When does a Controlled Subsidiary Company in India turn PE of its Foreign Principal and can be Held Liable to Pay Higher Tax?

A foreign enterprise is liable to be taxed in India on so much of its business profit as is attributable to the permanent establishment in India. Taxability of such foreign companies having subsidiaries for back office support operations in India has been a subject matter of debate before the courts. This article discusses various cases where controlled subsidiary companies in India were questioned to be permanent establishments (PEs) of their foreign principals. Read on…

Domain of Permanent Establishment

The Supreme Court in *DIT (International Taxation) vs. Morgan Stanley and Co. Inc., [2007] 292 ITR 416* explained the significance of this principle in the following words (page 442):

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"The object behind enactment of transfer pricing regulations is to prevent shifting of profits outside India. Under Article 7(2), not all profits of MSCO would be taxable in India but only those which have economic nexus with permanent establishment in India. A foreign enterprise is liable to be taxed in India on so much of its business profit as is attributable to the permanent establishment in India. The quantum of taxable income is to be determined in accordance with the provisions of the Income-tax Act. All provisions of Income-tax Act are applicable, including provisions relating to depreciation, investment losses, deductible expenses, carry-

forward and set-off losses, *etc*. However, deviations are made by the DTAA in cases of royalty, interest, *etc*. Such deviations are also made under the Income-tax Act (for example: Sections 44BB, 44BBA, *etc.*). Under the impugned ruling delivered by the AAR, remuneration to MSAS was justified by a transfer pricing analysis and, therefore, no further income could be attributed to the permanent establishment (MSAS). In other words, the said ruling equates an arm's length analysis (ALA) with attribution of profits. It holds that once a transfer pricing analysis is undertaken; there is no further need to attribute profits to a permanent establishment. *The impugned ruling is correct in principle in so far as an associated enterprise, that also constitutes a permanent establishment, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to the permanent establishment. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to the permanent establishment for those functions/risks that have not been considered. Therefore, in each case the data placed by the taxpayer has to be examined as to whether the transfer pricing analysis placed by the taxpayer is exhaustive of attribution of profits and that would depend on the functional and factual analysis to be undertaken in each case. Lastly, it may be added that taxing corporate on the basis of the concept of economic nexus is an important feature of attributable profits (profits attributable to the permanent establishment)." (Emphasis supplied)*

Subsidiary as a Permanent Establishment

Extracts from Bulletin for International Taxation, February 2011 titled 'The Subsidiary as a Permanent Establishment'

"A permanent establishment is, however, not always easy to identify. This is particularly true where a permanent establishment is hidden behind a dependent operating company, i.e., if an operating company in addition to its own business also carries on another company's business as a permanent establishment of the latter. In this regard, the 2010 OECD Model Tax Convention (the 'OECD Model') states in Article 5(7) that:

'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'. (Emphasis added)

This follows from the principle that, for the purpose of taxation, such a subsidiary constitutes an independent legal entity. Accordingly, both companies are subject to unlimited tax liability in the State in which they are resident or where their place of management is located.

However, by using the wording 'not of itself', the provision clarifies that a parent company (parent) can have an (agent) permanent establishment in its subsidiary's State of residence if the general requirements for a permanent establishment set out in Article 5(1) to (5) of the OECD Model are met. Accordingly, any space or premises belonging to the subsidiary that is at the disposal of the parent (the 'right-to-use test') and that constitutes a fixed place of business (the 'location test' and the 'duration test') through which the parent carries on its own business (the 'business activity test'), gives rise to a permanent establishment of the parent under Article 5(1), subject to Article 5(3) and (4), of the OECD Model. In addition, under Article 5(5) of the OECD Model, a subsidiary constitutes an agency permanent establishment of its parent if the subsidiary has the authority to conclude contracts in the name of its parent and habitually exercises this authority, unless these activities are limited to those referred to in Article 5(4) or unless the subsidiary does not act in the ordinary course of its business as an independent agent within the meaning of Article 5(6) . . ."

