* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

% **Judgment reserved on: 13 February 2024**
Judgment pronounced on: 28 May 2024

\+ W.P.(C) 12405/2019

PROGRESS RAIL LOCOMOTIVE INC.(FORMERLY ELECTRO MOTIVE DIESEL INC.), ... Petitioner

Through: Mr. Arvind Datar, Sr. Adv. with Mrs. Rubal Bansal Maini and Mr. Prakhar Pandey, Advs.

versus

DEPUTY COMMISSIONER OF INCOME-TAX (INTERNATIONAL TAXATION), CIRCLE - NOIDA & ORS. ..... Respondents

Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan, Advs.

\+ W.P.(C) 12406/2019

PROGRESS RAIL LOCOMOTIVE INC.(FORMERLY ELECTRO MOTIVEDIESEL INC.) ..... Petitioner

Through: Mr. Arvind Datar, Sr. Adv. with Mrs. Rubal Bansal Maini and Mr. Prakhar Pandey, Advs.

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Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan,

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Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan, Advs.

\+ W.P.(C) 12408/2019

PROGRESS RAIL LOCOMOTIVE INC (FORMERLY ELECTRO MOTIVE) ..... Petitioner

Through: Mr. Arvind Datar, Sr. Adv. with Mrs. Rubal Bansal Maini and Mr. Prakhar Pandey, Advs.

versus

DEPUTY COMMISSIONER OF INCOME TAX (INTERNATIONAL TAXATION),CIRCLE-NOIDA & ORS. ..... Respondents

Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan, Advs.

\+ W.P.(C) 12409/2019

PROGRESS RAIL LOCOMOTIVE INC. (FORMERLY ELECTRO MOTIVE DIESEL INC.), ... Petitioner

Through: Mr. Arvind Datar, Sr. Adv. with Mrs. Rubal Bansal Maini and Mr. Prakhar Pandey, Advs.

versus

DEPUTY COMMISSIONER OF INCOME-TAX (INTERNATIONAL TAXATION), CIRCLE - NOIDA & ORS. ..... Respondents

Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan, Advs.

\+ W.P.(C) 12410/2019

PROGRESS RAIL LOCOMOTIVE INC. (FORMERLY ELECTRO MOTIVE DIESEL INC.), ... Petitioner

Through: Mr. Arvind Datar, Sr. Adv. with Mrs. Rubal Bansal Maini and Mr. Prakhar Pandey, Advs.

versus

DEPUTY COMMISSIONER OF INCOME-TAX (INTERNATIONAL TAXATION), CIRCLE - NOIDA & ORS. ..... Respondents

Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan, Advs.

\+ W.P.(C) 12411/2019

PROGRESS RAIL LOCOMOTIVE INC. (FORMERLY ELECTRO MOTIVE DIESEL INC.), ... Petitioner

Through: Mr. Arvind Datar, Sr. Adv. with Mrs. Rubal Bansal Maini and

Mr. Prakhar Pandey, Advs.

versus

DEPUTY COMMISSIONER OF INCOME-TAX (INTERNATIONAL TAXATION), CIRCLE - NOIDA & ORS.

..... Respondents

Through: Mr. Sunil Agarwal, Sr.SC with Mr. Shivansh B. Pandya, Jr.SC along with Mr. Utkarsh Tiwari and Mr. Amaan Ahmed Khan, Advs.

CORAM:
HON'BLE MR. JUSTICE YASHWANT VARMA
HON'BLE MR. JUSTICE PURUSHAINDRA KUMAR KAURAV

J U D G M E N T

YASHWANT VARMA, J.

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A. INTRODUCTION

1. These writ petitions impugn notices issued under Section 148 of the **Income Tax Act, 1961**[1] by the first respondent. The details of the individual writ petitions are set out hereinbelow:-

Relevant AY	Notice issued on	W.P.(C).no
2012-13	28.03.2019	12408/2019
2013-14	29.04.2019	12406/2019

[1] Act

2014-15	29.04.2019	12405/2019
2015-16	31.05.2019	12407/2019
2016-17	31.05.2019	12409/2019
2017-18	31.05.2019	12410/2019
2018-19	31.05.2019	12411/2019

2. The first respondent has assumed authority to initiate reassessment proceedings upon finding that the production unit of the wholly owned subsidiary of the petitioner constitutes a Fixed Place **Permanent Establishment**[2], in the alternative a Service PE as well as a **Dependent Agent Permanent Establishment**[3]. The aforesaid conclusions are based on the provisions of the India-USA **Double Taxation Avoidance Agreement**[4].

3. The petitioner is stated to be a foreign company registered under the laws of Delaware, in the United States of America and is a part of the Caterpillar Group. It is stated to be one of the largest integrated and diversified manufacturers of rolling stock, infrastructure solutions and engaged in providing solutions and technologies to rail customers across the globe. According to the writ petitioner, it is also engaged in supplying equipment directly to the Indian Railways including to the **Diesel Locomotive Works**[5], Varanasi. These supplies are effected by way of imports which are made directly to the Indian Railways against Bills of Entries which are duly filed. The petitioner describes itself as

[2] PE
[3] DAPE
[4] DTAA
[5] DLW

being one of the largest global suppliers of new and reconditioned components for Class-1 railroads, short-lines, freight cars, freight car manufacturers and private freight car owners.

4. As per the petitioner, it has no income which can be said to accrue or arise in India under the provisions of the Act and although it has a registered office in Delhi, and has been allotted a **Permanent Account Number**[6] falling under the jurisdiction of the Commissioner of Income Tax, International Taxation-1, Delhi - the fifth respondent herein, it has not filed any Income Tax Returns since no income accrued or arose and nor could that income be said to have deemed to have accrued or arisen in India.

5. The petitioner, however, has a wholly owned Indian subsidiary - **Progress Rail Innovations Private Limited**[7], which was incorporated in 1996 and had a manufacturing unit at Noida and an office at Varanasi during the relevant **Assessment Years'**[8], namely AYs' 2012-13 up to 2018-19. It is the case of the petitioner that in **Financial Year**[9] 2021-22, the Noida plant was shut down and the manufacturing facility was shifted to Hubli in Karnataka. The Indian subsidiary, we were apprised, is assessed to tax in New Delhi where its registered office is situate and has also been subjected to transfer pricing studies by virtue of being an **Associated Enterprise**[10] of the petitioner. The petitioner has relied upon one such order dated 18 October 2016 pertaining to AY 2013-14 and which holds that the subsidiary provides only back office

[6] PAN
[7] PRIPL
[8] AYs'
[9] FY
[10] AE

and technical support services to the petitioner.

6. The petitioner asserts that neither the said Transfer Pricing Order nor any other order made by the authorities under the Act have ever found the Indian subsidiary to constitute a PE of the petitioner despite the said entity having been duly assessed for the past 25 years. It is also the case of the petitioner that the products manufactured by the Indian subsidiary are clearly distinct from those manufactured and supplied by it, and consequently it would be found that the core business activities of the petitioner and the Indian subsidiary are completely different. They have in this regard disclosed the following distinct production activities pursued by the two entities:-

Petitioner	**Subsidiary Company**
i. EMD OEM components available for locomotive, marine and power generation applications. ii. Freight and Tank Car Parts, Shortline and Industrials, Kershaw Parts, Marine and Stationary Engines.	Boards, panels, consoles, desks, cabinets and other bases for a voltage exceeding 1,000V.”

We are informed that prior to 01 September 2016, the petitioner was known as Electro Motive Diesel Inc., and whereafter its corporate name was changed to Progress Rail Locomotive Inc.

B. FACTUAL NARRATIVE

7. On the basis of a survey conducted on 06 March 2019 under Section 133A of the Act, a survey report dated 11 March 2019 came to be prepared, in which it was alleged that the petitioner has an office in

Noida and which was liable to be viewed as a Fixed Place PE/Service PE/ DAPE. On the basis of the aforesaid report, action was proposed to be initiated under Sections 147/148 of the Act. It is this report which led to the issuance of the impugned notices dated 28 March 2019 [W.P.(C) 12408/2019], 29 April 2019 [W.P.(C) 12405/2019, W.P.(C) 12406/2019] and 31 May 2019 [W.P.(C) 12407/2019, W.P.(C) 12409/2019, W.P.(C) 12410/2019 and W.P.(C) 12411/2019] under Section 148 of the Act.

8. For the purposes of considering the validity of the action undertaken by the first respondent, we deem it apposite to consider the broad factual matrix as obtaining in the lead petition, namely W.P.(C) 12408/2019.

9. Upon receipt of the impugned Section 148 notice dated 28 March 2019, the petitioner submitted a response dated 26 April 2019 asserting that it had not earned any income chargeable to tax and that consequently the notice was liable to be withdrawn. On 17 May 2019, the first respondent provided the reasons underlying the initiation of action under Sections 147/148 to the petitioner. As would be evident from a reading of those reasons, the first respondent principally relied upon the statements of Mr. Jeetendra Pratap Singh, Sales Executive of PRIPL's Varanasi branch, Mr. Shivanshu Narendra Kaushik, DGM, PRIPL, Noida and Mr. Phaneendra Kumar Potnuru, Director- Finance, PRIPL, Noida. Basis the aforenoted statements, the first respondent came to form the opinion that the petitioner had a "*virtual projection*" and presence in India in the form of its subsidiary - PRIPL. It was consequently held that since a PE existed, income attributable to that

entity was liable to be taxed under the Act. The petitioner questioned the assumption of jurisdiction as well as the reasons so noted as would be evident from its response dated 28 May 2019. It also sought further documentation including the statements taken from the employees of PRIPL as well as a copy of all the documents/information collected by the petitioner during the course of those survey proceedings in terms of its letter dated 06 June 2019.

10. On 24 June 2019, the petitioner addressed a letter to the first respondent asserting that its duly allotted PAN was linked to the office of the fourth respondent and consequently questioned the issuance of notices by the first respondent additionally on this score. It was thus contended that the first respondent had wrongly assumed jurisdiction and the notices were thus liable to be withdrawn on this ground alone. On 26 June 2019, and faced with the fact that the petitioner had failed to submit its **Return of Income**[11] in compliance with the notices issued, the first respondent initiated penalty proceedings referable to Section 271F read with Section 274 of the Act. In response to the said notice, the petitioner reiterated its stance that its PAN fell within the jurisdiction of the fourth respondent, and that consequently, both the Section 148 notice as well as the penalty notice issued by the first respondent were without jurisdiction. While responding to the penalty notice, the petitioner further asserted that it had not filed its returns proceeding on the assumption that its request for grant of four months to furnish the same stood granted.

11. By way of a letter dated 12 August 2019, the petitioner apprised

[11] ROI

the first respondent that the **Income Tax Business Application**[12] did not appear to facilitate uploading of the proposed ROIs' which were being sought to be submitted. In view of the above, the petitioner proceeded to forward physical copies of those returns to the said respondent under protest. The authority of the first respondent to undertake reassessment was again questioned by way of a letter dated 25 September 2019. It was further alleged that the fourth respondent purportedly acting pursuant to its powers under Section 120 of the Act had passed an order transferring the jurisdiction of the PAN of the petitioner from the fourth respondent to respondent no.1 vide its order dated 05 November 2019, and which was alleged to have been approved by the fifth respondent on 06 November 2019. Subsequently and on 13 November 2019, the petitioner discovered that its jurisdiction had been transferred from the fourth respondent to respondent no.1. It is thereafter that the instant writ petitions came to be filed.

12. While entertaining the present writ petitions, we had extended interim protection to the writ petitioner by way of an order dated 26 November 2019, and in terms of which it was provided that while it would be open for the first respondent to proceed with the assessment proceedings and conclude the same, it would be subject to further orders being passed on the writ petitions. Subsequently, on 09 September 2021, the interim relief granted to the writ petitioner was modified and the Court provided for a stay of further proceedings pursuant to Section 148 of the Act by the first respondent until the disposal of the writ petitions.

[12] ITBA

C. SUBMISSIONS OF PROGRESS RAIL LOCOMOTIVE INC.

13. Appearing for the writ petitioner, Mr. Datar, learned senior counsel, has on facts addressed the following submissions. Mr. Datar submitted that PRIPL, the wholly owned subsidiary of the petitioner was incorporated way back in 1996 and had a manufacturing unit at Noida and an office at Varanasi during the relevant AYs', namely, AYs' 2012-13 to 2018-19. Mr. Datar submitted that the said subsidiary had been regularly assessed to tax in Delhi by virtue of the location of its registered office which was situate in that jurisdiction and had also been subjected to transfer pricing assessments.

14. Mr. Datar took us through the following conclusions and findings which appear in a Transfer Pricing Order dated 18 October 2016:-

> "**1.** Reference u/s 92CA was made by the DCIT, Circle 8(1), New Delhi, New Delhi for determination of Arm's length price for the international transactions/domestic transaction undertaken by the assessee during the FY 2012-13. In response to notice Mr. Sahil Malhotra, being the authorized representatives appeared periodically. The documentations prescribed under Rule 10D of the Income Tax Rules, 1962 and other details asked for were submitted and placed on record.
>
> **2. Introduction**
>
> EMD Locomotive Technologies Pvt. Ltd. is engaged in provision of support services to EMD Group on which it is remunerated on a cost plus basis. The company provides back office support and technical support services starting from monitoring the Indian market for upcoming tenders and participating in such tender meetings to provide technical support including coordination with regard to the locomotives and spare parts / components etc. directly purchased by Indian Railways from EMD Group.
>
> **3.** The international transactions entered into, by the assessee are tabulated below.

S.No.	Type of International Transaction	Method Selected		Total Value of transaction (Rs.)
		MAM	PLI	
i.	Provision of Technical Support Services	Transactional Net Margin Menthod (TNMM)	Operating profit/Operating Cost (OP/OC)	110,850,531
ii.	Provision of Marketing Support Services	TNMM	OP/OC	111,464,189
iii.	Purchase of Goods	TNMM	Operating profit/Operating Sales (OP/OI)	434,372,844
iv.	Payment of repair and maintenace charges	TNMM	OP/OI	389,463
v	Issue of Equity Shares	Other Method	NA	70,391,000
vi.	Security Premium on Equity Shares alloted	Other Method	NA	413,899,080

4. Analysis of the Assessee's approach

The international transactions that have been entered into by the assessee have been tabulated above. The main international transaction of the assessee in question is the provision of technical support services. The TP report has described the functions of the assessee and its AE and the functions of the assessee as submitted in the TP report are found to be in order.

The business of the assessee is described below:

Business of the Assessee

EMD India, incorporated on December 2, 1996, is a 99.99% subsidiary of EMD International Holdings Inc., USA. It is primarily engaged in:

- **Technical Support Services**

EMD India is engaged in provision of support services to EMD Group for which it is remunerated on a cost plus basis. Herein, the Company supports EMD Group on a wide range of back-office activities starting from monitoring the Indian market for upcoming tenders and participating in such tender opening meetings to providing technical support services including coordination with regard to the locomotives and spare parts/ components etc. directly purchased by Indian Railways from EMD Group.

For these technical support services, the Assessee was remunerated on a cost plus basis. In essence, the Assessee was assured of a return on its costs and therefore insulated from majority of the business risks.

During FY 2012-13, EMD India was essentially engaged in the provision of support services to Group Companies. As part of its business operations, the Company also coordinates with Indian Railways for providing technical assistance with regard to the locomotives and spare parts/ components etc. directly purchased by it from EMD Group. In return for these services, the Company is remunerated on a cost plus basis.

The nature of the services rendered by EMD India is outlined below:

- Monitor upcoming tenders in the Indian market for locomotives and provide requisite support to EMD Group in preparation of the proposal.
- Attend tender opening meetings with Indian Railways and examine the terms and conditions based on which inputs/comments are provided to EMD Group.
- Coordinate with EMD Group for timely bid submission for tenders in the Indian market.
- Tracking LCs and shipments so as to provide updated information on the status of the consignment to Indian Railways.
- Regularly track the market situation to understand competitor movements and new business opportunities.
- Organise events and seminars and coordinate with industry associations such as CII, FICCI, AMCHAM in order to market the wide range of locomotives and diesel engines and technical expertise of EMD Group.

- Provide support to Indian Railways by detection of faults/issues on locomotives running in the field.
- Provide technical guidance to Indian Railways in taking corrective measures for replacement of part or rectification of the identified fault.
- Regularly update EMD Group on the interactions and assistance extended by EMD India to Indian Railways regarding issue of failure/ fault detected in the locomotives
- Gather technical details on the fault highlighted by Indian Railways and examine the same.
- Co-ordinate between EMD Group and Indian Railways for faulty products/parts under warranty or material replacement."

15. According to learned senior counsel, the **Transfer Pricing Officer**[13] had examined the activities of the Indian subsidiary in minute detail and ultimately proposed various adjustments. However, it was highlighted, that neither this order nor for that matter any other adjudication that may have been undertaken under the Act had come to hold or recognize the Indian subsidiary to be a PE of the petitioner. Mr. Datar also highlighted the distinct line of products which were manufactured by the petitioner and its Indian subsidiary as well as certain cost audit reports which were drawn in the course of oral submissions. In view of the above, it was his submission that the respondents' have incorrectly proceeded on the basis that the Indian subsidiary constituted a PE.

16. Learned senior counsel further submitted that the PAN which was held by the petitioner was linked to the office of the fourth respondent. It was his contention that the same was illegally and unilaterally migrated to Noida and under the jurisdiction of the first respondent on 05 November 2019. Mr. Datar submitted that although the Act embodies no provision which may envisage a transfer or

[13] TPO

migration of PAN, the respondents' resorted to that device solely to enable the first respondent to clutch at jurisdiction and undertake reassessment.

D. CBDT NOTIFICATION DATED 03 NOVEMBER 2014

17. Insofar as the territorial jurisdiction of the respondents' was concerned, Mr. Datar firstly placed for our consideration a Notification dated 03 November 2014 promulgated by the **Central Board of Direct Taxes**[14], and which had inter alia delineated the areas over which the second and the fifth respondent could exercise powers of assessment. Our attention was firstly drawn to Serial No. 1 of that Notification and which sets out the areas over which the fifth respondent could exercise the powers otherwise conferred upon it under the Act. Mr. Datar then drew our attention to Serial No. 3 of that Notification, and which spelt out the areas over which the second respondent was empowered to exercise authority and which extended to areas falling within the territorial limits of the States of Uttar Pradesh and Uttarakhand.

18. It is relevant to note that in terms of the arrangement made for entities falling within the ambit of Serial No. 3, the Notification further provided that the said authority would also have the right to assess persons who may be non-residents, including foreign companies having a PE in the territories noted above. In terms of the aforesaid Notification, the Commissioner of Income Tax (International Taxation-3), Delhi, the second respondent herein, issued an order on 15 November 2014 vesting jurisdiction upon the **Additional**

[14] CBDT

Commissioner of Income Tax[15]**/Joint Commissioner of Income Tax**[16] (Range Noida) over all foreign companies having a PE in the State of Uttar Pradesh. The said authority – ACIT (International Taxation), Range, Noida, in turn issued an order on the same date and proceeded to confer power upon the first respondent in respect of foreign companies having a PE within the territorial limits of the **Chief Commissioner of Income Tax**[17], Ghaziabad falling in the State of Uttar Pradesh. It is on the basis of the aforesaid distribution of the power to assess that the first respondent appears to have issued the impugned notices.

19. It becomes pertinent to note that initially the petitioner had questioned the assumption of jurisdiction by the first respondent based upon the provisions contained in the aforenoted Notifications. However, and although we had heard parties on the aforesaid aspect alone and reserved judgment, on a careful scrutiny of those Notifications, we found that it would be expedient, in the interest of justice, if the petitioner was apprised of some of the issues which emanate therefrom. It was this which led us to reopen the hearing on the writ petitions vide order dated 25 January 2024.

20. We find from a perusal of the Notifications in question that the construction which was sought to be advocated at the behest of the writ petitioner would not sustain. It becomes pertinent to note that the Notification of 03 November 2014 broadly distributes the territorial areas amongst the Commissioners' of Income Tax. That distribution is

[15] ACIT
[16] JCIT
[17] CCIT

made on an area/regional basis. However, the very same Notification proceeds to empower the Commissioners, ACITs and JCITs to further delegate their powers of assessment to officers' subordinate to them. It is on the basis of the aforesaid authorization made by the CBDT that the Commissioner of Income Tax (International Taxation-3), Delhi, the second respondent herein, proceeded to confer authority upon the ACIT/JCIT (Range Noida) on 15 November 2014, and who in turn and on the very same date, vested all powers relating to assessment upon respondent No. 1.

21. We thus find that the challenge as raised based upon the distribution of powers would not sustain. However, and it is necessary to so observe, undisputedly insofar as the first respondent is concerned, it could have derived authority to assess the petitioner or to subject it to proceedings under the Act, only if it had come to conclude that it had a PE within the territorial area assigned to it. It is this foundational link which joins the assumption of jurisdiction by the first respondent and the issue of PE of the petitioner in the State of Uttar Pradesh. The decision of the first respondent on the issue of PE thus emerges as being not only the central point of contestation, but also of significant import since the very foundation of the impugned reassessment action rests on the correctness of the view as taken by the said respondent in that respect.

