessees were asked to disclose and which they did not. From this, according to the learned Attorney General, an adverse inference should be drawn, and from this alone it should be inferred that a PE of the assessees, therefore, exists in India. We are afraid that this argument cannot be countenanced at this stage as it has never been raised before any of the authorities below and has not been raised before the High Court also. This being the case, we do not think it necessary to get into this aspect of the matter.

29. Having held in favour of the assessees that no permanent establishment in India can possibly be said to exist on the facts of the present case, we do not deem it necessary to go into the cross-appeals that were filed before the High Court, which were dismissed by the High Court agreeing with the ITAT that the calculation of the ITAT would lead to nil taxation. This point would not arise in view of our decision on the facts of the present case. It is, therefore, unnecessary to go into this aspect of the matter.

30. The appeals are accordingly dismissed with no order as to costs.

…….....J.
(R.F. Nariman)

..…….....J.
(Sanjay Kishan Kaul)

New Delhi;
October 24, 2017.