E-Funds IT Solution Case

Reading through the commentary on paragraph 5 of UN Model the Delhi High Court in *Director of Income-tax vs. e-Funds IT Solution (2014) 364ITR256* held that to hold a place of business a permanent establishment, the enterprise using it must carry on its business wholly or partly "through" it, though the activity need not be productive in character and need not be permanent in the sense that there is no disruption, but the operations must be carried out on regular basis. Branch offices and factory mentioned in paragraph 2 are examples of fixed place of business. In paragraph 4.6 of the OECD Commentary, the words "through which" have been interpreted to have a wide meaning but postulate

that the particular location should be at the disposal of the enterprise for that purpose and only then the business is carried through the location where the activity takes place. The word "through" has been interpreted and read in a manner that the foreign enterprise should have the right to use the location in the second State. The said right may or may not be formalised through legal documentation, but right to use should be established and shown. Then and then alone fixed place permanent establishment shall exist. Fixed location test may be in form of a legal right or can be inferred from the facts when the foreign establishment and its employees are allowed right to use the place of business belonging to a subsidiary, a third party. At the same time, the Court also observed that overwhelming international commentaries, write ups and decisions support the position that for applying the location test, requirements of paragraph (1) of Article 5 must be independently satisfied.

The LG Case Scenario

In *L. G. Electronics Inc. vs. Asstt. DIT (2014)* 368ITR401, the foreign holding company is called to pay tax in India on 25% of the total value of international transactions consisting of supply of raw materials, finished goods, commission and reimbursements for the following survey finds (19 in number) in the case of Indian subsidiary that revealed the assessee holding company having PE in India:

i. The Indian company, LGIL, is a 100% subsidiary company of the petitioner and it does not function as an independent corporate entity and is totally dependent on the petitioner.

ii. All the senior employees i.e. heads of all departments are Koreans. The hiring of these Korean expatriates is done by the petitioner.

iii. While working in India, the expatriates have a lien over their employment over the petitioner company and work on deputation in India clearly establishing a continuous connection between the subsidiary company and the petitioner, which is nothing but a business connection.

iv. The employees do not report only to the Indian management but also send reports to their principals in Korea.

v. The Korean expatriates visit Korea and other countries very frequently for business purposes and implement decisions taken thereof.

vi. The regional headquarters in Singapore monitors each and every function of the Indian company. It provides business consultancy and financial consultancy to the Indian company.

vii. The regional director visits India regularly and monitors the progress of the Indian company. It also looks after the interest of the petitioner and other affiliates in the region including India.

viii. The order of raw material and finished products is placed from India on a global portal provided by the petitioner which is accessed by the Indian company. This proves that there is a continuity of business and the office of LGIL is nothing but an extension of the petitioner company.

ix. The petitioner company has a menu card of products manufactured and launched by it. The Indian company can only import and launch those products as an independent business enterprise and cannot import or sell brands of any other company.

x. The Indian company does not own the brand. The brand promoted in India is LG brand which is owned by the petitioner. In India also, the brand is registered by the petitioner.

xi. The Indian company cannot hire expatriates from anywhere else other than Korea. Every requirement of heads of various divisions is processed by the petitioner.

xii. Before the launch of a particular product, the employees of the petitioner company visit India and understand the market and do a comprehensive market survey which is a core business activity and not ancillary or auxiliary business activity.

xiii. Once the decision is taken to launch a particular product in India is decided by the petitioner company, they provide the technology and details of parts to be used which are mainly supplied by the petitioner and its other affiliates.

xiv. The petitioner through its employees in India takes a decision as to what part can be localised or procured locally.

xv. Once the imported parts are decided by the petitioner, the quantity is decided by LGIL and order is placed through the portal without any price negotiation as price is strictly decided by the petitioner.

xvi. The contract for sale is concluded in India

once the orders are placed. No agreements are signed and no negotiation takes place. However, employees of the petitioner visit India to finalise the deal and in order to estimate the total sale to be made by them during a particular period.

xvii. As per the petitioner, the sale is on C & F basis and therefore, the sale is concluded in India.

xviii. The MD of LGIL reports to the HQ at Singapore and Korea and is responsible to the petitioner.

xix. For the imports made by the Indian company, it has not done any analysis of comparative pricing or the price at which it can get the product from any other company.