E. THE PE ISSUE- A BRIEF BACKGROUND

22. Since learned counsels for respective sides have addressed elaborate submissions on the concept of Fixed Place PE, Service PE and DAPE, we do not find any justification to go into the issue of PAN

migration and the challenge in that respect which was addressed. This, since we would have to necessarily answer the fundamental question of whether a PE could be said to have come into existence within the territorial area over which the first respondent stood empowered to exercise powers conferred by the Act and thus examine whether the Section 148 power was justifiably invoked.

23. The question of a PE existing in the State of Uttar Pradesh would have to be answered on the basis of Article 5 of the India-USA DTAA which is extracted hereinbelow:-

> "**ARTICLE 5 - Permanent establishment-**
>
> **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."

24. As would be manifest from a reading of Article 5, clauses (a) to (k) of Article 5(2) spell out establishments which would be liable to be acknowledged as constituting a Fixed Place PE. While Article 5(2)(l) is concerned with a Service PE, Article 5(4) stipulates the conditions when a DAPE would have to be accepted as existing.

25. The issue of PE has been answered by the first respondent against the petitioner and is based on the following conclusions which

are set out in detail in an email dated 17 May 2019 addressed to the petitioner. We deem it apposite to firstly extract the following parts of that communication and which contain the statement as made by Mr. Jeetendra Pratap Singh:

> "**Question 4**- What services are provided by you in your company and what is your role in the company?
>
> Answer- I provide Post Tender/ Post agreement services such as taking purchase orders, taking care of delivery of goods and punctuality in the same, providing information regarding purchase orders and modifications in the same to EMD Locomotive Technology Pvt. Ltd. and Electro Locomotive Diesel Inc. USA and providing goods to Diesel Locomotive Work in Benaras within time specified by them. In reference to this, following up on behalf of D.L.W. with companies situated in Noida and USA and vice-versa, providing information regarding any type of Rejection/Modification/Rectification/Correction. Providing follow-ups on payments, etc. roles are played here in Varanasi.
>
> xxxx xxxx xxxx
>
> **Questions 9**- During the inquiry of the survey, Purchase order, Bill of lading/OPT (Overseas Transport Project), etc, were found that are related to EMD Locomotive Technology Pvt. Ltd. and Electromotive Diesel Inc USA. Kindly elaborate.
>
> Answer- In relation to this, I would like to say that the purchase order whose information regarding their payment is in USD, is related to Electromotive Diesel Inc. USA and the purchase order whose payment is in INR is related to EMD Locomotive Technology Pvt. Ltd. Noida which is subsidiary of EMD Inc USA.
>
> **Question 10**- Does the risk or responsibility involved in the delivery of goods bear with EMD Locomotive Technology Pvt. Ltd. Noida or Electromotive Diesel Inc. USA?
>
> Answer- The risk/ responsibility with respect to supply of goods prior to May 2018 rested with Electromotive Diesel Inc. USA and the same has been rested with EMD Locomotive Technology Pvt. Ltd. Noida for supply of goods since 2018.
>
> xxxx xxxx xxxx
>
> **Q.12**. Please explain in detail the services rendered to PRL Inc. USA about tenders floated in India and submits the bid for the tenders on

their behalf?

Ans. PRIPL, India commercial team gives information/helps/guides alongwith M/s Indo Crest (Our agent) for which we have a services agreement and Indo Crest is paid directly by PRL Inc. USA.

xxxx xxxx xxxx

Q.17. I am showing you a list of employees which has 37 names with name of the employee, designation and person reporting to. In a number of cases, it is seen that the employee is reporting to persons of the foreign group companies. Please explain, why the employees of PRIPL, India are reporting to persons of the non-resident/foreign group company. For example, shivanshu Narendra Kaushik reporting to David Babnic, Avdhesh Pratap reporting to Andy Gunn, Kaushal Sansanwal reporting to Shanan Fox etc.

Ans. Most of the employees have Indian persons as their reporting manager except for functional heads who report to Indian managing director as well as foreign persons. Reporting to foreign person is kept to ensure compliance with global best practices of group companies.

Q.18 Who does the appraisal of the employees including functional heads Please specify the mode of control by your foreign associate companies on the appraisal process?

Ans. The performance evaluation is performed by the reporting managers of the employees. The same for functional heads is done by India managing director, India HR and based on feedback received from foreign managers as well."

26. As would be evident from the above, the first respondent appears to have borne in consideration the statement made by this individual to the effect that PRIPL was a subsidiary of the petitioner and the various purchase orders and Bills of Lading collected pertaining to the Indian subsidiary as well as the petitioner herein. These documents were explained by Mr. Jeetendra Pratap Singh, who is asserted to have stated, that purchase orders which carry details of payments in **US Dollars**[18] relate to the petitioner while those where payments were

[18] USD

expressed in INR concern the Indian subsidiary - PRIPL. The first respondent also relied upon the response of the said employee with respect to emails which were addressed to various individuals and details whereof are found in Question 15. While responding to that query, the employee is asserted to have stated that those emails were concerned with directions for procurement, modification of purchase orders, delivery of goods, refunds, sale and purchase of goods as received by the Indian subsidiary from the petitioner. The employee is also asserted to have stated that the emails so received are also reported to the petitioner from time to time through proper channels.

27. In the course of the survey operations, the first respondent also recorded the statements of Mr. Shivanshu Narendra Kaushik and Mr. Phaneendra Kumar Potnuru. The relevant extracts of the statement made by Mr. Shivanshu Kaushik is reproduced hereinbelow:-

> "**Q7.** Please tell whether your team gives design up gradation/technical inputs to only M/s PRIPL or these inputs are also utilized by M/s Progress Rail Locomotive Inc. (Previously known as M/s EMD Inc.)
>
> **Ans.** As far as my knowledge is concerned there is no India specific design office in USA in M/s PRL Inc., USA. Since, 2010 we are designing the traction system to fulfill the requirement of Indian Railways. However, If we feel any difficulty as need guidance then we take support from the USA technical team. Our designs/inputs are utilized by both the companies i.e. M/s PRIPL, India as well as M/s PRL Inc., USA.
>
> **xxxx xxxx xxxx**
>
> **Q9**. From the job profile which you explained it seems that if no new tender is floated by Indian Railway or non new tender is granted to M/s PRIPL for some time or even if a tender is granted to M/s PRlPL but the required specifications are not changed then you have nothing to do. Please put some light over it.
>
> **Ans.** In case the new tender is granted to M/s PRL Inc., USA or M/s PRIPL, India without any change in specification of the AC-AC

traction system, there are still some adjustment to be made in design. We as engineering team at this premises i.e. M/s PRIPL comprise seven (7) engineers and not only work for India specific projects/designs but also we are a part of the global team of M/s PRL Inc. and as and when asked by the USA team we also work for global designs. Our primary task is India specific but we also work for design of AC-AC traction system as well as locomotives of the global tenders of M/s PRL Inc. USA.

Q10. Please state for which global projects/tenders of M/s PRL lnc., USA you or your team have worked till date?

Ans. I have worked for orders of following countries on behalf of M/s PRL Inc., USA-

Country	**Order No.**	**Year**
Congo	20118584	2011 to 2013
Botswana	20138952	2015-2016
Tanzania	20138903	2013 to 2015
Bangladesh	20159278	Currently

As far as the full team is concerned I am not aware about the exact details as everyone has expertise in different field but others have also worked for global contracts of M/s PRL Inc., USA.

Q11. Who allocate you the work for design of the component/Locomotive of foreign/global tendered how the same is communicated to you? How you submit your work to the foreign team?

Ans. The designwork is allocated by M/s PRL Inc., USA and the same is communicated through e-mail from USA. A release note is provided by e-mail in which the work allocated to me. For every such project a project head is made in USA in M/s PRL Inc. Who co-ordinates such projects and we report to him. All the team members work on common platform/ software which is accessible by all members and team Head as well. The work is automatically submitted on that platform

xxxx xxxx xxxx

Q14. When did you last work on any Indian Contract/Project?

Ans. l have not worked on any Indian project for last 4-5 years.

However, at times I have given suggestions to my other colleagues working on Indian projects.

Q15. Who does your evaluation/appraisal in respect of the work done by you?

Ans. As far as annual appraisal of my work is concerned, the discipline, behavior etc. are appraised by Sh. Anand Chidambram, M. D. in M/s PRIPL but the appraisal of my technical performance is done by Mr. Dave Babnic of M/s PRL Inc., USA.

28. The statement made by Mr. Potnuru is extracted hereunder:

"Q4. Please tell about Directors in EMD India and to whom they report?

Ans. Sir, There are 4 Directors in EMD India. Out of which 2 are foreign directors.

i. Sh. Balakrishnan Chindambram- Managing Director-

He reports to Mr. John Nuwman, Vice-president of EMD USA.

ii. Sh. Phaneendra Potnuru- Director Finance-

He reports to Mr. Balakrishnan Chidambram (MD India) and Mr. Ryan Vickers, International Finance Controller of EMD Inc., USA.

iii. Mr. Paul Denton, represents to EMD Inc., USA & he reports to Mr. Martin Haycraft, Head of EMD Group which also includes EMD Inc., USA & EMD India

iv. Mr. Martina Haycraft, EMD Group Head- Overall Head.

Q5. Please give details of Sales products by EMD Inc. USA in India and to whom, this sales has been made?

Ans. Sir, Sales products of EMD Inc. USA are followings:-

Locomotive components, Power assembly, Turbocharger, Cylinder Head, Liner, Piston rings, Gas Kits, Fuel Motor Pumps, Injectors etc.

These sales are 95% made to Diesel Locomotive works (DLW) Varanasi and 5% sales are made to other Indian Railways Centres.

xxxx xxxx xxxx

Q7. Please explain the work, functions of EMD India office?

Ans. Sir, work-functions of EMD India office are -

- AC-AC System supply to DLW, Varanasi directly.

-Manufacturing of AC-AC System.

-AMC Service regarding AC-AC System directly to DLW Varanasi & Railway sheds.

Sir, we also work for EMD USA, which are following:-

-Tender clarification to EMD, USA.

-Technical clarification.

-Tender Support-follow up-paperwork clearance.

-Purchase order procurement.

-Documents to agents.

-Warranty Support & Warranty claim.

-Tracking of sales to DLW.

-Product design updation- upgradation and Engineering.

-Payment follow up and its collection.

-DLW and Indian Railways says that we cannot communicate to EMD USA. So we provide communication to DLW & Indian Railways we communicate on behalf of EMD USA with them.

-Information Technology Services, etc.

Q.8 We are showing you a list of employees. Their designations and their reportings of EMD Noida in which there are some foreign persons to whom these employees are reporting. Who are these foreign persons, to which company they are relating?

Ans. Sir, These persons are from EMD Inc. USA to whom there employees of EMD India are reporting."

29. On the basis of the aforesaid, the first respondent proceeded to hold that it was evident that the petitioner had a "*virtual projection*" in India in the form of the wholly owned subsidiary and whose activities could neither be viewed as being "*preparatory*" nor "*auxiliary*". It was on the aforesaid basis that the first respondent proceeded to hold that

the petitioner had a Fixed Place PE/Service PE/ DAPE. Ultimately and upon taking into consideration the statements as well as the material which was gathered prior to and post the survey which was conducted, the first respondent came to the following basic conclusions:-

> "**III. Brief appraisal of documents found during the survey & statements recorded :**
>
> a. Office of EMD Locomotive Technologies Pvt. Ltd. is at the disposal of EMD Inc. USA for all its activities in India including sales to DLW (Diesel Locomotive Works), Varanasi of Indian Railways. In fact, during the course of survey u/s. 133A of I.T. Act. 1961 at the office premises at Varanasi, the Rubber stamp of EMD Inc. USA (PRL Inc. USA) was found which was used as mark of identity in the statement on oath of Sales Executive of the Indian Co.
>
> b. M/s EMD Locomotive Technologies Pvt. Ltd. was authorized to take all decisions on the tenders and performed all actions w.r.t sales to DLW by EMD Inc., USA i.e. all functions relating to tenders like submission, follow-up for release of purchase orders, acceptance of purchase order, freight forwarding, tracking of delivery to DLW, follow-up of payments on behalf of EMD Inc. USA. Further, EMD India is not doing similar activities for any other entity, whether Indian or foreign.
>
> c. Key Officers numbering to around 13, of M/s. EMD Locomotive Technology Pvt. Ltd., an Indian entity like Managing Director, Finance Director, Head of Tech. Services & Sales Executive directly reports to M/s PRL Inc. In fact, the Finance Director of Indian Co. who was working as Business Support Manager in M/s Caterpillar Inc., USA which is the ultimate holding company of the group Cos has come on deputation basis to M/s EMD L.T. Pvt. Ltd. Further, as per organization chart of the Indian Co., there are around 13 Officers of EMD Inc. USA or other intermediary holding Cos. of the group who have authority to approve transactions of the Indian entity.
>
> d. M/s. EMD Locomotive Technology Pvt. Ltd., INDIA has four directors out of which two are foreign directors namely Mr. Martin Haycraft (Overall EMD Group Head) and Mr. Paul Denton (who represents to EMD Inc. USA and reports to Mr. Martin Haycraft-Head of EMD Group). Rest two are Indian directors namely Mr. Balakrishnan Chidambaram (who reports to Mr. John Nuwman, Vice-President of EMD Inc. USA) and Mr. PhaneendraPotnuru (who reports to Mr. Balakrishnan Chidambaram and also to Mr. Ryan Vickers, International Finance Controller of EMD Inc. USA).
>
> e. Salient points from the statement of Mr. Phaneendra Kumar

Potnuru, Finance Director of M/s. EMD Locomotive Technology Pvt. Ltd., Noida are:

- Products of EMD Inc. USA are Locomotive components, Power assembly, Turbo charger, Cylinder head, Liner, Piston rings, Gas kits, Fuel Motor Pumps, Injectors, etc., 95% of which are to M/s Diesel Locomotive Works, Varanasi and rest 5% are to other Indian Railway Centers.
- M/s. EMD Locomotive Technology Pvt. Ltd. also work for EMD Inc. USA as under:

✓ Providing tender information-Assistance regarding tenders from Indian Railways.

✓ Tender support-follow up-paper work clearance,

✓ Procurement of Purchase Orders,

✓ Tracking of Sales to Diesel Locomotive Works-Varanasi,

✓ Payments collection and its follow up.

✓ Communication on behalf of EMD Inc. USA with DLW, Varanasi,

✓ Warranty claim and support, etc.

f. As per Marketing and Engineering Services Agreement dated 1-1-2011 between EMD Locomotive Technology Pvt. Ltd. India (Service Provider) and Electro Motive Diesel Inc. USA (Service Recipient), listing out various services to be provided by service provider like Marketing Support, Engineering Support, Service Support, Warehousing. Assembly and Sourcing. As per the First Amendment to this agreement warranty service on the sales effected by EMD Inc. USA to DLW of Indian Railways have been assigned. to the Indian entity Co. viz. M/s EMD L.T. P. Ltd. which includes organizing all support activities, logging of warranty claims, performing joint inspections/investigations, etc. As per Second Amendment to this agreement, overseeing Customs brokerage activities, Managing Customs & Trade related compliance matters, managing inventory, transportation & shipping functions relating to the sales effected by EMD Inc. USA to DLW, have also been assigned to the Indian Co. Thus, Indian Company's activities cannot be termed as preparatory or auxiliary in nature.

g. Mr. Jitendra Pratap Singh, Sales Executive of M/s. EMD Locomotive Technology Pvt. Ltd., at Varanasi office has stated in his statement that this office also works for EMD Inc. USA. Before 2018, all responsibility regarding decision making of fixation of goods price/unit price of sales goods to DLW-Varanasi from EMD Inc. USA was being made by EMD Locomotive Technology Pvt.

Ltd., INDIA. Print outs of Emails relating to procurements of purchase orders, correction-modification-rejection in purchase orders, delivery of goods/units, bill of lading, outstanding payments, sales and purchase of goods, etc. directions given by EMD Inc. USA to EMD Locomotive Technology Pvt. Ltd. India, were found & taken.

h. Expatriates like senior officers of EMD Inc., USA visited India regularly for holding discussions with officials of Diesel Locomotive Works, Varanasi of Indian Railways w.r.t sales effected by the said foreign company and for such activities the office & officials of Indian entity viz. M/s EMD L.T. P. Lad was fully at the disposal of the foreign company. This conclusively establishes that the Non-Resident Company viz. Mis EMD Inc., USA was doing sales activities in India through the Indian Co. viz. M/s EMD L.T. P. Ltd. which was providing its office premises for the foreign company and also acting as a dependent agent by providing all kinds of services prior to, during and also post sales. Foreign Co. had full control of the activities of Indian Co., through its key officers who were sent on deputation to the Indian Co. or Officers of Indian Co. made reportable to the Officers of the foreign company."

30. On a consideration of the above, the first respondent held as follows:-

"**IV. Conclusion:**

a) On the basis of evidences collected & statements recorded during the course of Survey proceedings, which are discussed at length & detail herein above, it is quite evident that the Non-Resident Company **M/s Electro Motive Diesel Inc. USA (now known as M/s Progress Rail Locomotive Inc. USA)** has virtual projection in India, in the form of M/s EMD Locomotive Technologies Pvt. Ltd (Now known as M/s Progress Rail Innovation Pvt. Ltd.), whose activities are not merely preparatory or auxiliary w.r.t the said Non-Resident Company's business in India especially with Indian Railways.

b) The conclusion at 'a' above is in line with ratio decidendi of Hon'ble Supreme Court's judgment dated 24-04-2017 in the case of Formula One World Championship Vs. CIT (IT)-3, Delhi [reported in 394 ITR 80/295 CTR 12/248 Taxman 192 (SC)) and Hon'ble Andhra Pradesh High Court's judgment dated 17-06-1983 in the case of CIT Vs. Vishakhapatnam Port Trust [reported in 114 ITR 146/38 CTR 1/15 Taxman 72 (AP)]

c) Therefore, the Non-Resident Company **M/s Electro Motive Diesel Inc. USA (now known as M/s Progress Rail Locomotive Inc. USA) has a PE in India (Fixed Place PE/Service**

PE/Dependent Agent PE) in terms of Article 5 of India-USA DTAA and income attributable to this PE based on the said Non-Resident Co.'s sales in India is taxable in the hands of such PE.

d) **Reason to believe that income has escaped assessment necessitating initiation of action u/s. 147/148 of the I.T. Act, 1961**

As sales of the said Non-Resident Co. in India for the years 2011 & 2012 is Rs. 832.10 Crores & Rs. 1028.50 Crores, Sales of the said Co. for the period 1-4-2011 to 31-3-2012 relevant for A.Y. 2012-13 will be part of sales of the years 2011 (1-4-2011 to 31-12-2011) & 2012 (1-1-2012 to 31-3-2012) and considering the existence of PE of the said Non-Resident Co. in India, I have concrete reasons to believe that income exceeding Rs. 1 Lakh have escaped assessment for the A.Y. 2012-13 in the hands of the said Non- Resident Co. viz. M/s Electro Motive Diesel Inc. (now known as Progress Rail Locomotive Inc.), USA, especially as **no Return of Income has ever been filed by the said Non-Resident Co. in India.**

Hence, for initiating proceedings u/s 147/148 sanction of the Commissioner of Income Tax is hereby sought in terms of Section 151 of the I.T. Act, 1961."

F. THE CHALLENGE OF PROGRESS RAIL LOCOMOTIVE INC. CONTD.

31. Assailing the assumption of jurisdiction by the first respondent, Mr. Datar, learned senior counsel submitted that the first respondent had clearly erred in proceeding on the basis that the Noida factory constituted a Fixed Place PE of the petitioner. According to learned senior counsel, the Noida premises could have by no stretch of imagination be considered to be a "*virtual projection*" of the holding company. According to Mr. Datar, a Fixed Place PE in terms of Article 5(1) of the India-USA DTAA would come into existence either where an entity has "*a factory*", "*a branch*" or other place in India through which its core activities are carried out. Mr. Datar submitted that the impugned notices and the reasons for initiating action under Sections 147/148 nowhere hold that any particular part of the Noida or the

Varanasi establishment had been placed at the exclusive "*disposal*" of the petitioner and which, according to him has been consistently recognised as being the key element insofar as a Fixed Place PE is concerned.

32. It was his submission that even if the material which is relied upon and the various assumptions derived therefrom are accepted to be correct, they would clearly not constitute evidence of the core business activity of the petitioner being carried on at Noida or Varanasi. Mr. Datar laid emphasis on the fact that all supplies to Indian Railways are made by the petitioner directly. Learned senior counsel in this regard drew our attention to the various emails which form part of Annexure 8 of a compilation which was tendered in Court during oral submissions and in terms of which quantity and price issues were approved by the petitioner, and thereby establishing that the Indian subsidiary played no role whatsoever in relation to those activities. It was also highlighted by learned senior counsel that the core activities or business of the petitioner are not even carried out in the factory at Noida or in the office at Varanasi, and this, more so, since the products manufactured and supplied by the petitioner and the subsidiary are different. In view of the above, it was Mr. Datar's submission that the view taken by the first respondent on Fixed Place PE is wholly erroneous and untenable.

33. It was Mr. Datar's contention that the argument based on Article 5(2)(l)(ii) of the DTAA is equally misconceived since it was not even the first respondent's case that the petitioner was discharging a service within India for a "*related enterprise*". It was asserted that the first respondent has not based the impugned action on any material which

may have established or indicated any principal function that the Indian subsidiary may have performed or discharged in relation to the execution of contracts with the Indian Railways. Mr. Datar reiterated the undisputed fact of all products having been directly supplied to the Indian Railways by the petitioner in the relevant AYs', namely, AYs' 2012-13 till 2018-19.

34. Mr. Datar then questioned the opinion formed by the first respondent on the aspect of DAPE. It was contended that the factories of the Indian subsidiary, PRIPL, manufacture a completely different range of products and that the petitioner has no control or oversight over those factories or offices. It was then contended that a subsidiary which merely renders back office or technical support would not be liable to be viewed as a PE, bearing in mind the provisions contained in Article 5(3)(e) of the India-USA DTAA. Mr. Datar submitted that the aforesaid position stands settled in light of the decision of the Supreme Court in **Director of Income Tax (International Taxation), Mumbai vs. Morgan Stanley & Co. Inc.**[19]. Learned senior counsel contended that in *Morgan Stanley*, the Supreme Court had clearly enunciated the legal position with respect to "*preparatory*" or "*auxiliary*" services and consequently those principles are clearly attracted to the facts of the present case. It was also highlighted by Mr. Datar that the petitioner exercises no lien on the employees of the Indian subsidiary - PRIPL. All of the aforesaid factors, according to learned senior counsel, when considered cumulatively would lead one to the irresistible conclusion that no DAPE could be said to exist in India.

[19] (2007) 7 SCC 1

35. Proceeding further along these lines, Mr. Datar drew our attention to the judgments rendered by the Supreme Court in **Director of Income Tax-II (International Taxation) New Delhi & Anr. vs. Samsung Heavy Industries Company Limited**[20] and **Assistant Director of Income Tax – I, New Delhi vs. E-Funds IT Solution Inc.**[21] It was his submission that *Samsung Heavy Industries* was a binding verdict for the proposition that a liaison company would not amount to a Fixed Place PE. As per Mr. Datar, *Samsung Heavy Industries* had also clearly identified the fundamental premise pertaining to the PE question being the existence of an establishment "*through which the business of an enterprise is wholly or partly*" carried out. Similarly, in *E-Funds IT Solutions Inc.*, Mr. Datar submitted, the Supreme Court had clearly held that the mere existence of a wholly owned subsidiary in one of the Contracting States would not *ipso facto* amount to an assumption of a PE having come into existence and which is also evident from a plain reding of Article 5(6) of the India-USA DTAA. As in *E-Funds IT Solutions Inc.*, Mr. Datar submitted that here too, the various services and functions performed by the Indian subsidiary could have by no stretch of imagination been construed as extending beyond the performance of back office services.

36. Mr. Datar submitted that insofar as interrelated transactions were concerned, those were conducted at arm's length and had also been independently assessed and examined in transfer pricing studies. The petitioner had in this regard also placed reliance upon the observations as appearing in the TPO's report dated 18 October 2016 and relevant

[20] (2020) 7 SCC 347
[21] (2018) 13 SCC 294

parts whereof have been extracted hereinabove. It was Mr. Datar's submission that the services performed by the Indian subsidiary were identical to those which were noticed by the Supreme Court in *E-Funds IT Solutions Inc.*, and thus the first respondent has illegally assumed jurisdiction by invoking Sections 147/148 of the Act.

37. Mr. Datar then questioned the impugned notices on the ground that a reading thereof would establish that no prima facie view was either formed or reasons recorded in support of the charge of income having escaped assessment. It was his contention that the entire action was based solely on a survey carried out in the factory and office premises of the Indian subsidiary located at Noida and Varanasi respectively. As per Mr. Datar, the first respondent has not even expressed a prima facie view with respect to the petitioner having a PE in India and consequently a Section 148 action could have at best only been issued by the jurisdictional AO, namely, the fourth respondent.

38. Mr. Datar then questioned the fairness of the action impugned on the ground that the statements have been selectively extracted and taken into consideration in order to initiate reassessment proceedings against the petitioner. It was his submission that none of the complete statements have been noticed or holistically examined prior to the formation of opinion. It was also submitted that the partial statements which have been extracted in the "*reasons to believe*" for initiating action under Sections 147/148 of the Act would also not sustain the reassessment action as initiated. He had in this regard referred to the following material which had been tendered separately in Court during the course of his oral submissions:-

(a) Emails exchanged between the Petitioner's employees and PRIPL's employees regarding furnishing a bank guarantee to DLW for supplying goods to DLW;

(b) Letters exchanged between the petitioner and the Indian Railways regarding delivery of products to DLW, Varanasi by the petitioner;

(c) Copies of purchase orders directly raised by the Indian Railways in favour of the petitioner;

(d) Cost Audit Report of the Indian subsidiary – PRIPL for FY 2017-18;

(e) Financial Statements of the Indian subsidiary – PRIPL for FY 2021-22.

39. Without prejudice to the aforesaid submissions, Mr. Datar, on instructions, stated that even if it were to be assumed for the sake of argument that the Indian subsidiary is a PE of the petitioner, since its registered office is in New Delhi, it would be the appropriate **Assessing Officer**[22] in the Delhi jurisdiction who alone would have the jurisdiction to initiate reassessment proceedings under Section 148 of the Act.

40. Mr. Datar then drew our attention to an opinion rendered by the Authority for Advanced Ruling in **In re., Speciality Magazines P. Ltd**[23], and more particularly to the following passages of that decision:

> "**26.** ….. The terms "wholly" and "almost wholly" are not technical terms or terms of art. They must receive their ordinary meaning as

[22] AO
[23] 2005 SCC Online AAR-IT 20

understood by English speaking people. The word "wholly" means entirely, completely, fully, totally ; "almost wholly" would mean very near to wholly, a little less than whole. In terms of percentage "almost wholly" would mean anything less than 90 per cent. It is shown that though SMPL has other clients, the fact remains that the activities of SMPL for TENL yield 75 per cent, to 80 per cent, of its income and income from other clients is between 22 per cent, to 25 percent., so it cannot be said that the activities of the SMPL are carried out wholly or almost wholly for TENL. It follows that SMPL does not fall in the second part of para. 5 of article 5 of the Treaty."

41. The said decision was cited by Mr. Datar in the context of the phrase "*wholly or almost wholly for the enterprise*" as occurring in Article 5(4)(c) of the India-USA DTAA and to therefore contend that the activities of the Indian subsidiary could not be said to fall within the ambit of that provision. In this backdrop, our attention was also drawn to the following chart which sets out details of the income derived by the Indian subsidiary from transactions with the petitioner between FYs' 2011-12 to 2017-18 and which is extracted hereinbelow:-

"S.No	**FY**	**Service Income received from US Co.**	**Other income**	**Total income**	**Percentage of total income received from US Co.**
1.	2011-12	9,832,370	3,760,831	13,593,201	72.33%
2.	2012-13	222,314,720	200,160,033	422,474,753	52.62%
3.	2013-14	241,513,441	2,436,970,440	2,678,483,881	9.02%
4.	2014-15	325,496,881	1,732,056,593	2,057,553,474	15.82%

5.	2015-16	290,187,274	1,111,341,569	1,401,528,843	20.71%
6.	2016-17	221,431,732	2,040,244,440	2,261,676,172	9.79%
7.	2017-18	157,000,000	2,507,000,000	2,664,000,000	5.89%"

42. According to Mr. Datar, the aforesaid chart would establish the minuscule percentage of income which the Indian subsidiary earned from transactions entered into with the petitioner when compared to its total income, and all of which would establish that it was less than 75%, a threshold which was recognized in the decision in *Speciality Magazines*. For this reason also, according to Mr. Datar, the opinion as formed by the first respondent is clearly rendered unsustainable and the action for reassessment liable to be quashed.

43. While closing submissions, Mr. Datar also relied upon the decision of the Supreme Court in **Union of India vs. UAE Exchange Centre**[24] and had also placed for our consideration a comparative chart in support of his submission that the said judgment along with the decision in *Morgan Stanley & Co.* came to be rendered in similar factual scenarios. The commonality of the factual features in the context of which those judgments were rendered was highlighted by way of the following comparative table:

"Particulars	**Union of India vs. UAE Exchange Centre**	**DIT vs. Morgan Stanley and Co. (2007) 292 ITR**	**Progress Rail Locomotive Inc.**

[24] (2020) 9 SCC 329

	(2020) 425 ITR 30 (SC)	**416 (SC)**	
Applicable DTAA	India-UAE DTAA	India-USA DTAA	India-USA DTAA
Article 5(3) of DTAA provides that- notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include the maintenance of a fixed place of business solely for the purpose of other activities which have a "preparatory or auxiliary character", for the enterprise (under Article 5(3)(e) of DTAA).			
Main business activities of the respective Assessee company	Providing remittance services for transfer of monies from the UAE to various places in India.	Providing financial advisory services, corporate lending and underwriting.	Providers of rolling stock and infrastructure solutions and technologies for global rail securities customers.
Back office support services, liaison office - held to be activities which have 'preparatory or auxiliary character' - thus, the Indian Subsidiary/Office providing these activities cannot be treated as a "PE" of the foreign company [Article 5(3)(e)]			
Ancillary Services provided by the Indian Office/Subsidiary of the respective Assessee company to the Assessee Company.	Indian company operated a liaison of the UAE Exchange Centre in India - carried out activities like – dispensing the remittances to beneficiaries in India, downloading of information from the main server of the parent company in respect of transfer of monies and printing and preparing cheques/drafts and sending the same to the beneficiaries in India.	The Indian Subsidiary was providing support services like - supporting the front office functions of parent company in fixed income and equity research, providing IT enabled services such as data processing support centre	The Indian Subsidiary provides back office support services in the nature of marketing and technical support services to the EMD Group at a cost-plus basis. (**para 4 at page 2 and 3 of the Transfer**

		and technical services, reconciliation of accounts.	**Pricing Order dated 18/10/2016)**
Held by Supreme Court	Activities of liaison offices were of preparatory or auxiliary character, same would fall within excepted category under Article 5(3)(e) of India-UAE DTAA. (Para 11)	The back-office functions performed by Indian Subsidiary falls under Article 5(3) (e) of the India-USA DTAA. (Para 12)	Therefore, the same principle should be followed in the case of Petitioner since the Indian Subsidiary, like in the case of Morgan Stanley and UAE, provides back office support services which are activities of 'preparatory or auxiliary character'."

44. Mr. Datar then drew our attention to the following pertinent observations as rendered by the Supreme Court i*n UAE Exchange Centre:-*

> "**36.** Having said thus, it must follow that the respondent was not carrying on any business activity in India as such, but only dispensing with the remittances by downloading information from the main server of the respondent in UAE and printing cheques/drafts drawn on the banks in India as per the instructions given by the NRI remitters in UAE. The transaction(s) had completed with the remitters in UAE, and no charges towards fee/commission could be collected by the liaison office in India in that regard. To put it differently, no income as specified in Section 2(24) of the 1961 Act is earned by the liaison office in India and

> more so because, the liaison office is not a PE in terms of Article 5 of DTAA (as it is only carrying on activity of a preparatory or auxiliary character). The concomitant is — no tax can be levied or collected from the liaison office of the respondent in India in respect of the primary business activities consummated by the respondent in UAE. The activities carried on by the liaison office of the respondent in India as permitted by RBI, clearly demonstrate that the respondent must steer away from engaging in any primary business activity and in establishing business connection as such. It can carry on activities of preparatory or auxiliary nature only. In that case, the deeming provisions in Sections 5 and 9 of the 1961 Act can have no bearing whatsoever."

45. Mr. Datar then submitted that the first respondent appears to have proceeded on a wholly incorrect presumption that the existence of a wholly owned subsidiary in one of the Contracting States would invariably result in the creation of a PE. It was submitted that a wholly owned subsidiary, would by virtue of the investments in its capital and in the larger business interest of a group as a whole, always be subject to policy interventions and broad oversight by the holding entity. It was contended that the premise on which the impugned reassessment proceeds is in the teeth of the clarification in this respect which stands enshrined in Article 5(6) of the India-USA DTAA.

46. It would be pertinent to recall that Article 5(6) proclaims that merely because a company which controls or is controlled by one which is a resident of the other Contracting State shall not of itself constitute a PE. Insofar as the issue of subsidiary PE is concerned and in order to enable us to have the benefit of a broad conceptualization of principles pertaining thereto, Mr. Datar firstly drew our attention to certain passages as appearing in **Permanent Establishment, Erosion of a Tax Treaty Principle**[25] authored by Arvid Aage Skaar. By way of

[25] Permanent Establishment, Erosion of a Tax Treaty Principle, Wolters Kluwer, 2nd edition (1991)

a historical background, *Skaar's* work contains the following illuminating passages:-

> "**36.2.2 Historical Background**
>
> Early in the history of PE, the opinion seems to have been that related, independent companies should constitute a PE. Thus, the first model treaty submitted by the Group of Technical Experts to the League of Nations included "affiliated companies" as a PE" and had some influence on bilateral treaties. However, the model treaties submitted by the conference of Governmental Experts in 1928 omitted "affiliated companies" from the "positive list." During the 1930s the principle of protecting related companies from PE taxation through the activity of each other prevailed in several bilateral treaties and was also briefly mentioned in the 1933 Report of the Fiscal Committee of the League of Nations. The uncertainty within this field led the US negotiators to ask for a specific provision on the issue in the first general US double taxation treaty, concluded with France in 1932. It was not until the Mexico model of 1943 that this issue became subject to a more comprehensive treatment in the model treaties. Today practically all tax treaties include specific protection against PE taxation based solely on related companies.
>
> Although older German Supreme Court practice concerning domestic laws allowed a basic-rule PE to be constituted." this position was later given up by the tax authorities." Since the 1934 tax legislation," German domestic laws have not explicitly allowed subsidiary-PE taxation. In tax-treaty regulations, it was established in 1941 that a subsidiary was not to be considered a PE under the tax treaties, unless this was explicitly stated in the treaty. "A basic-rule PE could not be constituted by a subsidiary for a parent company under German domestic laws." Hence, the provision in the former German treaty with Italy, which allowed PE taxation of subsidiaries, was without significance in Germany."
>
> **36.2.3 Policy Considerations**
>
> A neutral tax system would allow a subsidiary PE to be constituted in all cases where the same conclusion would be reached for unrelated companies. This solution is expressly stated for a subsidiary PE under the agency clause. Consequently, the position of some older pre-OECD authors that a subsidiary can never constitute a PE for the parent has not been sustained. The conventional position of the OECD-based tax-treaty doctrine used to be that a subsidiary PE can only be based on the agency clause.

However, the tax treaties aim at allowing the source state to tax business profits with a certain economic allegiance to the country, expressed through the enterprise's PE. This intention must also apply when the parent company's business income is earned by the intermediation of a subsidiary. Thus, from *a de lege ferenda* point of view, PE taxation of the parent company is justified in cases where residence- state taxation of the subsidiary does not under domestic laws adequately attribute taxing jurisdiction to the source state. Today, the commentaries to the OECD model treaty's give conclusive reasons for the conventional wisdom with regard to this question."

47. Proceeding further to deal with the agency clause that appears in various tax treaties and how the same has been examined in the commentaries pertaining to **Organization for Economic Cooperation and Development**[26] model treaties, *Skaar* observes as follows:-

"**36.3.2 The Subjectivity of the Subsidiary PE**

xxxx xxxx xxxx

b) The Agency Clause

The commentaries to the pre-2017 OECD model treaties were somewhat ambiguous on the significance of share control for the "dependence test" under the agency clause. It was generally stated that a "subsidiary is not to be considered dependent upon its parent company solely because of the parent's ownership of the share capital." The reality is, of course, that a subsidiary is dependent upon the parent company, both legally and economically. Although the statement in the pre-2017 OECD commentaries seems to create a presumption that the subsidiary is independent, until the opposite is proved, the underlying significance of the commentaries was that they established the principle that the same rules apply to subsidiaries as to other "persons." The evidence necessary to prove that a subsidiary is "dependent" will therefore be the same as for other agents.

In the OECD 2017 model treaty, the "closely related test" was introduced in the agency clause, stating that "person" working "exclusively or almost exclusively" for a closely related enterprise shall not be considered independent in this respect. This rule appears to admit that the intra group-relationship is significant for the

[26] OECD

independence of the "person" acting on behalf of somebody else; however, this is not exactly true. A "person" working "exclusively or almost exclusively" for an unrelated "enterprise" will normally be economically dependent upon the "enterprise." An agency PE would therefore normally be created also under the pre-2017 OECD model treaties, anyway. The significance of the "closely related test" for the creation of an agency PE should therefore not be overestimated."

48. Explaining the importance of the functionality test regulating a subsidiary PE, *Skaar* makes the following pertinent observations:-

"**36.3.3 The Functionality of the Subsidiary PE**

a) General

A PE can only be created by the carrying on of the *business activities* of the taxpayer as distinguished from other activities. Thus, a parent company can, for example, get a PE in a country if it carries out the business of a subsidiary in the facilities of the subsidiary, and a subsidiary may get a PE if the parent company carries on the business of the subsidiary through its facilities at home. In this respect, it is important to distinguish between the parent company's activities as a shareholder (shareholder activities), and the business activities of the subsidiary or parent company. A parent company's activities abroad as a shareholder in other companies cannot create a PE. Hence, participation in meetings of the Board of Directors and annual shareholders' meetings do not create a PE.

However, what if a member of the Board of Directors performs activities for the company that go beyond the activities the directors are supposed to do in their capacity as members of the Board of Directors, such as taking over functions of the managing director, engage in sales activities, management of production and hiring personnel (except hiring of managing director)? These activities are the business of the subsidiary and not the business of the parent, if a "person" representing another company is engaged in the performance of the business of the "enterprise," this may indicate that the "person" and the "enterprise" is conducting a joint business activity, which may qualify for a PE.

The main problem pertaining to the subsidiary PE is whether the parent company performs the business activity of the subsidiary or vice versa. With one exception, the general basic-rule provisions also apply to the subsidiary PE. It is expressly stated in the commentaries that the parent company cannot be the subsidiary's "place of management," even if extensive management and supervision services are provided."

49. As would be evident from the aforesaid passage, the author suggests that the functionality test is met where it is found that the asserted PE is engaged in the carrying on of the business activities of the taxpayer. After noticing the various precedents handed down with respect to a subsidiary PE, including some rendered by Tribunals in India, *Skaar* enunciates the legal position by way of the following conclusions:-

> **"36.4.10 Conclusions**
>
> In conclusion, when a separate legal entity exists, the treaty presumes that the activity performed is the subsidiary's own business. This also applies when separate legal entities cooperate extensively. Nevertheless, the facts in the case may show, how- ever, that the cooperation between two or more closely related companies makes it difficult to distinguish one company from the other: The companies are alter ego companies and may be considered to perform a joint business activity through the same place of business. Under the circumstances, this may create a PE-in this work called a subsidiary PE. However, a joint business activity requires that the two companies perform the business of one of the companies.
>
> The performance of shareholder activities is not sufficient to constitute a PE. Moreover, the operational top management of the group's business activities, which influences the activities of the subsidiaries of the group, does not create a PE if the initiatives are carried out by the subsidiary alone. Moreover, there are no reasons why this principle should not apply also to the management performed by individuals. Rather than applying an artificial interpretation of the conditions, for PE," the OECD model treaty's Principal Purposes Test" may be considered if the tax authorities fear that the tax treaties are abused, as probably was the case in Cicero Practice from some national courts, in particular in Spain and Italy," also shows examples of departure from the task to interpret the tax treaties and the tax laws in good faith, and instead attempt to change the law as a response to fundamental changes in business structures." The possibilities created by the combination of electronic commerce (e.g., the website in Dell Spain), contract manufacturing (as in Borax.") and *commissionnaire* agreements (DSM Nutritional Products and Dell Spain) lead to reactions that reflect discontent with the threshold, which the OECD model treaty and the commentaries have established. As much as the present writer sympathizes with this view *de lege ferenda*, such a reaction should

come from the treaty negotiators and the lawmakers, and not from the courts."