Further taking note of such findings, the AO drew following ten conclusions, namely:

i. There is a continuity of business between the Indian company and the non-resident.

ii. The transaction of import is not an isolated transaction but a close business connection on a regular basis.

iii. The non-resident is doing business in India through its employees who are heading various divisions in the Indian company and also through employees visiting India regularly.

iv. There is a close business connection in terms of the dependence of the Indian company on the non-residents for all imports as it does not have the authority or choice to make imports from any other concerns other than LG affiliates.

v. The whole transaction is so intermixed that supply of equipment cannot be segregated from the supply of technology and marketing of product. Each transaction is dependent on the other and has a close nexus with India.

vi. The products supplied including raw material and finished products are customised for India e.g. the sound system in television is customised for India as per the local needs. The Indian company is nothing but an extension of the Korean company. If we analyse the functioning of LG India, it works as a branch of LG Korea.

vii. LG India and LG Korea work as partners in business.

viii. The transactions between both the parties are so inter-linked that the Indian company cannot move an inch without the support and supplies of the non-resident.

ix. The function of the Indian company is marketing for the non-resident companies to build their brand and also manufacturing which is primarily assembly of products already launched by the non-residents.

x. The business arrangement between the two companies is something like a partnership where roles are defined and divided but the ultimate decision is taken by the non-residents.

On the aforesaid basis, the Assessing Officer in LG case concluded that the assessee had business connection in India and was liable to be taxed under Section 9(1)(i) of the Act and income is taxable in India under Article 7 of the DTAA as the petitioner has a permanent establishment in India. The AO invoked provisions of Section 147 and reopened the case of the assessee and called for a return of income from the holding company. The foreign company filed NIL return and further objected to reassessment on the ground that the transactions that it had with its subsidiary in India are already tested for their arm's length by the TPO having taken into consideration FAR analysis carried by the Indian subsidiary post which no further taxes could be determined as payable by it. The AO however rejected such study as well as the objections filed by the foreign company and held as under:

"The survey clearly indicated that the petitioner had a permanent establishment in India and, consequently, the profits were required to be attributed to the permanent establishment in India in terms of the functions performed, risks assumed and assets deployed by the permanent establishment."

The foreign company then filed a writ petition before the Allahabad High Court. The High Court referred to both, Section 9 of the Income-tax Act and Article 7 of the DTAA and commented the two as identical. Further, sub-Article (1) of Article 7 of Indo Korea DTAA states that the profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as are attributable to that permanent establishment. The High Court from their reading of clause (1) held that the establishment of a permanent

establishment pre-supposes that business operations are being carried out for profit. In other words, if the AO is able to establish presence of PE in India as per Article 5 then there would perhaps be a statutory requirement upon the foreign entity to submit a return of income. And for this reason, the High Court declined to admit the contention of the company of precluding AO to take reopening action after conclusion of TP proceedings. The Court held the following after drawing reference to Supreme Court decision in ***DIT (International Taxation) vs. Morgan Stanley and Co. Inc., 292 ITR 416:***

'The contention that as per the provisions of Chapter X of the Act, the Indian subsidiary, in terms of the provisions of Section 92E of the Act had disclosed all the transactions with the petitioner relating to purchase of raw materials, finished goods, commission and reimbursements and further, in terms of Section 92CA of the Act, the TPO of the Indian subsidiary had already examined the said transaction and by its order dated 20th December, 2006 found the same to be meeting the arm's length principle, consequently, the Assessing Officer was precluded from drawing any inference that any further income of the petitioner from the same transactions was chargeable to tax had escaped assessment is erroneous and cannot be accepted.'

As in this case, the survey had been conducted after conclusion of order of TPO, the High Court held that the survey findings and documents impounded did reveal the existence of permanent establishment of the foreign company and its business operations in India without disclosing its taxable income for which reason the reopening cannot be adjudged as invalid under the law. Now to know whether TPO's acceptance of arm's length price would undermine any further action in this regard to separately determine profits/income of the foreign company *vis-a-vis* any permanent establishment that it has is something that the Allahabad High Court held it as independent and necessitating in certain situations as in the case of LG.