50. According to the learned author, the existence of a subsidiary alone would not validate an assumption of a PE coming into existence. Bearing in mind the fact that a subsidiary would have a separate legal entity, according to the author, treaties proceed on the basis that subsidiaries are essentially set up to carry out their own business activities. According to *Skaar*, a subsidiary PE may come into existence where it is found that both entities are in fact *"alter egos"* and undertake a *"joint business activity"*. It further significantly holds that performance of shareholder activities, including having a say in the operational top management would not in itself be dispositive of the question. It ultimately refers to the "*principal purposes*" test as propounded in the commentary relating to OECD tax treaties. The aforesaid position is explained in greater detail in Para 36.6 which is extracted hereinbelow:-

"**36.6SUMMARY AND CONCLUSIONS: PRESSURE ON THE PE CONCEPT AS AN ALTERNATIVE TO UNITARY TAXATION?**

The starting point de lege fata is that a parent company's control and supervision cannot justify subsidiary-PE taxation. Source-state taxation of a foreign enterprise's business activities with related domestic companies is the kind of taxation at source which the subsidiary clause is specifically designed to prevent. Thus, as a general rule, the normal management contribution of a parent company does not create a place of management of the subsidiary. However, the subsidiary clause aims at protecting related companies from PE taxation beyond what unrelated enterprises are subject to. Thus, a related company may in special cases constitute a place of management for another related company, if the business of the parent is managed de facto by the other company. Moreover, a subsidiary PE is constituted when the conditions for identification of construction work (a geographically and commercially coherent whole) are met. Thus, a subsidiary which participates in the

completion of the parent's work may constitute a construction PE. Moreover, related enterprises, which cooperate in a joint venture-like manner, may constitute a subsidiary PE for each other. And clearly, an agency PE will be the result if one of the companies concludes contracts on behalf of the other, or is playing the principal role in the conclusion of contracts on behalf of the other company.

Neutrality and equity considerations justify de lege ferenda PE taxation in cases where "empty" companies are used to conclude and later pass on contracts to a related foreign enterprise if a PE would otherwise have been constituted. The practical result of a subsidiary PE will be that the company, which takes over the obligations under the contract and performs the work, is subject to PE taxation. The cases discussed in this chapter show de lege lata that a subsidiary PE is only created when the parent company itself would have met the conditions for PE if the transactions had not been performed through a subsidiary. Thus, a completely empty subsidiary with no material significance for the performance of the work does not constitute a subsidiary PE. For example, a parent company's transportation business does not create a PE simply because the contracts are concluded by a subsidiary with an office and passed on to the parent, provided that the parent would not have a PE in the absence of the subsidiary (i.e., the contracts were concluded by the parent directly). Moreover, international practice seems to suggest that a subsidiary PE is not constituted for an enterprise which subcontracts an assignment, if the enterprise does not take part in the physical work itself, even though it contributes the equipment necessary for the work.

Moreover, a "slender" subsidiary may perform a true business activity, although insufficient to comply with the obligations under the contract. In these cases, a joint venture-like cooperation may be the result. When a basic-rule PE would have been constituted between unrelated companies, a subsidiary PE must be the result among related entities. Thus, a subsidiary PE between related companies will be constituted under circumstances where an unrelated company would also have been a PE under the basic rule.

To counteract tax planning through related companies, tax authorities in some countries have adopted special versions of the unitary allocation method. In other cases, the authorities have claimed taxing jurisdiction over the foreign headquarters of the group, under the assumption that it has a PE in the country through the domestic subsidiary there. This has been done even if the subsidiary has only performed auxiliary functions, or no functions at all, for a related foreign construction enterprise.

> The impression left from the discussion of the subsidiary PE is that the conditions for subsidiary PE may be subject to creative interpretation in the future, as a method of counteracting tax planning through use of captive companies. Instead of dealing with the imperfections of the arm's-length principle through implementation of a unitary taxation system, tax authorities may aim at imposing PE taxation based on related companies. The unitary allocation method, through which a disproportionate amount of income is allocated to the domestic entity regardless of the accounts of the enterprise, is clearly a violation of the tax treaties, as well as an inadequate method of securing source-state taxation. Subsidiary PE taxation, however, is accepted in the treaties, and consistent with the aim of securing source-state taxation. Thus, subsidiary-PE taxation may become an instrument to combat tax avoidance in cases where the application of the arm's-length principle is difficult.
>
> It seems to be undisputable under OECD-based treaties that control, supervision, and subordination cannot de lege lata justify a subsidiary PE. However, a possible reason for PE taxation is that a PE is constituted through extensive, joint venture-like cooperation between two related (alter ego) companies. Such cooperation may justify PE taxation between unrelated companies under the basic rule and the fact that the companies are related cannot protect then against PE taxation."

51. Mr. Datar then drew our attention to a work titled **New Trends in the Definition of Permanent Establishment**[27], edited by Professor Guglielmo Maisto and which examines the subsidiary PE question with reference to the position as found in various international jurisdictions. Dealing firstly with the position as understood by authorities in Australia, Mr. Datar drew our attention to Para 10.2.6 which is reproduced hereinbelow:-

> "**10.2.6. Subsidiary companies as PE of the parents (and vice versa)**
>
> One example as to when a subsidiary company can give rise to a PE is if the subsidiary allows the parent company to operate from its premises such that the primary test in article 5(1) is satisfied, or, if

[27] New Trends in the Definition of Permanent Establishment, edited by Prof. Gugliemlo Maisto, EC and International Tax Law series, 2017

the subsidiary acts as an agent of the parent company such that a dependent agent PE is constituted. In Federal Commissioner of Taxation v. Tasman Group Services Pty. Ltd.," the Full Federal Court found that an Australian subsidiary was not a PE of the foreign parent where the subsidiary was substantially financed by loans from the parent. A single judge of the Federal Court had earlier found that the offices and plant of the subsidiary constituted a PE of the parent in that situation. The Full Federal Court noted that there were two separate businesses even though the parent may closely monitor the subsidiary's activities and/or second employees to the subsidiary to assist in the subsidiary's business. In this case, the Full Federal Court also rejected a separate argument that the overseas parent was carrying on business in Australia as a PË as a holding company managing and financing the Australian subsidiary."

52. The subject of subsidiary PEs and group of companies, and as that subject is treated by authorities in Belgium was explained in Paras 11.2.6 and 11.2.7 of that work and which are reproduced hereunder:-

"**11.2.6. Subsidiary companies as PE of the parents (and vice versa)**

A subsidiary does not ipso facto constitute a PE of the parent company or vice versa. This is also not the case if two subsidiaries are held by a common parent company. A subsidiary will only be deemed to be a PE of the parent company (or vice versa) if the criteria of article 5(1) or (5) of the OECD Model are fulfilled.

The above is also applicable to a BE. If a parent company is given the possibility to dispose of the premises that belong to a subsidiary and it carries on its business through that place, the parent company will in principle dispose of a basic rule PE. The Belgian tax authorities clarified that, a subsidiary could constitute an agency PE of the parent company if it acts as an agent for the latter and it concludes contracts in the name of the parent company. We believe, however, that it is not required that a subsidiary concludes contract in the name of the parent company. The mere fact that a parent company holds shares in the subsidiary is not sufficient to qualify it as a dependent agent.

If a subsidiary is recognized as a PE of its parent company or vice versa, the general consequences in relation to the recognition of a PE are applicable, i.e. part of the profit realized by the head office should be attributed to the PE and will be taxed in the source state. Moreover, this will also have an impact on the taxation of certain specific types of income that are attributable to the PE, such as

passive income (i.e. dividends, interest and royalties) capital gains and other income in the meaning of article 21 of the OECD Model. The taxation of income stemming from employment can also be impacted by the presence of a PE.

In case a PE is recognized, it will have to fulfil certain Belgian compliance requirements, such as the annual filing of a non-resident tax return, the with-holding of professional withholding tax on remuneration paid to employees provided that the remuneration is taxable in Belgium and the sincere cooperation with the tax authorities in case of a request for information.

11.2.7. Group of companies and closely related enterprises

The DTCs concluded by Belgium typically contain a provision identical to article 5(7) of the OECD Model according to which closely related companies (eg, subsidiaries) are not automatically deemed a PE of the other In other words, a PE is not recognized solely by the fact that one company controls the other or vice versa. It should be examined for every single entity whether a PE should be recognized.

Some DTCs concluded by Belgium have broadened the scope of this provision to enterprises that do not qualify as a company. In such case, the provisions are applicable, for example, to an individual that carries on a business and holds in that capacity the shares in a company located in another state:

According to the Belgian tax authorities, the rule included in article 5(7) of the OECD Model confirms the general principle applicable under Belgian domestic law according to which the conditions of a basic rule PE (article 5(5) of the OECD Model) or an agency PE (article 5(5) of the OECD Model) need to be met in order that a closely related enterprise could trigger the recognition of a PE. The Belgian tax authorities have not provided any guidance on the interpretation of the notion "control"."

53. In Chapter 16 of that publication, the Indian position relating to subsidiary companies was explained in the following terms:-

"**16.2.6. Subsidiary companies as PE of the parents (and vice versa)**

Under the BC provision of the domestic law, a subsidiary created a per se BC although no profits could be allocated unless some activities were undertaken in India. With the introduction of a specific provision relating to agency from 2003, even the scope of creating such BC has become limited.

Although the IR asserts the existence of a PE through a subsidiary wherever it comes across any evidence of close interaction between the principal and the subsidiary, whether through presence of employees or transactions with other group companies, courts in India have not always sided with the IR. It has to be noted that India also has a service PE provision and therefore the risk is created of exposure to a fixed place PE, agency PE or service PE. In case of EPC contracts, there may also be a risk of construction PE exposure.

Generally speaking, the following areas seem to create PE exposure:

- Use of facilities of the subsidiary for any important work, including meeting clients for negotiation, secondment of personnel, particularly when parent or group companies retain some kind of control or the seconded person is in regular contact with the parent. If personnel of the enterprise have free access to the premises and undertake any important activities that cannot be called auxiliary functions, when the subsidiary acts almost like a sales office of the enterprise, and when the subsidiary has and habitually exercises an authority to conclude contracts even if the formal acceptance is done elsewhere.

- Where the activities of the foreign company and the Indian subsidiary are intertwined and the Indian entity participates in the economic activities of the foreign company, the activities of the Indian entity are to be analysed to determine whether there is a fixed place PE.

- There is also a view that when the subsidiary is merely an alter ego of the parent, being entirely dependent on the parent for its survival, it may result in a virtual projection of the foreign enterprise in India thereby creating a PE in India.

- When the enterprise claims to have made direct sales to customers and the subsidiary is claimed to engage purely in after-sales functions, the absence of any expenditure on selling (together with other corroborating factors) has also recently been taken as an indicator that the subsidiary is actually a PE of the enterprise.

- However, even if a subsidiary is found to be an agent, it does not necessarily follow that the subsidiary's premises are automatically at the disposal of the enterprise. The disposal test has to be separately established. In this connection, it may be noted that the Supreme Court has upheld the Delhi High Court's finding that the Indian subsidiary company will not become a location PE under article 5(1) merely because there is interaction or cross transactions between the Indian subsidiary and the foreign principal; that 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. As for the existence of a service PE under the relevant treaty, the Supreme Court held that if any customer is rendered a service in India, whether resident in India or outside India, a "service PE" would be established in India. When all the customers of the foreign entity receive services only in locations outside India, there will be no service PE when only auxiliary operations that facilitate such services are carried out in India. In another case, it has also been held that if only support services are rendered, then there will also be no PE.

- The existence of a PE may result in attribution of a part of the income of the enterprise. In some cases, the existence of a PE may be favourable to the taxpayer, particularly in the context of the treaties containing the FTS article if the same is held to be effectively connected to the PE. Indian judicial authorities have given such benefits whenever any provision is beneficial to the taxpayer."

54. Mr. Datar also placed for our consideration extracts from the **Double Taxation Conventions, A Manual on the OECD Model Tax Convention**[28]. The OECD Commentary while seeking to explain the meaning liable to be ascribed to "*preparatory*" and "*auxiliary*" functions in Paras 23 and 24 observes as follows:-

> "**23.** Sub-paragraph e) provides that a fixed place of business through which the enterprise exercises solely an activity which has for the enterprise a preparatory or auxiliary character, is deemed not to be a permanent establishment. The wording of this sub-paragraph makes it unnecessary to produce an exhaustive list of exceptions. Furthermore, this sub-paragraph provides a generalised exception to the general definition in paragraph 1 and, when read with that paragraph, provides a more selective test, by which to determine what constitutes a permanent establishment. To a considerable degree it limits that definition and excludes from its rather wide scope a number of forms of business organisations which, although they are carried on through a fixed place of business, should not be treated as permanent establishments. It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual

[28] Double Taxation Conventions, A Manual on the OECD Model Tax Convention on Income And On Capital, Philip Baker Q.C, Thomson Reuters, (2009)

realisation of profits that it is difficult to allocate any profit to the fixed place of business in question. Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a pa- tent or a know-how contract, if such activities have a preparatory or auxiliary character.

24. It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity. Where, for example, the servicing of patents and know-how is the purpose of an enterprise, a fixed place of business of such enterprise exercising such an activity cannot get the benefits of sub-paragraph e). A fixed place of business which has the function of managing an enterprise or even only a part of an enterprise or of a group of the concern cannot be regarded as doing a preparatory or auxiliary activity, for such a managerial activity exceeds this level. If enterprises with international ramifications establish a so-called "management office" in States in which they maintain subsidiaries, permanent establishments, agents or licensees, such office having supervisory and coordinating functions for all departments of the enterprise located within the region concerned, a permanent establishment will normally be deemed to exist, because the management office may be regarded as an office within the meaning of paragraph 2. Where a big international concern has delegated all management functions to its regional management offices so that the functions of the head office of the concern are restricted to general supervision (so-called polycentric enterprises), the regional management offices even have to be regarded as a "place of management" within the meaning of sub-paragraph a) of paragraph 2. The function of managing an enterprise, even if it only covers a certain area of the operations of the concern, constitutes an essential part of the business operations of the enterprise and therefore can in no way be regarded as an activity which has a preparatory or auxiliary character within the meaning of sub-paragraph e) of paragraph 4."

55. The subject of DAPEs' is explained in 5C.28 to 5C.32.1 as under:-

"**5C.28.** The fixed places of business mentioned in paragraph 4 cannot be deemed to constitute permanent establishments so long as their activities are restricted to the functions which are the prerequisite for assuming that the fixed place of business is not a permanent establishment. This will be the case even if the contracts necessary for establishing and carrying on the business are concluded by those in charge of the places of business themselves. The employees of places of business within the meaning of paragraph 4 who are authorised to conclude such contracts should not be regarded as agents within the meaning of paragraph 5. A case in point would be a research institution the manager of which is authorised to conclude the contracts necessary for maintaining the institution and who exercises this authority within the framework of the functions of the institution. A permanent establishment, however, exists if the fixed place of business exercising any of the functions listed in paragraph 4 were to exercise them not only on behalf of the enterprise to which it belongs but also on behalf of other enterprises. If, for instance, an advertising agency maintained by an enterprise were also to engage in advertising for other enterprises, it would be regarded as a permanent establishment of the enterprise by which it is maintained.

5C.29. If a fixed place of business under paragraph 4 is deemed not to be a permanent establishment, this exception applies likewise to the disposal of movable property forming part of the business property of the place of business at the termination of the enterprise's activity in such installation (ef. paragraph 11 above and paragraph 2 of Article 13). Since, for example, the display of merchandise is excepted under sub- paragraphs a) and b), the sale of the merchandise at the termination of a trade fair or convention is covered by this exception. The exception does not, of course, apply to sales of merchandise not actually displayed at the trade fair or convention.

5C. 30. A fixed place of business used both for activities which rank as exceptions 5C.30 (paragraph 4) and for other activities would be regarded as a single permanent establishment and taxable as regards both types of activities. This would be the case, for instance, where a store maintained for the delivery of goods also engaged in sales.

5C.31. It is a generally accepted principle that an enterprise should be treated as having a permanent establishment in a State if there is under certain conditions a person acting for it, even though the enterprise may not have a fixed place of business in that State within the meaning of paragraphs 1 and 2. This provision intends to give that State the right to tax in such cases. Thus paragraph 5 stipulates the conditions under which an enterprise is deemed to have a permanent establishment in respect of any activity of a person acting

for it. The paragraph was redrafted in the 1977 Model Convention to clarify the intention of the corresponding provision of the 1963 Draft Convention without altering its substance apart from an extension of the excepted activities of the person.

5C.32. Persons whose activities may create a permanent establishment for the enterprise are so-called dependent agents i.e. persons, whether employees or not, who are not independent agents falling under paragraph 6. Such persons may be either individuals or companies. It would not have been in the interest of international eco- nomic relations to provide that the maintenance of any dependent person would lead to a permanent establishment for the enterprise. Such treatment is to be limited to persons who in view of the scope of their authority or the nature of their activity involve the enterprise to a particular extent in business activities in the State concerned. Therefore, paragraph 5 proceeds on the basis that only persons having the authority to conclude contracts can lead to a permanent establishment for the enterprise maintaining them. In such a case the person has sufficient authority to bind the enterprise's participation in the business activity in the State concerned. The use of the term "permanent establishment" in this context presupposes, of course, that that person makes use of this authority repeatedly and not merely in isolated cases.

5C.32.1 Also, the phrase "authority to conclude contracts in the name of the enterprise" does not confine the application of the paragraph to an agent who enters into contracts literally in the name of the enterprise; the paragraph applies equally to an agent who concludes contracts which are binding on the enterprise even if those contracts are not actually in the name of the enterprise. Lack of active involvement by an enterprise in transactions may be indicative of a grant of authority to an agent. For example, an agent may be considered to possess actual authority to conclude contracts where he solicits and receives (but does not formally finalise) orders which are sent directly to a warehouse from which goods are delivered and where the foreign enterprise routinely approves the transactions."

56. Seeking to shed light on the meaning liable to be ascribed to the word "*habitually*" when employed in Article 5(4)(a) and used in conjunction with an authority to conclude contracts, Mr. Datar referred for our consideration the following passages from the OECD Commentary:-

"**5C.33** The authority to conclude contracts must cover contracts relating to operations which constitute the business proper of the enterprise. It would be irrelevant, for instance, if the person had authority to engage employees for the enterprise to assist that person's activity for the enterprise or if the person were authorised to conclude, in the name of the enterprise, similar contracts relating to internal operations only. Moreover the authority has to be habitually exercised in the other State; whether or not this is the case should be determined on the basis of the commercial realities of the situation. A person who is authorised to negotiate all elements and details of a contract in a way binding on the enterprise can be said to exercise this authority "in that State", even if the contract is signed by another person in the State in which the enterprise is situated or if the first person has not formally been given a power of representation. The mere fact, however, that a person has attended or even participated in negotiations in a State between an enterprise and a client will not be sufficient, by itself, to conclude that the person has exercised in that State an authority to conclude contracts in the name of the enterprise. The fact that a person has attended or even participated in such negotiations could, however, be a relevant factor in determining the exact functions performed by that person on behalf of the enterprise. Since, by virtue of paragraph 4, the maintenance of a fixed place of business solely for purposes listed in that paragraph is deemed not to constitute a permanent establishment, a person whose activities are restricted to such purposes does not create a permanent establishment either.

5C.33.1 The requirement that an agent must "habitually" exercise an authority to conclude contracts reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is "habitually exercising" contracting authority will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in paragraph 6 would be relevant in making that determination."

G. TAX AUTHORITY'S RESPONSE

57. Appearing for the respondents and while controverting the submissions of Mr. Datar, Mr. Agarwal addressed the following submissions. Mr. Agarwal first relied upon the statements of the

employees of PRIPL and more specifically the statement of Mr. Shivanshu Kaushik, DGM, PRIPL, Noida and drew our attention to the following statements made by Mr. Kaushik:

> "**Q9.** From the job profile which you explained it seems that if no new tender is floated by Indian Railway or non new tender is granted to M/s PRIPL for some time or even if a tender is granted to M/s PRIPL but the required specifications are not changed then you have nothing to do. Please put some light over it.
>
> **Ans.** In case the new tender is granted to M/s PRL., Inc., USA or M/s PRIPL, India without any change in specification of the AC-AC traction system, there are still some adjustment to be made in design. We as engineering team at this premises i.e. M/s PRIPL comprise seven (7) engineers and not only work for India specific projects/designs but also we are a part of the global team of M/s PRL Inc. and as and when asked by the USA team we also work for global designs. Our primary task is India specific but we also work for design of AC-AC traction system as well as locomotives of the global tenders of M/s PRL Inc. USA.
>
> **Q10**.Please state for which global projects/tenders of M/s PRL lnc., USA you or your team have worked till date?
>
> **Ans**. I have worked for orders of following countries on behalf of M/s PRL Inc., USA-

Country	**Order No.**	**Year**
Congo	20118584	2011 to 2013
Botswania	20138952	2015-16
Tanzania	20138903	2013 to 2015
Bangladesh	20159278	Currently

> As far as the full team is concerned I am not aware about the exact details as everyone has expertise in different field but others have also worked for global contracts of M/s PRL Inc., USA.
>
> xxxx xxxx xxxx
>
> **Q14.**When did you last work on any Indian Contract/Project?
>
> **Ans**. I have not worked on any Indian project for last 4-5 years. However, at times I have given suggestions to my other colleagues working on Indian projects."

58. Besides the aforesaid statements, Mr. Agarwal also relied upon the fact that while signing the aforesaid statements, the employees of PRIPL were affixing the seal of the petitioner. Therefore, and in this backdrop, it was contended that PRIPL was acting for and on behalf of the petitioner and that PRIPL was a "*virtual projection*" of the petitioner. He also additionally contended that the premises of PRIPL were at the complete "*disposal*" of the petitioner, thereby constituting a Fixed Place PE in India. To buttress his submissions, he also relied upon the judgment of the Supreme Court in **Formula One World Championship vs. CIT, International Taxation – 3, Delhi & Anr**[29].

59. Mr. Agarwal then submitted that PRIPL constituted a Service PE of the petitioner. In support of the aforesaid proposition, learned counsel first relied upon the response to Question No. 15 by Mr. Kaushik, where it was stated that the appraisal of his technical performance was done by employees of the petitioner and not the Indian subsidiary – PRIPL. He then relied upon emails obtained from the Noida office of PRIPL which contained information regarding visits to India by foreign expatriates, minute to minute programs of the said expatriates during their visit to India and other related information. Mr. Agarwal highlighted some of those emails and whose contents were, according to him, suggestive of foreign expatriates undertaking visits to India to overview PRIPL's operations, devise short term and long term plans for India, diversify business and to engage in discussion aiding the formulation of future business strategies. Relying upon these emails, Mr. Agarwal contended that the petitioner was furnishing

[29] (2017) 15 SCC 602

services through its employees for the benefit of PRIPL and thus constituting a Service PE under Article 5(2)(l)(ii) of the India-USA DTAA.

60. To buttress his submission that PRIPL constituted a Service PE, Mr. Agarwal also placed reliance upon the Technical Explanation of the India-USA DTAA, and more particularly to the following extracts:

> "Subparagraph (l) provides the rule for determining the conditions under which the activity of furnishing services, through employees or other personnel, constitutes a permanent establishment. These rules apply only to the provision of services which are not considered to be "included services", as the term is defined in Article 12 (Royalties and Fees for Included Services). Under the subparagraph, the furnishing of services gives rise to a permanent establishment if either the activity continues for an aggregate of more than 90 days in a twelve month period, or the services are performed for a person related to the enterprise providing the services. In the latter case, no time threshold test must be met for a permanent establishment to exist. The determination of whether persons are related for purposes of this test is made in accordance with the rules of Article 9 (Associated Enterprises). Under the U.S. Model such activities would constitute a permanent establishment only if they are exercised through a fixed place of business or by a dependent agent. (See explanation below of Ad Article 5 of the Protocol for a description of the rule applicable when the 90 day time period extends over two taxable years.)"

61. Relying upon the aforesaid explanation, Mr. Agarwal contended that even a single visit by employees of the petitioner to oversee PRIPL's India operations would constitute a Service PE, especially when there is no requirement of a specific time period for the furnishing of service by the parent enterprise for its "*related enterprise*".

62. Mr. Agarwal then contended that PRIPL constitutes a DAPE of the petitioner in terms of Article 5(4) of the India-USA DTAA. Learned counsel in this regard placed reliance upon the statement of Mr.

Phaneendra Kumar Potnuru, and more specifically to his response to Question No. 7, whereby Mr. Potnuru stated that PRIPL communicates on behalf of the petitioner with DLW, Varanasi and Indian Railways. Therefore, and in this backdrop, Mr. Agarwal contended that PRIPL acts as a DAPE for the petitioner and that it falls within the contours of Article 5(4)(a) of the India-USA DTAA, since it had the "*authority to conclude contracts*" on behalf of the petitioner.

63. Mr. Agarwal also contended that the activities of PRIPL do not fall within the negative list as specified in Article 5(3) of the India-USA DTAA and that by no stretch could the activities of PRIPL be considered to be of an "*auxiliary*" or a "*preparatory*" character. Mr. Agarwal also sought to distinguish the decisions of the Supreme Court in *E-Funds IT Solutions Inc.* and *Samsung Heavy Industries Limited*, which were cited by Mr. Datar in support of his argument that the activities of PRIPL constituted an "*auxiliary*" or "*preparatory*" function. As per Mr. Agarwal, *E-Funds IT Solutions Inc.* was a case where the Indian subsidiary was performing only back office or support service functions in order to enable the foreign company to render services to its clients abroad. That, according to learned counsel is clearly distinct from the facts which have been found by the AO in the present case.

64. Likewise, Mr. Agarwal submitted that the decision in *Samsung Heavy Industries Limited* was also a case where the Indian subsidiary's project office was functioning merely as a liaison office performing back office functions as opposed to the core business of the foreign enterprise. As per Mr. Agarwal, the said decision would not apply to

the facts of the present case, since PRIPL was assisting in the core services performed by the petitioner and therefore, it cannot be said that PRIPL was performing "*auxiliary*" or "*preparatory*" functions.

65. Finally, Mr. Agarwal submitted that the survey report, which forms the basis for the issuance of the impugned Section 148 notice had found that PRIPL was functioning as a Fixed Place PE/Service PE/DAPE and that this Court, in the exercise of its writ jurisdiction ought not to interfere with the impugned notices at this stage. Mr. Agarwal submitted that at the stage of issuance of a notice for reassessment, the AO has to merely come to a prima facie conclusion whether in the facts as gathered or obtained, a further and more detailed exercise of reassessment is warranted. According to learned counsel, the reasons which have been recorded by the AO in support of the initiation of action cannot be said to be either patently erroneous or perverse so as to warrant the exercise of our powers conferred by Article 226 of the Constitution.

H. PE- A BROAD OVERVIEW

66. While we are conscious of the limited scope of judicial scrutiny which should be brought to bear with respect to a Section 148 notice and a challenge being liable to be countenanced, only if it were to raise a serious jurisdictional question with respect to assumption of jurisdiction, we are confronted with a case, where admittedly, the first respondent would have no authority to initiate a reassessment action unless a PE were found to exist within its jurisdiction. The issue of existence of a PE and the Noida premises constituting an establishment which would fall within the ambit of Article 5 are thus aspects which

form the very basis and foundation for the invocation of the Section 148 power by the first respondent. Our task thus is limited to examining whether the view as taken by the said respondent and the conclusions drawn on the basis of the material that existed is legally sustainable and one which could have been plausibly rendered. We thus proceed to examine the challenge that stands raised, cognizant and mindful of the narrow expanse over which which our power of review must extend.

67. Mr. Datar had with his characteristic erudition and clarity not only sketched out the well-recognised principles governing the question of a PE, he had also placed for our consideration various academic texts and treatises to enable us to obtain a broader perspective on the concept of a PE. We, however, deem it apposite to additionally notice some of the principles which stand enunciated in **Klaus Vogel's** seminal work on **Double Taxation Conventions**[30]. While explaining the "*control*" test which would be determinative for the purposes of acknowledging the existence of a place of business under the sufficient command of an entity situate in one of the Contracting States, the learned author observes as under:-

> "**110**. For all types of business activities, control can be based on legal titles or factual circumstances**. Legal control** might be derived from ownership or any other right, including equitable rights under common law if the respective right conveys factual mastery of a POB to the taxpayer enterprise. Such rights are perfect where the taxpayer enterprise is the legal proprietor of the POB. Likewise, the position of the taxpayer as a tenant, a lessee (leaseholder, even in cases of short-term lease) or even a co-tenant will usually qualify as a controlling interest under Article 5(1) OECD and UN MC (no. 44 OECD MC Comm. on Article 5).

[30] Klaus Vogel on Double Taxation Conventions, Edited by Ekkehart Reimer and Alexander Rust, Wolters Kluwer, 5th edition, 2022

> **111.**But even in the absence of a legal right to use that place, the control test can be met if the taxpayer enterprise has **sufficient command** of the POB as **a matter of fact** (no. 11 et seq. OECD MC Comm. on Article 5). Thus, for instance, a PE could exist where an enterprise illegally occupied a certain location where it carried on its business (as mentioned explicitly in no. 11 et seq. OECD MC Comm. on Article 5). Likewise, a company may create a PE on the premises of an associated company if this associated company grants accommodation to, or tolerates the lasting presence of employees of the first-mentioned company (see *infra* m.no. 430 et seq.)."

68. *Klaus Vogel*, while seeking to amplify the importance of the expression "*through*" when used in the context of the business of the holding company being carried on by the subsidiary, makes the following pertinent observations:-

> "**134.** Article 5(1) OECD MC (since 1977; see *supra* m.no.45) requires that the business of an enterprise (for these terms, see supra m.no.27 et seq.) is carried on **through** the fixed POB. The preposition 'through' specifies the **functional relation** between the POB and the activities of the **taxpayer.** This relation can be described best by the notion of a functional integration of the POB in the enterprise of the taxpayer. Such functional integration contains several aspects which need to be carefully distinguished from one another. Their common denominator, however, is the type and degree of proximity of the POB to, or even identification with, the taxpayer's paramount economic activity.
>
> **135.** The first function of the term 'through' is to make it clear that the taxpayer has to **control** the PE (see *supra* m.no. 106 et seq. for details).
>
> **136.** Secondly, functional integration presupposes that the taxpayer 'wholly or partly **carrie[s] on' his business** (Article 5(1) OECD MC; the OECD MC Comm. uses the verb 'carried out' synonymously (no. 35 OECD MC Comm. on Article 5)). However, like 'business' and 'enterprise' (cf. *supra* m.no.27 et seq.), these words do not function as a substantive filter either. While early draft Model Conventions contained the condition that the fixed POR should have a productive character, this requirement was never adopted by the OECD Model (see no. 35 OECD MC Comm. On Article 5). None of the current MCs provide a specific productivity test. It follows that POBs may constitute a PE even if they perform activities which mainly or exclusively expenditures to show for.

137. Likewise, the 'carrying-on' requirement does not imply an activity in the sense of an **active and visible work**. It includes even **stand-by services and omissions**. This gains significant relevance where the omission is profitable (e.g., in the case of a POB earning money in the source State simply by fulfilling, for whichever period of time, a non-competition agreement relating to the territory of that State).

138. However, a **diffuse passivity** which equals a (temporal or lasting) suspension of the activities which the POB has been designed for may indicate that the POB is not 'permanent'. For details, see *supra* m.no.87 et seq.

139. Thirdly, the phrase 'through which' indicates that the taxpayer makes use of the POB in that he employs it is an **instrument** (equalling or resembling an operating asset) for his **entrepreneurial activities**. This third aspect of the functional integration is by far the most disputed one.

140. Historically, the instrumental character of the POB for the carrying-on of the enterprise could not be taken for granted. Between 1963 and 1977, the OEEC/OECD did not employ this term. Rather, it was sufficient that the taxpayer carried on his business '**in' the POB** (see *supra* m.no.45). Based on the old Model, some older DTCs use the words' in which' still today. While some authors have denied any divergence in substance, the 1977 amendment is a strong reason to assume a semantic shift indeed.

141. In a different context (viz., in Article 5(4.1) of the OECD and UN MC, as amended in 2017), the OECD and UN have returned, in one specific regard, to this old line by stating that an enterprise should carry on business 'at the same place'. However, the simultaneous use of this language on the one hand and the terms 'used or maintained by an enterprise' on the other, in one and the same sentence in the initial phrase of Article 5(4.1) OECD and UN MC, proves how careful and attentive the 2017 Models have been drafted. This dualism is another good reason to stipulate a different meaning of 'through', as opposed to 'in' or 'at'. For all of these reasons, we do see a **substantial difference** between both terms.

142. It follows that on the one hand, the activities mentioned in Article 5(1) OECD and UN MC need no longer be carried on 'in' or 'at' the POB. In this respect, the **1977 change** of Article 5(1) OECD MC has **enlarged the scope** of the PE definition. Especially if one thinks of an activity as a human behaviour, one can now (unlike before 1977) easily subsume unmanned facilities under the PE definition (see *supra* m.no. 45 and see, e.g., no. 127 OECD MC Comm. on Article 5).

> **143.** On the other hand, the requirement of an **instrumental character of the POB** has become irrefutable. Even stronger than the English amendment ('through which' instead of 'in which'), the corresponding modification of the French text ('par l'intermédiaire de laquelle' instead of 'où') has stressed the functional integration of the POB in the business.
>
> **144.** The **OECD MC Comm**. has weakened the meaning of 'through' since 2003. The Commentary holds the view that the requirement of a functional integration is met as soon as the taxpayer exercises the business **in a fixed POB** which is at his disposal (no. 20 OECD MC Comm. on Article 5 (added on 28 January 2003)). This is the reason for the characterization of the famous painter example (i.e., the fictitious case of a painter who, for two years, spends three days a week in the large office building of its main client) as a service PE. In substance, the view of the OECD MC Comm. limits the meaning of 'through' to the first two instead of all three semantic aspects required by Article 5(1) OECD MC (*supra* m.no. 135 et seq. and 139 et seq.)."

69. Proceeding further to deal with the concepts of "*preparatory*" and "*auxiliary*" services and which are intended to remove a place of business which may otherwise fall within the meaning of a PE, and which phraseology is mirrored in Article 5(3)(e) of the India-USA DTAA, *Klaus Vogel's* work has the following instructive passages:-

> "**59**. **[Determination of the activity's character]** It is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity.
>
> **60. [Preparatory character]** As a general rule, an activity that has a preparatory character is one that is carried on in contemplation of the carrying on of what constitutes the essential and significant part of the activity of the enterprise as a whole. Since a preparatory activity precedes another activity, it will often be carried on during a relatively short period, the duration of that period being determined by the nature of the core activities of the enterprise. This, however, will not always be the case as it is possible to carry on an activity at

a given place for a substantial period of time in preparation for activities that take place somewhere else. Where, for example, a construction enterprise trains its employees at one place before these employees are sent to work at remote work sites located in other countries, the training that takes place at the first location constitutes a preparatory activity for that enterprise. An activity that has an auxiliary character, on the other hand, generally corresponds to an activity that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole. It is unlikely that an activity that requires a significant proportion of the assets or employees of the enterprise could be considered as having an auxiliary character.

xxxx xxxx xxxx

69**. [Collect information]** The second part of subparagraph d) relates to a fixed place of business that is used solely to collect information for the enterprise. An enterprise will frequently need to collect information before deciding whether and how to carry on its core business activities in a State. If the enterprise does so without maintaining a fixed place of business in that State, subparagraph d) will obviously be irrelevant. If, however, a fixed place of business is maintained solely for that purpose, subparagraph d) will be relevant and it will be necessary to determine whether the collection of information of information goes beyond the preparatory or auxiliary threshold. Where, for example, an investment fund sets up an office in a State solely to collect information on possible investment opportunities in that State, the collecting of information through that office will be a preparatory activity. The same conclusion would be reached in the case of an insurance enterprise that sets up an office solely for the collection of information, such as statistics, on risks in a particular market and in the case of a newspaper bureau set up in a State solely to collect information on possible news stories without engaging in any advertising activities: in both cases, the collecting of information will be a preparatory activity."

70. Speaking in greater detail on the aspect of "*preparatory*" and "*auxiliary*" functions, the author observes:-

"**303.** Already before the 2017 Update to the OECD MC, all of the activities listed in Article 5(4)(a) to (f) OECD and UN MC had to be preparatory or auxiliary (infra m.mo. 304 et seq.). This followed from the use of the word '**other'** in Article 5(4)(e) UN MC. This word relates not only to the subsequent word 'activity' (otherwise, one should have expected an if-clause or a 'provided that'- clause after 'activity', like in Article 5(4)(f) UN MC) but to the entire phrase 'activity of a preparatory or auxiliary character'. The 2017

Update to the OECD MC has made this entirely clear by adding the words 'provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character' as a joint supplement to subparagraphs (a)-(f). By contrast, other requirements in Article 5(4)(e) UN MC have no paramount relevance but apply within the ambit of this subparagraph only (infra m.no. 315 et seq.).

304. The preparatory or auxiliary character of the activities listed in Article 5(4) OECD MC can be based on an **absolute standard** or based on a **relative standard**. For example, consider a comparison of two enterprises: 1) an integrated enterprise which covers many steps in the creation of value (e.g., all steps from agricultural production through the processing of raw materials, further refinement up to marketing, sale and delivery of the goods to final consumers) and 2) a specialized enterprise which focuses on one of these steps only (eg, on the delivery of goods). Suppose that each enterprise maintains a POB in a foreign State just for the sake of the delivery of goods. The same activity (the delivery of goods) is ancillary and subordinate for enterprise (1) while it constitutes the core business of enterprise (2).

305. The **amount of** value added by either enterprise is the same, and so is the potential tax revenue in the source State. An absolute standard suggests equal treatment of case (1) and (2).

306. However, the ordinary meaning of both 'preparatory' and 'auxiliary' requires the identification of a **point of reference**. One may say that the absolute standards are based on an analysis of the function of the core activity in relation to the entire chain of economic value added. It is more convincing, however, to apply relative standards in the sense that the value added is considered on a micro rather than a macro level, that is, that the core activity should be compared to the entirety of all activities exercised by the enterprise. This relative view would deny a PE in case (1), and assume a PE in case (2). This view is shared by no. 60 OECD MC Comm. on Article 5 as well as by most authors.

307. It seems to your author, however, that the strict and exclusive application of relative standards would not do justice to cases where an enterprise of type (1) above (*supra*m.no. 283) is so large that POBs which, from an absolute perspective, are respectable entities with valuable assets, a considerable number of employees and fully-fledged bureaucratic and administrative facilities of their own, just seem to be small, preparatory or auxiliary from the perspective of the company's headquarters. If they are still the **biggest employer in a given municipality**, it is hardly justified from the viewpoint of fiscal

equivalence to **exempt such POBs under Article 5(4) OECD and UN MC.**

308. It follows that a combined approach is most appropriate. While relative standards apply at the outset (*supra* m.no. 304), absolute standards require a second filter:

-The activities of a POB qualify as being 'of a preparatory or auxiliary character', as compared to the overall activities of the enterprise if they have **not more than a marginal relevance** within the enterprise's overall business plan. It should be noted that it is not the share in actual profits or losses on which the comparison should be based. Rather, the characterization of an activity as preparatory and/or auxiliary depends on the type, sector and intensity of the activity, as compared to the core business of the enterprise as a whole.

-If the activities of a POB qualify as preparatory and/or auxiliary under these relative standards, they still do not fall under Article 5(4) OECD MC if the POB (and the activities exercised through it) alone, when looked at separately from the rest of the enterprise, **exceeds a certain size and degree of professional entrepreneurship.**

xxxx xxxx xxxx

313. A further group of examples covers rooms and facilities which an employer makes available in order to accommodate his employees or help them to recreate or spend their idle time. This includes hotels, bedrooms, lounges or restrooms maintained outside the ordinary premises which the employer uses for the purpose of his core business. Similarly, locker rooms and coaches' rooms occupied by a baseball team while playing in venues outside the headquarters of the team do not constitute PEs of the baseball clubs. In contrast, **sales activities of a manufacturing company** are not of an auxiliary character. If they occur in a fixed POB, they create a PE even if the sales contracts are subject to approval by the head office or another PE."

71. The expression "*habitually*" as appearing in Article 5(4) is succinctly explained by *Vogel* as under:-

"98. **[Requirement of habitual exercise]** The requirement that an agent must 'habitually' conclude contracts or play the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise reflects the underlying principle in Article 5 that the presence which an enterprise maintains in a Contracting State should be more than

merely transitory if the enterprise is to be regarded as maintaining a permanent establishment, and thus a taxable presence, in that State. The extent and frequency of activity necessary to conclude that the agent is 'habitually' concluding contracts or playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise will depend on the nature of the contracts and the business of the principal. It is not possible to lay down a precise frequency test. Nonetheless, the same sorts of factors considered in paragraph 6 would be relevant in making that determination."

72. Of equal significance are the following principles which are set out by the author while seeking to emphasize the necessity of it being found that the subsidiary or asserted PE carries on activities which are recurrent in nature:-

"**91.** Within the permanence test, a crucial problem arises wherever the taxpayer enterprise does not perform its activities continuously, but activities are performed with **significant interruptions** (as opposed to those described *supra* m.no.87 et seq.) or in **multiple tranches**. Where none of these activities of a recurrent nature meets the requirement of 'permanence' in itself, a PE may still exist if the single activity forms part of one comprehensive project or one ongoing homogeneous business.

92. The standards are stricter than under Article 5(5) OECD and UN MC, however. While an agent qualifies as a PE as soon as he exercises his authority to conclude contracts 'habitually' ('habituellement"), a POB constitutes a 'permanent' establishment under Article 5(1) OECD and UN MC only under more rigorous conditions. It is required that, given its frequency and rhythm, the recurring activities are **equal to a non-transient business** from an economic viewpoint. Here, the **conceptual criterion** is the question: Could the taxpayer have reasonably set up a subsidiary (rather than a POB) for the same activities? If so, we can equate the activities of a recurrent nature with a corresponding permanent uninterrupted activity.