Guidance for the Assessing Officer

The Allahabad High Court order further carried the following guidance for the Assessing Officer:

'Once the Assessing Officer is satisfied that a permanent establishment of the petitioner exists in India and business is being conducted from this permanent establishment, the attribution of profits is a necessary consequence. The order of TPO will not come in the way for the reason that the TPO's order is in relation to the transactions between a subsidiary company and the petitioner. The situation becomes different when the subsidiary company also works as a permanent establishment of the petitioner. Once a permanent establishment is established, the petitioner becomes liable to be taxed in India on so much of its business profits as is attributable to the permanent establishment in India. The order of the TPO is in relation with the subsidiary company and not in relation with the permanent establishment of the petitioner. The transfer pricing analysis is to be undertaken between the petitioner and its permanent establishment which has not taken place as yet. Once a transfer pricing analysis is done, the computation of income arising from international transaction has to be done keeping in mind the principle of arm's length price. Once this is done, there is no further need to attribute profits to a permanent establishment. However, where the transfer pricing analysis does not take into account all the risk taking functions of the enterprise and it does not adequately reflect the function performed and the risk assumed by the petitioner, the situation would be different and, in such a situation, there would be a need to attribute profits to the permanent establishment for those functions/risk that have not been considered. This is precisely what was considered in ***Morgan Stanley's case (supra)*** wherein the Supreme Court held:

"As regards attribution of further profits to the PE of MSCo where the transaction between the two are held to be at arm's length, we hold that the ruling is correct in principle provided that an associated enterprise (that also constitutes a P.E.) is reimbursed on arm's length basis taking into account all the risk taking functions of the multinational enterprise. In such a case, nothing further would be left to attribute to the P.E. The situation would be different if the transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a case, there would be need to attribute profits to the P.E. for those functions/risks that have not been considered. The entire exercise ultimately is to ascertain whether the service charges payable or paid to the service provided (MSAS in this case) fully represent the value of the profit attributable to his service."

Hiring Policy and Agency PE

Ordinarily, hiring of labour by the subsidiary from the associated enterprise does not constitute it a

The LG case somehow affirms the AAR 1996 ruling in which it is held that when a subsidiary performs services for its foreign parent, it constitutes a "service PE". The ruling further states that for ascertaining the position in this regard, the exact working of the subsidiary, the correspondence between the subsidiary and the principal and the mode of their functioning and operations would have to be examined in toto.

permanent establishment of the parent company *vide Director of Income-tax vs. e-Funds IT Solution (2014) 364ITR256.* In the LG case, however it was found that much of the hiring of senior heads is done by the holding company. This fact establishes the dependence of the subsidiary upon its holding company for day-to-day management of affairs of the business in India. On the subject of agency permanent establishment, the Delhi High Court in E-Funds case further held as under:

'Agency Permanent Establishment under Article 5(4) and (5) of DTAA

Paragraphs (4) and (5) of Article 5 relate to creation of agency permanent establishment in the second contracting country. Agency replaces fixed place with personal connection. Arvid K. Skaar in his work Permanent Establishment has opined that primacy of "location test" of the basic rule is consistent with the conceptual structure of the permanent establishment clause itself. An agency will constitute a permanent establishment only when a permanent establishment cannot be found according to those conditions in the basic rule which are altered or replaced by the agency clause. OECD and UN Model Treaties recognise agency permanent establishment. The principle being, that a foreign enterprise may choose to perform business activities itself or through a third person in the other States. An agent is a representative who acts on behalf of another with third persons. International taxation laws recognise and accept two distinct types of agency permanent establishment, dependent and independent. Every agent by very nature of principle of agency is to follow the principal's instructions. But this principle is not squarely applicable to the DTAAs, as third parties may not be strictly an agent under the domestic law. Further, the aforesaid dependency cannot be the distinguishing factor which determines whether the agency is dependent or an independent agency for the purpose of Article 5, paragraphs (4) and (5), respectively. A dependent agency is one which is bound to follow instructions and is personally dependent on the enterprise he represents. Such dependency must not be isolated or once in a while transaction but should be of comprehensive nature.'