93. The OECD MC Comm. suggests that each **period of time** during which the place is used should be considered in combination with the **number of times** during which that place is used, even if these periods extend over a number of years (no. 29 OECD MC Comm. on Article 5). Where each period is of the same numbers of days, a multiplication of the duration of the single periods with the number of periods is plausible. In contrast, where the single periods vary in

length, all periods should be added on the basis of full days (see *supra* m.no.78 et seq.). Typically, the shorter each single period is, the more regular and the more often the activity should recur (cf. no. 32 OECD MC Comm. on Article 5). This hypothesis cannot be used in a strictly mathematical sense, however.

94. Whether or not such comprehensive project or ongoing homogeneous business can be acknowledged should be decided under the same criteria as the concept of one single project or venture (*supra* m.no. 64 et seq.).

95. Based on the above-mentioned standards, a PE has convincingly been acknowledged in the case of a **market pitch** which a taxpayer used on a regular basis year in, year out. Likewise, a PE has been acknowledged in the case of a US resident salesman who sold wares at an exhibition in Canada from a **trailer and portable sales booth** two weeks each year for fifteen years. However, twice he left the trailer and stand in Canada between exhibitions, allegedly for repairs. It seems to your author that this decision is not beyond doubt, however. Similarly, the Swedish Kammarrätteni Göteborg ruled that the activities of a recurrent nature of a German company constituted a PE in Sweden despite the fact that the activities lasted only for a short period of time every year. In the case at hand a German company tested a special software for cars during the winter in northern Sweden. The activities in Sweden lasted only for three or four month search year with alternating employees. The Kammarrätten ruled that the company had fixed POB in Sweden although it was not present in Sweden for more than six months, given that the company was testing its software in Sweden for several years at the same place. Quite far-fetched, yet again not unjustifiable is the Formula One (F1) judgement of the Indian High Court of 30 November 2016 where the Court acknowledged an Indian PE of a UK resident company that had access to an Indian company's premises for up to six weeks during the F1 Championship season each year for a five year period. The UK Company entered into two contracts giving the Indian Company rights to host, stage and promote the F1 Grand Prix of India.

96. Not every recurring activity qualifies as a permanent activity. The longer it takes for the enterprise to **fulfil the 183-day requirement**, the less convincing is the acknowledgment of such recurring activities as 'permanent'.

97. Examples where a PE has correctly been **denied** include:

- a Norwegian case concerning **fifty stays** within **600 days** divided in different offices and in two different cities;

- **travelling circuses**, **ice skating shows** and similar enterprises which carry on their business on an itinerant basis do not create a PE at the places where they perform for no more than a short period;

- **dancing and music groups** who come to the source State only once a year.

- a repeated entry of **a horse in races** within the source State, provided that each race takes place at a different race course."

I. RESPONDENTS' TAKE ON PE- A RECAP

73. Reverting then to the facts as they obtain here, we take note of the basic and principal conclusions which have been derived from the material which was gathered in the course of the survey as well as thereafter, and which constitutes the foundation for the first respondent forming the opinion that sufficient ground existed for initiation of action under Section 148 of the Act. The first respondent initially observes that the Indian subsidiary - PRIPL was authorized to take all decisions pertaining to tenders and action with respect to sales to DLW on behalf of the petitioner. It proceeds further to chronicle the functions performed by the Indian subsidiary to include subjects such as work relating to tenders, submission thereof, follow up for release of purchase orders, freight forwarding, tracking of delivery to DLW, Varanasi and others.

74. It then took into consideration the fact that as many as 13 key officers of the Indian entity report directly to the petitioner. Proceeding further to notice the constitution of the Board of the Indian subsidiary, the first respondent noted that of the four, two are foreign nationals and represent the petitioner in the top echelon of the management of the subsidiary. Proceeding further to highlight the functions which the Indian subsidiary performs for the petitioner, it has taken note of the **Marketing and Engineering Services Agreement dated 01 January**

2011[31] and the obligation of the Indian entity in terms thereof to provide support in relation to Marketing, Engineering, Servicing, Warehousing, Assembly and Sourcing.

75. Dealing with the Second Amendment to that agreement, it also proceeded to observe that the Indian entity was also discharging functions pertaining to compliance, inventory management, transportation and shipping functions. On the basis of the aforesaid, it came to hold that the activities discharged by the Indian subsidiary could not be said to be "*preparatory*" or of an "*auxiliary*" character.

76. The first respondent also highlights the statement of Mr. Jeetendra Pratap Singh, who is asserted to have stated that the office to which he was attached also worked for the petitioner. He is also asserted to have stated that all decisions relating to pricing of goods intended to be supplied to DLW, Varanasi by the petitioner was being controlled by the Indian subsidiary. The first respondent also bore in consideration the visits by senior officers of the petitioner to India during the period in question. On the basis of the aforesaid, it ultimately came to conclude that it was evident that the premises of the Indian subsidiary at Noida constituted a "*virtual projection*" of the petitioner and that since the activities and functions discharged by that entity could not be said to be confined to "*preparatory*" or "*auxiliary*" services, a PE came into existence and consequently the income earned and generated by the Indian subsidiary was liable to tax.

77. Having noticed the principal grounds which weighed upon the first respondent to initiate the reassessment, this would be an appropriate juncture to advert to the relevant articles of the India-USA

[31] MES Agreement

DTAA in order to lend context and clarity to the discussion which follows.

J. ANALYSING ARTICLE 5 OF THE INDIA-USA DTAA

78. Article 5(1) defines the term "*permanent establishment*" to mean "*a fixed place of business through which the business of an enterprise is wholly or partly carried on*". The aforesaid definition contains and speaks of three primary factors, namely, "*a fixed place of business*", being a place from where the business of an enterprise is conducted. The second strand of that definition is the expression "*through which*" and which underlines the primary purpose for which the place of business is to be utilised. The last of the determinative indicators of a PE is concerned with the aforesaid business activity being "*wholly or partly carried on*" therefrom. Some of the categories of establishments which stand specifically included are thereafter set out in clauses (a) to (k) of Article 5(2) and which include a "*place of management*", "*a branch*", "*an office*", "*a factory*" and "*workshop*" amongst others.

79. Article 5(2)(l) of the India-USA DTAA enumerates the conditions which if found to exist would lead to the creation of a Service PE. In terms of that Article, where it is found that the entity of a Contracting State is engaged in providing services through employees or other personnel in another Contracting State, and where those services are rendered for a "*related enterprise*", it would result in a Service PE coming into existence. Article 5(3) constitutes the negative list, and in terms of which activities of the nature specified therein would result in a presumption of a PE being dispelled.

80. Article 5(4) then proceeds to deal with what is commonly known in the context of tax treaties as DAPE. An establishment existing in

one of the Contracting States which stands empowered to "*habitually*" exercise "*an authority to conclude*" contracts is one of the first categories which the treaty would recognize as constituting a DAPE. A similar conclusion would be liable to be drawn if it were found that the establishment "*habitually*" maintains a "*stock of goods or merchandise*" for supply on behalf of an enterprise situated outside that Contracting State. The last of the categories which stand culled out in terms of Article 5(4) are those enterprises who while situated in one of the Contracting States are engaged in "*habitually*" securing orders "*wholly or almost wholly*" for the foreign enterprise.

K. THE COURT'S ANALYSIS

81. Having broadly set out the construct of Article 5 and the three categories of PEs' which are envisaged therein, this would be an appropriate juncture to commence the evaluation of the conclusions recorded by the first respondent. As we read the reasons recorded for initiating action under Sections 147/148 of the Act, it becomes manifest that the first respondent has sought to place the petitioner in all three conceivable silos of PEs', namely, a Fixed Place PE, Service PE and DAPE.

K.1. THE SERVICE PE

82. However, and insofar as the asserted stand of the first respondent of the Indian establishment constituting a Service PE is concerned, suffice it to state that the same is thoroughly misconceived and untenable as is manifestly evident from a plain reading of Article 5(2)(l) of the India-USA DTAA. As we had noticed hereinabove, the same is concerned with situations where a foreign enterprise performs or provides services to a "*related enterprise*" in the other State. The

respondent nowhere asserts or places reliance upon any material which may have even remotely established or indicated that the petitioner is rendering services in favour of the wholly owned Indian subsidiary. As we peruse the reasons that have been assigned, it becomes apparent that this conclusion is based solely on the visit of employees of the petitioner and their travel itineraries having been discovered. That cannot possibly be countenanced as being sufficient to render a finding with respect to Service PE.

83. In order to fall within the ambit of Article 5(2)(l)(ii), it was incumbent upon the respondents to have established that the employees of the petitioner were in fact discharging functions in connection with the business of the Indian entity. In fact, the Article envisages the rendering of service "*for a related enterprise*". A finding on Service PE could not have been rendered unless the respondents had found that the petitioner had deployed personnel who were posted in the Indian establishment, and were concerned with performing services for the Indian subsidiary. In fact, and as would be evident from a reading of the reasons set out for initiating action under Sections 147/148, the same were principally concerned with the Indian subsidiary performing functions and services for the petitioner. These reasons form the foundation for the respondent holding that the Indian subsidiary constituted a DAPE. Both are thus clearly self-contradictory. In any case, the principal agreements which were taken into consideration related to services that the Indian entity was to discharge and that too on the basis of remuneration, which was asserted to be at arm's length.

84. All that need be additionally stated in this regard is that the mere fact that if the petitioner standing in the shoes of the parent company

deemed it appropriate and expedient to exercise a degree of managerial oversight, the same would not result in a Service PE coming into existence. The visit of employees of the parent company, their interaction with employees of the Indian subsidiary, discussion on subjects of mutual concern or interest is not the rendering of a service. Such forays are principally concerned with sharing of best practices, experiences and problem solving. It cannot possibly be understood to constitute the rendering of a service. Similarly, the periodic visits of employees of the petitioner to India were at best liable to be recognised as an extension of the right of the holding company to oversee India operations and exercise broad managerial oversight. These are, as some authors have chosen to describe, *"normal management contribution"*. Therefore, and in light of the aforesaid discussion, we find that the argument addressed on Article 5(2)(l) of the DTAA is wholly misconceived and untenable.

K.2. THE FIXED PLACE PE

85. That leads us to examine the correctness of the opinion as formed with respect to the Noida factory and the Varanasi office constituting a Fixed Place PE. Decades before global commerce attained the degree of complexity which attaches to it today, the Andhra Pradesh High Court in **Commissioner of Income Tax, Andhra Pradesh vs. Vishakapatnam Port Trust**[32], and which decision constitutes the locus classicus on the subject, explained the concept of a "*permanent establishment*" as postulating a substantial element of presence of a foreign enterprise in another country. The presence, as Jagannadha Rao, J. explained, had to additionally meet the test of an enduring and

[32] 1983 SCC Online AP 287

permanent nature. It was this seminal decision which propounded the concept of "*virtual projection*".

86. The principles pertaining to Fixed Place PE were more lucidly explained by the Supreme Court in *Formula One World Championship Limited* in the following terms: -

> "**30.** Emphasising that as a creature of international tax law, the concept of PE has a particularly strong claim to a uniform international meaning, Philip Baker discerns two types of PEs contemplated under Article 5 of OECD Model. First, an establishment which is part of the same enterprise under common ownership and control—an office, branch, etc., to which he gives his own description as an "associated permanent establishment". The second type is an agent, though legally separate from the enterprise, nevertheless who is dependent on the enterprise to the point of forming a PE. Such PE is given the nomenclature of "unassociated permanent establishment" by Baker. He, however, pointed out that there is a possibility of a third type of PE i.e. a construction or installation site may be regarded as PE under certain circumstances. In the first type of PE i.e. associated permanent establishments, primary requirement is that there must be a fixed place of business through which the business of an enterprise is wholly or partly carried on. It entails two requirements which need to be fulfilled: (*a*) there must be a business of an enterprise of a contracting State (FOWC in the instant case); and (*b*) PE must be a fixed place of business i.e. a place which is at the disposal of the enterprise. It is 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.
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> **33.** 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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38. 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….

39. 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:

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

(*ii*) this place of business must be "fixed" i.e. it must be established at a distinct place with a certain degree of permanence;

(*iii*) 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.

40. The term "place of business" is explained as covering any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose. It is clarified that a place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal. Further, it is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. A certain amount of space at the disposal of the enterprise which is used for business activities is sufficient to constitute a place of business. No formal legal right to use that place is required. Thus, where an enterprise illegally occupies a certain location where it carries on its business, that would also constitute a PE. Some of the examples where premises are treated at the disposal of the enterprise and, therefore, constitute PE are: a place of business may thus be constituted by a pitch in a market place, or by a certain permanently used area in a customs depot (e.g. for the storage of dutiable goods). Again the place of business may be situated in the

business facilities of another enterprise. This may be the case for instance where the foreign enterprise has at its constant disposal certain premises or a part thereof owned by the other enterprise. At the same time, it is also clarified that the mere presence of an enterprise at a particular location does not necessarily mean that the location is at the disposal of that enterprise.

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74. As per Article 5 of the DTAA, the PE has to be a fixed place of business "through" which business of an enterprise is wholly or partly carried on. Some examples of fixed place are given in Article 5(2), by way of an inclusion. Article 5(3), on the other hand, excludes certain places which would not be treated as PE i.e. what is mentioned in clauses (*a*) to (*f*) as the "negative list". A combined reading of sub-articles (1), (2) and (3) of Article 5 would clearly show that only certain forms of establishment are excluded as mentioned in Article 5(3), which would not be PEs. Otherwise, sub-article (2) uses the word "include" which means that not only the places specified therein are to be treated as PEs, the list of such PEs is not exhaustive. In order to bring any other establishment which is not specifically mentioned, the requirements laid down in sub-article (1) are to be satisfied. Twin conditions which need to be satisfied are: (*a*) existence of a fixed place of business; and (*b*) through that place business of an enterprise is wholly or partly carried out.

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85. We are of the opinion that the test laid down by the Andhra Pradesh High Court in *Visakhapatnam Port Trust case* [*CIT* v. *Visakhapatnam Port Trust*, 1983 SCC OnLine AP 287 : (1983) 144 ITR 146] fully stands satisfied. Not only the Buddh International Circuit is a fixed place where the commercial/economic activity of conducting F-1 Championship was carried out, one could clearly discern that it was a virtual projection of the foreign enterprise, namely, Formula-1 (i.e. FOWC) on the soil of this country. It is already noted above that as per Philip Baker [A Manual on the OECD Model Tax Convention on Income and on Capital] , a PE must have three characteristics: **stability, productivity and dependence**. All characteristics are present in this case. Fixed place of business in the form of physical location i.e. Buddh International Circuit, was at the disposal of FOWC through which it conducted business. Aesthetics of law and taxation jurisprudence leave no doubt in our mind that taxable event has taken place in India and non-resident FOWC is liable to pay tax in India on the income it has earned on this soil."

87. As per the *Manual on the OECD Model Tax Convention*, and the precedents rendered on the subject, there are two basic conditions which are spelt out and which must be fulfilled for acknowledging a PE being existent and constituting a fixed place of business. They are:

(a) a place which stands placed at the "*disposal*" of an enterprise; and

(b) The establishment answering the characteristics of stability, productivity and dependence.

88. The expression "*disposal*" was explained to mean a right to use a place and exercise "*control*" thereupon. "*Control*" was explained further to mean the place of business being at the "*disposal*" of an enterprise and which may have use of the same to a considerable extent. It was further observed that the test of place of business being under the "*control*" of a foreign enterprise would be met even though the said premises may not be directly owned or taken by way of lease or on rental basis. In *Formula One World Championship Limited*, the Supreme Court observed that even a certain amount of space which may be placed at the "*disposal*" of an enterprise for the purposes of the use of its business activities would be sufficient. The Supreme Court significantly observed that for the purposes of recognizing the existence of a Fixed Place PE, no formal legal right to use need be discerned or proven. It was thus held that as long as it is space in an establishment or premises placed at the constant "*disposal*" of the enterprise, it would satisfy the test of a Fixed Place PE as contemplated under Articles 5 (1) and 5(2)(a)-(k) of the DTAA.

89. The principles governing Fixed Place PE were again spelt out and enunciated by the Supreme Court in *Morgan Stanley & Co. Inc* and

Samsung Heavy Industries Company Limited. In *Morgan Stanley & Co. Inc*, and where the following pertinent observations came to be rendered:

> "**8.** With globalisation, many economic activities spread over to several tax jurisdictions. This is where the concept of PE becomes important under Article 5(1). There exists a PE if there is a fixed place through which the business of an enterprise, which is multinational enterprise (MNE), is wholly or partly carried on. In the present case MSCo is a multinational entity. As stated above it has outsourced some of its activities to MSAS in India. A general definition of PE in the first part of Article 5(1) postulates the existence of a fixed place of business whereas the second part of Article 5(1) postulates that the business of MNE is carried out in India through such fixed place. One of the questions which we are called upon to decide is whether the activities to be undertaken by MSAS consist of back office operations of MSCo and if so whether such operations would fall within the ambit of the expression "the place through which the business of an enterprise is wholly or partly carried out" in Article 5(1).
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> **10.** In our view, the second requirement of Article 5(1) of DTAA is not satisfied as regards back office functions. We have examined the terms of the Agreement along with the advance ruling application made by MSCo inviting AAR to give its ruling. It is clear from reading of the above Agreement/application that MSAS in India would be engaged in supporting the front office functions of MSCo in fixed income and equity research and in providing IT enabled services such as data processing support centre and technical services as also reconciliation of accounts. In order to decide whether a PE stood constituted one has to undertake what is called as a functional and factual analysis of each of the activities to be undertaken by an establishment. It is from that point of view, we are in agreement with the ruling of AAR that in the present case Article 5(1) is not applicable as the said MSAS would be performing in India only back office operations. Therefore to the extent of the above back office functions the second part of Article 5(1) is not attracted."

90. *Morgan Stanley & Co. Inc*. was followed by the Supreme Court in *Samsung Heavy Industries Company Limited* and where and in the context of a Fixed Place PE, the Supreme Court held:

"**24.** A recent judgment of this Court, namely, *E-Funds IT Solution Inc.* [*CIT* v. *E-Funds IT Solution Inc.*, (2018) 13 SCC 294] , concerned itself with the India-US Double Taxation Avoidance Agreement with similar provisions. Dealing with what was referred to as a "fixed place", permanent establishment, this Court held : (SCC p. 310, para 16)

> "*16*. The Income Tax Act, in particular Section 90 thereof, does not speak of the concept of a PE. This is a creation only of 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 fulfil 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."

25. Dealing with "support services" rendered by an Indian company to American companies, it was held that the outsourcing of such services to India would not amount to a fixed place permanent establishment under Article 5 of the aforesaid treaty, as follows : (*E-Funds IT Solution Inc. case* [*CIT* v. *E-Funds IT Solution Inc.*, (2018) 13 SCC 294] , SCC p. 320, para 22)

> "*22*. 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 [*CIT* v. *E-Funds IT Solution*, (2014) 9 HCC (Del) 70 : (2014) 364 ITR 256] is, therefore, correct on this score."

26. A reading of the aforesaid judgments makes it clear that when it comes to "fixed place" permanent establishments under double

taxation avoidance treaties, the condition precedent for applicability of Article 5(1) of the double taxation treaty and the ascertainment of a "permanent establishment" is that it should be an establishment "through which the business of an enterprise" is wholly or partly carried on. Further, the profits of the foreign enterprise are taxable only where the said enterprise carries on its core business through a permanent establishment. What is equally clear is that the maintenance of a fixed place of business which is of a preparatory or auxiliary character in the trade or business of the enterprise would not be considered to be a permanent establishment under Article 5. Also, it is only so much of the profits of the enterprise that may be taxed in the other State as is attributable to that permanent establishment."

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31. Though it was pointed out to ITAT that there were only two persons working in the Mumbai office, neither of whom was qualified to perform any core activity of the assessee, ITAT chose to ignore the same. This being the case, it is clear, therefore, that no permanent establishment has been set up within the meaning of Article 5(1) of the DTAA, as the Mumbai project office cannot be said to be a fixed place of business through which the core business of the assessee was wholly or partly carried on. Also, as correctly argued by Shri Ganesh, the Mumbai project office, on the facts of the present case, would fall within Article 5(4)(*e*) of the DTAA, inasmuch as the office is solely an auxiliary office, meant to act as a liaison office between the assessee and ONGC. This being the case, it is not necessary to go into any of the other questions that have been argued before us."

91. When we test the stand taken by the respondents, bearing in mind the aforesaid precepts as culled out from the various judgments noticed hereinabove, we find ourselves unable to sustain even the prima facie formation of opinion by the first respondent in this respect. It is pertinent to note that the impugned notices and the reasons set out for initiating action under Sections 147/148 nowhere allude to a particular space or a part of the premises situated in Noida or Varanasi having been placed under the exclusive or significant "*control*" or *"disposal"* of the petitioner. The first respondent fails to rest its prima facie opinion

with respect to Fixed Place PE on any part of the Noida or Varanasi premises which may have been set apart or exclusively placed in and under the "*control*" of the petitioner for use of its business activities and which may have tended to indicate that the space was made available for the use of the petitioner and from where it was conducting its business activities. It would have had to be shown that the "*control*" of that space answered the test of considerable extent. We recall *Vogel* describing this particular genre of a PE as being akin to an *"instrument (equalling or resembling an operating asset) for his entrepreneurial activity"*. The concept of "*virtual projection*" is concerned with a functional integration between the two units and which would mean an establishment which has been virtually used for all purposes to carry out the paramount business activity of the petitioner. None of these factors are either alluded to or appear to have been borne in consideration before arriving at the conclusion that the Indian establishment constituted a Fixed Place PE.

92. While it is true that at the stage of initiating an action of reassessment, the first respondent was obliged to merely arrive at a preliminary satisfaction, as we view the ultimate reasons assigned, they clearly fall short of being reflective of the question of a Fixed Place PE having been answered in accordance with the principles consistently recognized to govern that particular aspect.

93. As had been eloquently observed by the Andhra Pradesh High Court in *Vishakapatnam Port Trust*, the Noida and/or the Varanasi premises would have had to be found to amount to a "*virtual projection*", and thus essentially a complete takeover of the premises, either in its entirety or even in part, for the purposes of conducting the

core business activities of the petitioner. None of the material which has been relied upon for the formation of opinion to initiate action under Section 148 answers the aforesaid test.

94. We also take note of the judgment in *Formula One World Championship Limited*, and where it was significantly observed that a PE must qualify and meet the tests of stability, productivity and dependence. Of equal significance were the observations which explained the phrases "*at the disposal of*" and "*through*". Tested on the aforesaid precepts also, the impugned notices and the reasons set out for initiating action under Sections 147/148 woefully fail to rest on any evidence which could have possibly compelled us in acknowledging that a Fixed Place PE had come into being.

95. Undisputedly, the Noida factory premises and the Varanasi office would clearly not fall under any of the categories which stand specifically enumerated in Article 5(2) and sub-clauses (a) to (k) of the India-USA DTAA. We also bear in mind the distinct and divergent categories of products, and in the manufacture of which, the petitioner and the Indian subsidiary were engaged. Of equal significance was the Noida outfit undertaking manufacturing activity in its own right and supplying products to various arms of the Indian Railways. All of the above, in our considered opinion, when viewed cumulatively, would have been sufficient to dispel any presumption of the petitioner conducting its business activity from a permanent premises situate in India. We are consequently of the firm opinion that the assumption of a Fixed Place PE is misconceived and untenable.

K.3. ARTICLE 5(3)- PREPARATORY AND AUXILIARY FUNCTIONS

96. We then proceed to test the correctness of the prima facie conclusions arrived at by the first respondent on the anvil of Article 5(3) of the India-USA DTAA. As was noticed hereinabove, Article 5(3) excludes PEs' which may otherwise fall within the ambit of Article 5(1) or Article 5(2), if it were found that the said PE were engaged in the discharge of functions enumerated therein. While and undisputedly sub-clauses (a), (b) and (c) of Article 5(3) are not even invoked, even if we were to examine the correctness of the view taken by the first respondent based on sub-clauses (d) and (e), we find ourselves unable to sustain the impugned notices and the reasons set out for initiating action under Sections 147/148, basis which the impugned notices were issued.

97. In terms of Article 5(3)(d), if a PE were to be engaged solely for the purposes of purchase of goods or merchandise, or for that matter for "*collecting information*" for a foreign enterprise, the same would stand excluded from the ambit of sub-clauses (1) & (2) of Article 5. The first respondent appears to have been heavily influenced by the Indian subsidiary - PRIPL routing communications between the petitioner and DLW and other arms of the Indian Railways. The first respondent also alludes to certain supportive functions such as gathering of information and other allied activities allegedly undertaken by PRIPL for and on behalf of the petitioner. It becomes pertinent to note that be it collecting information or for that matter studying market trends or future business prospects, the same would clearly fall not only within the ken of sub-clause (d), but also partly within the scope of sub-clause (e) of Article 5(3). This, since both sub-clauses (d) & (e) are concerned with collection or supply of information. We also bear in consideration the

Supreme Court in *Morgan Stanley & Co. Inc* having held that market research or analysis, data processing support or for that matter, account reconciliation are essentially back office functions and support services and which would not be sufficient to acknowledge a Fixed Place PE existing.

98. That takes us then to further test the stand as struck by the respondents and to examine the correctness of their conclusion that the activities undertaken by the Indian subsidiary could not be said to be of a "*preparatory*" or "*auxiliary*" character. The decision of the Supreme Court in *Morgan Stanley & Co. Inc*., while explaining the meaning to be ascribed to support services and activities of a "*preparatory*" or an "*auxiliary*" nature enunciates the legal position in the following terms:

> "**10.** In our view, the second requirement of Article 5(1) of DTAA is not satisfied as regards back office functions. We have examined the terms of the Agreement along with the advance ruling application made by MSCo inviting AAR to give its ruling. It is clear from reading of the above Agreement/application that MSAS in India would be engaged in supporting the front office functions of MSCo in fixed income and equity research and in providing IT enabled services such as data processing support centre and technical services as also reconciliation of accounts. In order to decide whether a PE stood constituted one has to undertake what is called as a functional and factual analysis of each of the activities to be undertaken by an establishment. It is from that point of view, we are in agreement with the ruling of AAR that in the present case Article 5(1) is not applicable as the said MSAS would be performing in India only back office operations. Therefore to the extent of the above back office functions the second part of Article 5(1) is not attracted.
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> **14.** There is one more aspect which needs to be discussed, namely, exclusion of PE under Article 5(3). Under Article 5(3)(*e*) activities which are preparatory or auxiliary in character which are carried out at a fixed place of business will not constitute a PE. Article 5(3) commences with a non obstante clause. It states that notwithstanding

what is stated in Article 5(1) or under Article 5(2) the term PE shall not include maintenance of a fixed place of business solely for advertisement, scientific research or for activities which are preparatory or auxiliary in character. In the present case we are of the view that the abovementioned back office functions proposed to be performed by MSAS in India falls under Article 5(3)(*e*) of DTAA. Therefore, in our view in the present case MSAS would not constitute a fixed place PE under Article 5(1) of DTAA *as regards its back office operations*."

99. Dealing with the very same issue, the Supreme Court in *E-Funds IT Solutions Inc.* made the following pertinent observations:

"**21.**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 13-3-2009, 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*

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Services provided by e-Funds US: e-Funds 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 e-Funds India: The only involvement of e-Funds 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*

e-Funds 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.

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Services provided by e-Funds US: e-Funds 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 e-Funds US. All risks and responsibilities for performance of the contract at all times were of e-Funds US only. All software's/solutions are developed by e-Funds US. Software writing and conceptualisation of ideas were done by e-Funds US. All networks and infrastructure for this category of services is owned by e-Funds US only. Connex was developed by a company acquired by e-Funds US. e-Funds 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, e-Funds 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 e-Funds India: e-Funds India provided testing, bug fixing and other related software development support services to e-Funds US for various software/software based solutions developed by e-Funds US. Such services are required by e-Funds 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 e-Funds US which avails the services of e-Funds India for bug fixing.

The work performed by e-Funds India for e-Funds 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*

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Services provided by e-Funds US: e-Funds US was responsible for customer interface and agreement/contracts with the customers were entered into by e-Funds US. All risks and responsibilities for performance of contracts at all times were of e-Funds US only. All e-Funds risk management services are based on, or enhanced by e-Funds' proprietary Debit Bureau database, which is located in data centres of the group situated in USA. Debit Bureau contains over three billion records and includes data form e-Funds Chex Systems SM and Scansm databases and other sources. The data in Debit Bureau is used to screen for potentially incorrect, inconsistent, or fraudulent social security numbers, home addresses, telephone numbers, driver licence information, and other indicators of possible identity manipulation. Using this data, e-Funds 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. e-Funds US software development centres in the United States, as well as in the US data centres and remotely at the customers' sites develop and maintain software for these service offerings.

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

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

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

xxxx xxxx xxxx

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

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

(*i*) Data Processing Services including making outbound calls to collate data;

(*ii*) Making soft outbound calls to customers of e-Funds US clients to follow up payment; and

(*iii*) Responding to inbound calls from customers from dealers/customers of telecom services providers (who are customers of e-Funds 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 e-Funds India directly by Logica Global. The appellant had nothing to do with this contract."

22. 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."

100. A more elaborate discussion on this aspect is found in its decision in *UAE Exchange Centre*. The Supreme Court while dealing with this issue held:

"**28.** The expression "preparatory" is not defined in the 1961 Act or the DTAA. The dictionary meaning of that expression can be traced to term "preparatory work" and "travaux preparatoires", which in *Black's Law Dictionary* (11th Edn.), read thus:

"*preparatory work*. See travaux preparatoires.

travaux préparatoires. Materials used in preparing the ultimate form of an agreement or statute, and esp. of an international treaty; the draft or legislative history of a treaty."

29. The expression "auxiliary" is also not defined in the 1961 Act or the DTAA. In common parlance, the meaning of that expression is predicated in *Concise Oxford English Dictionary* (12th Edn.), which reads thus:

"*Auxiliary-adj*. providing additional help or support. *n*. an auxiliary person or thing. N. Amer. A group of volunteers who assist a church, hospital, etc. with charitable activities."

In *Black's Law Dictionary* (11th Edn.), the term "auxiliary" is defined as follows:

"*Auxiliary* adj. *1*. Aiding or supporting. *2*. Subsidiary. *3*. Supplementary."

30. The crucial activities in the present case are of downloading particulars of remittances through electronic media and then printing cheques/drafts drawn on the banks in India, which, in turn, are couriered or dispatched to the beneficiaries in India, in accordance with the instructions of the NRI remitter. While doing so, the liaison office of the respondent in India remains connected with its main server in UAE and the information residing thereat is accessed by the liaison office in India for the purpose of remittance of funds to the beneficiaries in India by the NRI remitters. These are combination of virtual and physical activities unlike the virtual activity of funds being remitted by telegraphic transfer through banking channels. As regards the latter, it is not the case of the Department that the same would be covered and amenable to tax liability by virtue of deeming provision in the 1961 Act.

31. While answering the question as to whether the activity in question can be termed as other than that "of preparatory or auxiliary character", we need to keep in mind the limited permission given by RBI to the respondent under Section 29(1)(*a*) of the 1973 Act, on 24-9-1996. From Para 2 of the stated permission, it is evident that RBI had agreed for establishing a liaison office of the respondent at Cochin, initially for a period of three years to enable the respondent to:

(*i*) respond quickly and economically to enquiries from correspondent banks with regard to suspected fraudulent drafts;

(*ii*) undertake reconciliation of bank accounts held in India;

(*iii*) act as a communication centre receiving computer (via modem) advices of mail transfer T.T. stop payments messages, payment details, etc., originating from the respondent's several branches in UAE and transmitting to its Indian correspondent banks;

(*iv*) printing Indian Rupee drafts with facsimile signature from the Head Office and counter-signature by the authorised signatory of the office at Cochin; and

(*v*) following up with the Indian correspondent banks.

These are the limited activities which the respondent has been permitted to carry on within India. This permission does not allow the respondent assessee to enter into a contract with anyone in India,

but only to provide service of delivery of cheques/drafts drawn on the banks in India.

32. Notably, the permitted activities are required to be carried out by the respondent subject to conditions specified in Clause 3 of the permission, which includes not to render any consultancy or any other service, directly or indirectly, with or without any consideration and further that the liaison office in India shall not borrow or lend any money from or to any person in India without prior permission of RBI. The conditions make it amply clear that the office in India will not undertake any other activity of trading, commercial or industrial, nor shall it enter into any business contracts in its own name without prior permission of RBI. The liaison office of the respondent in India cannot even charge commission/fee or receive any remuneration or income in respect of the activities undertaken by the liaison office in India.

33. From the onerous stipulations specified by RBI, it could be safely concluded, as opined by the High Court, that the activities in question of the liaison office(s) of the respondent in India are circumscribed by the permission given by RBI and are in the nature of preparatory or auxiliary character. That finding reached by the High Court is unexceptionable.

xxxx xxxx xxxx

36. Having said thus, it must follow that the respondent was not carrying on any business activity in India as such, but only dispensing with the remittances by downloading information from the main server of the respondent in UAE and printing cheques/drafts drawn on the banks in India as per the instructions given by the NRI remitters in UAE. The transaction(s) had completed with the remitters in UAE, and no charges towards fee/commission could be collected by the liaison office in India in that regard. To put it differently, no income as specified in Section 2(24) of the 1961 Act is earned by the liaison office in India and more so because, the liaison office is not a PE in terms of Article 5 of DTAA (as it is only carrying on activity of a preparatory or auxiliary character). The concomitant is — no tax can be levied or collected from the liaison office of the respondent in India in respect of the primary business activities consummated by the respondent in UAE. The activities carried on by the liaison office of the respondent in India as permitted by RBI, clearly demonstrate that the respondent must steer away from engaging in any primary business activity and in establishing business connection as such. It can carry on activities of preparatory or auxiliary nature only. In that case, the deeming provisions in Sections 5 and 9 of the 1961 Act can have no bearing whatsoever."

101. The aspect of whether an Indian establishment was performing functions of a "*preparatory*" or an "*auxiliary*" character was considered by this Court in **National Petroleum Construction Co. vs. Director of Income-tax (International Taxation)**[33], and where it was pertinently observed:

> "**26.** The language of sub-paragraph (e) of paragraph (3) of article 5 of the Double Taxation Avoidance Agreement is similar to the language of sub- paragraph (e) of paragraph (4) of article 5 of the Model Conventions framed by OECD, United Nations as well as the United States of America. The rationale for excluding a fixed place of business maintained solely for the purposes of carrying on activity of a preparatory or auxiliary character has been explained by Professor Dr. Klaus Vogel. In his commentary on "Double Taxation Conventions, Third Edition", he states that "It is recognised that such a place of business may well contribute to the productivity of the enterprise, but the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question. Examples are fixed places of business solely for the purpose of advertising or for the supply of information or for scientific research or for the servicing of a patent or a know-how contract, if such activities have a preparatory or auxiliary character".
>
> xxxx xxxx xxxx
>
> **28.** The Black's Law Dictionary defines the word "auxiliary" to mean as "aiding or supporting, subsidiary". The word "auxiliary" owes its origin to the Latin word "auxiliarius" (from auxilium meaning "help"). The Oxford Dictionary defines the word "auxiliary" to mean "providing supplementary or additional help and support". In the context of article 5(3)(e) of the Double Taxation Avoidance Agreement, the expression would necessarily mean carrying on activities, other than the main business functions, that aid and support the assessee. In the context of the contracts in question, where the main business is fabrication and installation of platforms, acting as a communication channel would clearly qualify as an activity of auxiliary character—an activity which aids and supports the assessee in carrying on its main business.
>
> **29.** In view of the above, the activity of the assessee's project office in Mumbai would clearly fall within the exclusionary clause of

[33] 2016 SCC Online Del 571

> article 5(3)(e) of the Double Taxation Avoidance Agreement and, therefore, cannot be construed as the assessee's permanent establishment in India."

102. When tested on the aforesaid principles, it becomes apparent that the activities undertaken by the Indian subsidiary clearly do not appear to travel beyond being "*preparatory*" or "*auxiliary*". It is pertinent to note that both entities do not appear to have been established with a commonality of general purpose. The expression "*preparatory*" has been understood to mean work which is undertaken in contemplation of the essential and significant part of the principal activity of an entity. The principal or for that matter the essential activity of the petitioner is the manufacture and production of goods needed by railroad companies. The principal activity is concerned with the core business activity of the petitioner. That has clearly not been shown to have been undertaken at the Noida premises. Of equal significance are the observations appearing in *National Petroleum*, and where the Court had held that while activities undertaken by an entity which is asserted to be a "*permanent establishment*" may contribute to the productivity of the foreign enterprise, but if those functions be remote from the actual realisation of profits, the tests of a PE would not be satisfied.

103. Although, we have on an independent analysis found that the Noida and Varanasi premises would not constitute a Fixed Place PE or a Service PE, the first respondent appears to have been significantly influenced by the statements which were recorded in the course of the survey, and has thereafter come to conclude that various Indian officers and employees were working in aid of the business activities of the petitioner and providing support services.

104. As we view the statement of Mr. Jeetendra Pratap Singh, it transpires that the said officer is stated to have submitted that he was providing post tender/ post agreement services such as obtaining purchase orders, delivery of goods, and providing purchase related information to the petitioner as well as the Indian subsidiary. As per his statement, he was also engaged in providing information with respect to rejections/ modification/ rectification and correction of supplies made to DLW, Varanasi. The said employee is further recorded to have stated that the risk and responsibility connected with the supply of goods prior to May 2018 was placed upon the petitioner, and that after the said period, the same came to rest with the Indian subsidiary - PRIPL. A similar disclosure was made with respect to the rate of goods to be quoted in tenders.

105. It becomes pertinent to note that the aforesaid officer appears to have discharged a dual role in keeping a track of supplies made by both the Indian subsidiary as well as the petitioner, overseeing the time frames for supply of goods and articles, as also following up on any rejections or modifications which may have been made by the procurers. The aforesaid statement is liable to be viewed in the backdrop of the undisputed fact that both the petitioner as well as the Indian subsidiary were engaged in effecting supplies to DLW and other arms of the Indian Railways. Similarly, the issue of risk and responsibility with respect to supply of goods or the quotation of rates pertained to periods both prior to and post 2018. It is however unclear from a bare reading of the extracts of that statement as to whether that function was being discharged with respect to the distinct line of

products that were being supplied by the petitioner or for the Indian subsidiary.

106. In our considered opinion, even if the aforesaid officer were assumed to be working in a dual capacity and discharging supportive functions pertaining to the independent business activity of the petitioner and of the Indian subsidiary, the same would clearly not take the case of the respondents any further. Regard must be had to the fact that the following up of purchase orders or gathering information with respect to tenders is work which is clearly of an "*auxiliary*" or "*preparatory*" character or concerned with the supply or collection of information. The follow up functions, though not asserted to have been discharged with sufficient repetition or recurrence, would fall more in the ken of an "*auxiliary*" function as opposed to a core business function.

107. The officer concerned was also asked to disclose details with respect to functional heads and the reporting mechanism of personnel. The employee significantly states that reporting to foreign personnel is essentially "*to ensure compliance with global best practices of group companies*". He further stated that performance evaluation is undertaken by functional heads present in India and insofar as it relates to employees of the Indian subsidiary. The appraisal of functional heads was stated to be a function discharged by the Indian Managing Director, the HR Department of the Indian subsidiary and "*based on feedback received from foreign managers as well*". This too is indicative of administrative control of the employees of the Indian subsidiary resting in the hands of the management situate in India. The

officer lastly submitted that from 2018 onwards, the Indian subsidiary had also started importing after-market/ spare parts from the petitioner and supplying them to customers in India. This too would be liable to be recognized as an activity independently undertaken by the Indian subsidiary as opposed to the carrying on of an essential business activity of the petitioner.

108. From the statement of Mr. Shivanshu Narendra Kaushik, it transpires that designs and inputs created by employees of the Indian subsidiary were also shared with the petitioner. The said officer further stated categorically while responding to Question No. 9 that while their primary task is "*India specific*", they were also engaged with teams created for designing traction systems as well as locomotives in relation to global tenders that may have been submitted by the petitioner. The details of the work with which the petitioner was engaged and related to overseas tenders submitted by the petitioner have also been recorded in his answer to Question No. 10. The officer then appears to have been queried with respect to the allocation of work pertaining to design of components and locomotive parts for global tenders. Responding to the said query, the officer submitted that a team is generally designated and created by the petitioner and all the team members work together and coordinate with each other.

109. It may only be observed that the engagement of Indian personnel in connection with global tenders that were proposed to be submitted or one in which the petitioner intended to participate would also clearly fall within the ambit of work of an "*auxiliary*" or "*preparatory*" character and not be in furtherance of the core activity of the petitioner.

All that need be observed is that merely because the submission of those tenders was aided by a collaborative exercise between employees of the petitioner and those of the Indian subsidiary, the same would clearly not meet the test of a complete takeover, a "*virtual projection*" or for that matter the Indian subsidiary being liable to be viewed as an "*alter ego*".

110. We are of the firm opinion that the respondents have clearly failed to appreciate that a collaborative team comprising of Indian and foreign employees would really not be indicative or evidence of the Noida or Varanasi premises having been virtually placed fully at the "*disposal*" of the petitioner. To meet that test, it would have to be found on facts that the Indian establishment was a mere conduit created for the business interests of the petitioner.

K.4. ARTICLE 5(4) AND DAPE

111. It is pertinent to recall that in order to fall within the scope of Article 5(4), it was imperative for the respondents to have found that the Indian subsidiary not only stood conferred with the "*authority to conclude contracts*" but also that it was in fact "*habitually*" engaged in acting in discharge of that authority. The issue of a habitual or recurrent exercise of authority does not arise at all since we have already found that an "*authority to conclude contracts*" never stood conferred. Suffice it to observe that there is not an iota of evidence which may have even remotely justified Article 5(4)(a) being invoked.

112. Similar is the position which emerges when the case as set up against the petitioner is examined on the anvil of Article 5(4)(c) of the India-USA DTAA. This would have required the respondents to have

established or found, as a matter of fact, that the Indian subsidiary was engaged or created solely for the purpose of securing orders for the petitioner. Clause (c) of Article 5(4) would have been attracted if the respondents had, even on a prima facie examination, found that the Indian subsidiary was concerned primarily with securing orders for the petitioner. This, in light of the said clause using the expression "*wholly or almost wholly for the enterprise*". Clause (c) not only alludes to aspects of an enterprise being exclusively concerned with working for the fulfilment of the business interests of another, it would also have to be additionally proven that it does so "*habitually*".

113. The respondents do not dispute the indubitable fact that both the petitioner as well as the Indian subsidiary had independent dealings with DLW and other arms of the Indian Railways. Of equal importance is the table which was relied upon by Mr. Datar extracted hereinabove and which indicated the extent of revenue earned by the Indian subsidiary and the minuscule percentage of that income being referable or relatable to receipts from the petitioner.

L. CONCLUDING OBSERVATIONS

114. As was noticed by us in the preceding parts of this decision, the precedents rendered on the subject of Fixed Place PE bid us to answer that question based upon a finding of a fixed place being at the "*disposal*" of and under the *"considerable control*" of a foreign enterprise. There is also no material which the respondents may have taken into consideration and which would have been indicative of the Noida or the Varanasi premises having been virtually placed for the use of the petitioner and at its discretion. Even as we go through the various

statements which came to be recorded, they fail to evidence the Noida or the Varanasi premises having been placed at the constant "*disposal*" of the petitioner.

115. For the purposes of adjudging whether a Fixed Place PE had come into existence, one would have to necessarily come to the conclusion that the core business of a foreign entity was being carried on through a PE. The core business of the petitioner is the manufacture of a wide range of products, details whereof have been set out in the preceding parts of this decision. As we view and weigh the import of the statements which have been heavily relied upon by the respondents, it becomes apparent that the view as taken is rendered wholly untenable and proceeds on various assumptions which cannot possibly be countenanced. Regard must also be had to the fact that the respondents do not allege that the products being supplied by the petitioner to DLW or other arms of the Indian Railways were being manufactured in India and through the Indian subsidiary. This is a factor which weighs heavily against the respondents.

116. Insofar as the issues emanating from the MES Agreement including the General Services Agreement dated 01 January 2011 which has been taken into consideration, those and issues arising therefrom would have to be necessarily evaluated bearing in mind the significant observations which appear in the TPO's order, which not only speaks of the Noida premises providing back office support and technical support services, but also takes into consideration the Indian subsidiary being duly remunerated for those services on a cost plus basis. Even if one were to take into consideration the nature of services

which were rendered by the Indian subsidiary under the aforesaid agreements, it becomes apparent that all of those would really fall within the scope of supportive "*preparatory*" and "*auxiliary*" services. Be it tracking of Letters of Credit for shipments, monitoring of upcoming tenders, coordinating with the petitioner for timely bid submission for tenders in the Indian market, gathering technical details, these are all services rendered which would fall under the larger umbrella of "*preparatory*" and "*auxiliary*" services.

117. We have also had an occasion to take note of Article 5(3) and sub-clauses (d) and (e) excluding fixed place of businesses used "*solely for the purpose of purchasing goods or merchandise*" or for that matter for "*collecting information*". The supply of information is a subject which is considered alongside activities which would fall within the scope of "*preparatory*" or "*auxiliary*" functions. Of equal significance is the statement of Mr. Phaneendra Kumar Potnuru, the Director-Finance of PRIPL, Noida, which came to be recorded under Section 131 of the Act. While explaining the composition of the Board of Directors of the Indian subsidiary, the Director-Finance disclosed that two out of the four Directors are foreigners. However, the mere fact that the parent company places representatives on the Board of its wholly owned subsidiary, would hardly compel one to hold that a PE had come into existence.

118. Explaining the working and the functions discharged by the Indian subsidiary, the Director-Finance stated as follows: -

> "**Q7**. Please explain the work, functions of EMD India office?
>
> **Ans.** Sir, work-functions of EMD India office are -

- AC-AC System supply to DLW, Varanasi directly.

-Manufacturing of AC-AC System.

-AMC Service regarding AC-AC System directly to DLW Varanasi & Railway sheds.

Sir, we also work for EMD USA, which are following:-

-Tender clarification to EMD, USA.

-Technical clarification.

-Tender Support-follow up-paperwork clearance.

-Purchase order procurement.

-Documents to agents.

-Warranty Support & Warranty claim.

-Tracking of sales to DLW.

-Product design updation- upgradation and Engineering.

-Payment follow up and its collection.

-DLW and Indian Railways says that we cannot communicate to EMD USA. So we provide communication to DLW & Indian Railways we communicate on behalf of EMD USA with them.

-Information Technology Services, etc."

The aforesaid response would also establish that the Indian subsidiary was undertaking business activities independently and in its own right with DLW, Varanasi. This was therefore not a case where the subsidiary stood created solely for the purposes of undertaking activities and discharging functions concerned solely with the core business activity of the petitioner.

119. While taking note of the disclosures made by the Director-Finance, the first respondent chronicled the work undertaken by the Indian subsidiary for and on behalf of the petitioner by observing as follows: -

III. <u>Brief appraisal of documents found during the survey & statements recorded:</u>

xxxx xxxx xxxx

e. Salient points from the statement of Mr. Phaneendra Kumar Potnuru, Finance Director of M/s. EMD Locomotive Technology Pvt. Ltd., Noida are:

- <u>Products of EMD Inc. USA are Locomotive components, Power assembly, Turbo charger, Cylinder head, Liner, Piston rings, Gas kits, Fuel Motor Pumps, Injectors, etc., 95% of which are to M/s Diesel Locomotive Works, Varanasi and rest 5% are to other Indian Railway Centers</u>.
- M/s. EMD Locomotive Technology Pvt. Ltd. also work for EMD Inc. USA as under:

✓ Providing tender information - Assistance regarding tenders from Indian Railways.

✓ Tender support-follow up-paper work clearance,

✓ Procurement of Purchase Orders,

✓ Tracking of Sales of Diesel Locomotive Works-Varanasi,

✓ Payments collection and its follow up,

✓ Communication on behalf of EMD Inc. USA with DLW, Varanasi

✓ Warranty claim and support etc."

120. The first respondent failed to bear in mind that most of the functions so discharged by the Indian subsidiary were relatable to the agreements which formed part of the transfer pricing study. This, in our considered opinion, would have been sufficient to discharge any presumption of a PE that the said respondent had harboured. This, more so since not only did the TPO harbour no doubts in respect of those transactions having been undertaken at arm's length, but it also having additionally accepted the assertion of the petitioner that those were mere back office operations.

121. While on this aspect it may be additionally noted that once the issue of arm's length remuneration had come to be settled by the TPO, the question of ascertaining the existence of a PE would be rendered essentially academic since no further attribution could have been made. This clearly flows from a reading of Article 7(2) of the India-USA DTAA, and which ordains in unambiguous terms that only such part of the profit which is attributable to the PE would be taxable in the Contracting State. This position was succinctly explained by the Supreme Court in **Honda Motor Company Limited, Japan vs. Assistant Director of Income Tax, Noida & Ors**[34]**,** as would be evident from the following passages of that decision:-

> "**1.** Leave granted. We have heard the learned counsel for the parties and perused the record. In the judgment of this Court dated 24-10-2017 in *CIT* v. *E-Funds IT Solution Inc.* [*CIT* v. *E-Funds IT Solution Inc.*, (2018) 13 SCC 294] , it has been held that once arm's length principle has been satisfied, there can be no further profit attributable to a person even if it has a permanent establishment in India.
>
> **2.** Since the impugned notice for the reassessment is based only on the allegation that the appellant(s) has permanent establishment in India, the notice cannot be sustained once arm's length price procedure has been followed. Accordingly, the impugned order(s) is set aside and the appeals are allowed."

122. It may however be clarified that the above is noticed only as an aside since our conclusions on the question of PE have been rendered uninfluenced by the order of the TPO placed before us and which pertained to AY 2013-14 only.

123. More importantly, we note that the first respondent has utterly failed to bear in consideration the aspects pertaining to a subsidiary PE, and which was elaborately canvassed for our consideration by Mr.

[34] (2018) 6 SCC 70

Datar. One cannot possibly overlook or ignore the significant provisions which stand incorporated in Article 5(6) and which forbids us from presuming the existence of a PE, merely because an entity residing in a Contracting State is controlled by an entity situate in the other Contracting State. This was also not a case where the respondents had found that the Indian subsidiary was not engaged in any business activity of its own and was acting merely for the purposes of advancing the business and economic interests of the petitioner, or one which was engaged in a joint business activity through a common place of business. A subsidiary PE could be said to have become a mere "*alter ego*" provided it were found that it had no independent business activity to undertake or were working only to subserve the business interests of the petitioner. The two entities in question also do not appear to have functioned with a commonality of general purpose or of dependence.

124. The initiation of the impugned proceedings may also be examined on the anvil of Article 5(4) of the India-USA DTAA. Although, much was argued at the behest of the respondents resting on the seal of the petitioner having been discovered during the course of the survey, the impugned notices and the reasons recorded neither rest nor proceed on the basis of the Indian subsidiary having been conferred the "*authority to conclude contracts*" on behalf of the petitioner. It becomes pertinent to note that the reassessment is not founded on any material which may have evidenced the Indian subsidiary having entered into contracts for and on behalf of the petitioner with the Indian Railways. The respondents have thus not only failed to prima facie establish a conferral of authority upon the Indian subsidiary to contract on behalf of the petitioner, they also do not base the impugned order on

any material that may have even remotely established the contracts of the petitioner having been executed by the Indian subsidiary for and on its behalf.

125. As we had noticed above, the reasons recorded in support of reassessment woefully fail to allude to any material or evidence which may have even remotely qualified the attraction of the concept of Fixed Place PE. As has been repeatedly held, the principle of Fixed Place PE is concerned with functional integration and which would satisfy the the test of "*through which the business of an enterprise is wholly or partly carried out*". Courts have consistently held that the words "*at the disposal of*" must meet the test of significant "*control*" and a usage of the place of business to a considerable extent. We had noticed hereinabove the *Manual on the OECD Model Tax Convention* and which while defining a "*place of business*" had spoken of an establishment which was available to be used at any time of the choosing of the foreign enterprise and for its internal administrative work.

126. Authoritative texts on the subject speak of a Fixed Place PE coming into existence where a space or a part of a facility stand duly earmarked for the carrying on of the business of an enterprise. Viewed in light of the above, it becomes manifest that the assumption of a Fixed Place PE being existing is wholly perverse. We also bear in mind the undisputed fact that the Indian subsidiary was not undertaking any manufacturing activity of the petitioner. It is equally significant to note the absence of any assertion on the part of the respondents that any space or part of the Indian establishment had been exclusively set apart

or earmarked for the use of the petitioner. The view as expressed in this respect thus also fails to meet the "*at the disposal*" test as enunciated.

127. It was also not the case of the respondents that the entire complement of staff of the Indian subsidiary work under the administrative control of the petitioner. In fact, the evidence which has been taken note of would establish to the contrary. This, since administrative oversight, appraisal and all other HR related functions in respect of most of the Indian employees was being regulated by the Indian subsidiary.

128. Even as we go through the various statements which were recorded in the course of the survey or thereafter, we find that the functions discharged by the Indian employees could at best be said to be supportive of the business that the petitioner had with DLW and other Indian Railway entities. The follow-up of purchase orders or modification suggested and the various emails exchanged between the petitioner and the Indian subsidiary would at best lead us to conclude the latter constituting a medium of communication between the petitioner and DLW. In any case, those functions cannot possibly be countenanced as constituting the core business activity of the petitioner. The core business activity of the petitioner was the manufacture of articles and goods detailed hereinabove and their supply to DLW and other Indian Railways entities.

129. The respondents also do not rest their case on any alleged sharing of revenue between the petitioner and the Indian subsidiary in connection with those contracts. As we view the working relationship that is asserted to have existed between the petitioner and the Indian

subsidiary, it clearly fails to answer to the test of "*alter ego*" companies. While not losing sight of the admitted fact that both the petitioner and the Indian subsidiary were engaged in the supply of goods to DLW and the Indian Railways, it cannot possibly be said that they were performing a joint business activity through a common place of business. This, since the line of products themselves were different and were being supplied separately. The respondents do not dispute the fact that the products of the petitioner were being directly imported to India for onward supply to DLW and other constituents of the Indian Railways. It was also not their case that there existed some arrangement of sharing of revenues between the petitioner and its Indian subsidiary in that respect. Neither the emails, the communication trail or for that that matter the statement of employees, could lead one to arrive at the conclusion that the business of the petitioner was being managed by the Indian subsidiary *de facto*.

130. Regard must also be had to the fact that this Court in **Director of Income Tax vs. E-Funds IT Solution Inc**.[35], had held that mere interaction or cross-transactions between an Indian enterprise and its foreign principal would not meet the location PE test comprised in Article 5(1) & (2). The relevant extracts of the judgment in *E-Funds IT Solutions Inc*., as rendered by this Court is set out hereinbelow:

> "**52.** The assessing officer, Commissioner (Appeals) and the Tribunal have primarily relied upon the close association between e-Fund India and the two assessee 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

[35] 2014 SCC Online Del 555

> 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 taxpayer. 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."

The decision of this Court in *E-Funds IT Solutions Inc*., was subsequently affirmed by the Supreme Court in *ADIT v. E-Funds IT Solutions Inc*., which has been noticed hereinabove.

In fact, the Supreme Court had pertinently observed that even if some of the functions were transferred to the Indian entity by way of handing over of business or back-office operations, the same would not result in the creation of a Fixed Place PE.

131. The second test which must necessarily be borne in mind is the nature of the activity which was undertaken by the Indian employees albeit and allegedly for and on behalf of the petitioner. One must not lose sight of the fact that while such interaction and collaboration may

well contribute to the productivity of the petitioner, they clearly appear to be extremely remote and removed from the actual realization of profits. The collaboration between the two entities and the supportive services, if they could legitimately be described as such, clearly did not constitute a significant part of the core business activity of the petitioner.

132. The inputs that were received from the Indian design team, although not specifically shown to be in respect of products or goods supplied to Indian Railways, even if one were to proceed on that assumption, the same would also not lend any credence to the stand taken by the respondents. A collaboration between the constituents of the independently employed industrial engineers or designers has firstly not been established to be in connection with an India project. The respondents had essentially borne in consideration the collaborative activities undertaken by the Indian design team for contracts and tenders pertaining to Congo and other African nations as well as Bangladesh. That collaboration was thus not even concerned with any income that could be said to have arisen or accrued in India. Those activities in any case would not give rise to any income being earned in India.

133. Even if one were to test the conclusions arrived at by the respondents on the basis of the response proffered to Question No. 11 by Mr. Shivanshu Kaushik, the conclusion would remain the same. Question No. 11 which was posted to Mr. Kaushik is extracted hereinbelow:

> "**Q11. Who allocate you the work for design of the component/Locomotive of foreign/global tendered how the same is communicated to you? How you submit your work to the foreign team?**
>
> **Ans.** The designwork is allocated by M/s PRL Inc., USA and the same is communicated through e-mail from USA. A release note is provided by e-mail in which the work allocated to me. For every such project a project head is made in USA in M/s PRL Inc. Who co-ordinates such projects and we report to him. All the team members work on common platform/ software which is accessible by all members and team Head as well. The work is automatically submitted on that platform."

134. Insofar as the MES Agreement and other allied agreements are concerned, it is clear that in terms of the said agreements, the employees of the Indian subsidiary were to keep track of monetary balances and record the movement of goods, maintain and coordinate the implementation of accounting control procedures, assist in the development of both short term and long-term strategy plans, study market trends and other such allied activities. Regard must be had to the fact that the Indian entity - PRIPL was undoubtedly a wholly owned subsidiary of the petitioner, and formed part of the multi-national group – Caterpillar. There would undoubtedly be some degree of collaboration and exchange of information between a principal and its wholly owned subsidiary. However, that alone would not justify a presumption of a PE having come into existence. As has been repeatedly emphasized, a subsidiary would be deemed to become a PE only if satisfies the tests as laid out in Articles 5(1), 5(2), 5(4) and 5(5). A group of companies may well engage in discussions at different levels so as to evolve a marketing strategy or identify a research output with respect to future prospects. That, however, cannot be viewed as being sufficient to hold that the Indian establishment attains the

character of a PE. The exchange and collaboration between entities forming part of a larger conglomerate would clearly be intended towards subserving the growth of the group as a whole and could relate to not only operations in India, but also to any market in the globe in which the petitioner may have a footprint.

135. Insofar as the tests laid down in Article 5(4)(a), (b) and (c) are concerned, the same are clearly not met since the respondents have failed to refer to any authority that may have been conferred upon the Indian entity "*to conclude contracts*" on behalf of the petitioner. The mere discovery of the seal of the petitioner is also not liable to be viewed as resulting in clause (a) and stipulations contained therein being satisfied. This, since it is not the case of the respondents that the Indian entity had been authorized to affix that seal on any document or contract. This, quite apart from there being no material that the seal was in fact affixed on any contract or agreement to which the petitioner was a party. The reasons recorded by the first respondent in support of the proposed action under Sections 147/148, also does not refer to any contract that the petitioner may have entered into with the Indian Railways, and which may have been executed for and on its behalf by the Indian subsidiary. The conclusions recorded on this score thus clearly appear to proceed on surmises and conjecture.

136. Even clause (c) of Article 5(4) would not stand attracted since undisputedly the Indian subsidiary had independent transactions with DLW and other Indian Railway entities. It was thus not a mere arm or an extension of the petitioner established to secure orders on its behalf and that too "*wholly or almost wholly*" for it.

137. Accordingly, and for all the aforesaid reasons, we are of the considered opinion that the opinion as formed by the first respondent on the issue of a PE is wholly perverse and untenable. We find ourselves unable to sustain that opinion even on a tentative, formative or prima facie basis. We are of the firm opinion that that since the very foundation on which the impugned action is based is itself rendered wholly arbitrary and unsustainable, the impugned reassessment proceedings would be liable to be quashed.

138. We bear in mind the indubitable fact that but for the PE question being liable to be answered against the petitioner, the first respondent would have no authority to proceed. It was thus incumbent for the Court to have come to a conclusion that the decision on the question of PE had been correctly decided or was at least a tenable or plausible view which could have been taken or harboured. We, for reasons aforenoted, have found ourselves unable to sustain the opinion as formed. In our considered view, the same would not sustain even if that opinion were to be tested on a prima facie basis. We also bear in mind the fact that the view as expressed by the first respondent in the impugned proceedings cannot possibly be countenanced as being either tentative or one which left very much for contestation or debate. We consequently find ourselves unable to sustain the assumption of jurisdiction.

M. OPERATIVE DIRECTIONS

139. We accordingly allow the present writ petitions and quash the impugned notices issued under Section 148 dated dated 28 March 2019 [W.P.(C) 12408/2019], 29 April 2019 [W.P.(C) 12405/2019, W.P.(C)

12406/2019] and 31 May 2019 [W.P.(C) 12407/2019, W.P.(C) 12409/2019, W.P.(C) 12410/2019 and W.P.(C) 12411/2019] as well as other consequential notices issued by the first respondent. This order, however, shall be without prejudice to the respondents to independently examining whether the office of the petitioner in the Delhi Circle constitutes a PE. That is an issue which has neither been examined nor ruled upon. Consequently, all rights and contentions of parties in that respect are kept open.

140. Since the transfer of the PAN of the petitioner was solely to facilitate the first respondent conducting the reassessment, and which we have for reasons aforenoted found to be unsustainable, the order dated 05 November 2019 passed by the fourth respondent transferring the jurisdiction of the PAN of the petitioner from the fourth to the first respondent shall also stand quashed. The PAN mapping shall revert to the jurisdictional AO of the petitioner, namely, the fourth respondent in W.P.(C) 12408/2019, W.P.(C) 12405/2019, W.P.(C) 12406/2019, and the fifth respondent in W.P.(C) 12407/2019, W.P.(C) 12409/2019, W.P.(C) 12410/2019, W.P.(C) 12411/2019, namely – DCIT/ACIT, International taxation, Circle 1(1)(1), Delhi.

YASHWANT VARMA, J.

PURUSHAINDRA KUMAR KAURAV, J.

MAY 28, 2024/RW