In the LG case, the employment of expats was not an isolated instance but a recurring instance and they had a lien over their employment over the holding company and further they were to report to their principal in Korea apart from the Indian management, thereby, meeting the test of dependent agency.

Stewardship Activities and PE

The Delhi High Court in *DIT vs. E-Funds IT Solution (2014) 364ITR256* held that every subsidiary which engages an employee on the non-resident, would always become a service permanent establishment of the controlling foreign company is a misconceived notion. In this case, the employees of the non-resident holding company were hired to provide stewardship services only. Drawing their reference to Supreme Court ruling in *DIT (International Taxation) vs. Morgan Stanley and Co. Inc. (2007) 292ITR41,6* the High Court held that the stewardship activity would not fall under Article 5(2)(l) of DTAA.

Extracts of SC Ruling in Morgan Stanley – Pages 427-428

'Article 5(2)(l) of the DTAA applies in cases where the MNE furnishes services within India and those services are furnished through its employees. In the present case, we are concerned with two activities namely, stewardship activities and the work to be performed by deputationists in India as employees of MSAS. A customer like an MSCo who has worldwide operations is entitled to insist on quality control and confidentiality from the service provider. For example, in the case of software permanent establishment, a server stores the data which may require confidentiality. A service provider may also be required to act according to the quality control specifications imposed by its customer. It may be required to maintain confidentiality. Stewardship activities involve briefing of the MSAS staff to ensure that the output meets the requirements of the MSCo. These activities include monitoring of the outsourcing operations at MSAS. The object is to protect the interest of the MSCo. These stewards

are not involved in day to day management or in any specific services to be undertaken by MSAS. The stewardship activity is basically to protect the interest of the customer. In the present case as held hereinabove, the MSAS is a service permanent establishment. It is in a sense a service provider. A customer is entitled to protect its interest both in terms of confidentiality and in terms of quality control. In such a case it cannot be said that MSCo has been rendering the services to MSAS. In our view, MSCo is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of MSAS services.

We do not agree with the ruling of the Authority for Advance Rulings that the stewardship activity would fall under Article 5(2)(l).'

Management Reporting and Agency PE

The periodic reporting of the results of operations of the subsidiary to the management of the holding company highlight continuous business monitoring in which case the subsidiary would provide the face of dependent agency where it is bound to follow instructions of its holding entity.

Engagement of Expats on Deputation and Service PE

When the expats are hired directly by the holding company and deputed to subsidiary for a specified period, they would sense service PE in India if they report to the parent company or associated enterprise. In LG case, it was found that the expats reported to the parent company management too.

Extracts of SC Ruling in Morgan Stanley- Page 428

'As regards the question of deputation, we are of the view that an employee of MSCo when deputed to MSAS does not become an employee of MSAS. A deputationist has a *lien* on his employment with MSCo. As long as the *lien* remains with MSCo, the said company retains control over the deputationist's terms and employment. The concept of a service P.E. finds place in the U.N. Convention. It is constituted if the multinational enterprise renders services through its employees in India, provided the services are rendered for a specified period. In this case, it extends to two years on the request of MSAS. It is important to note that where the activities of the multinational enterprise entails it being responsible for the work of deputationists and the employees continue to be on the payroll of the multinational enterprise or they continue to have their lien on their jobs with the multinational enterprise, a service P.E. can emerge. Applying the above tests to the facts of this case, we find that on request/requisition from MSAS the applicant deputes its staff. The request comes from MSAS depending upon its requirement. Generally, occasions do arise when MSAS needs the expertise of the staff of MSCo. In such circumstances, generally, MSAS makes a request to MSCo. A deputationist under such circumstances is expected to be experienced in banking and finance. On completion of his tenure, he is repatriated to his parent job. He retains his lien when he comes to India. He lends his experience to MSAS in India as an employee of MSCo as he retains his lien and in that sense there is a service P.E. (MSAS) under Article 5(2)(l). We find no infirmity in the ruling of the ARR on this aspect. In the above situation, MSCo is rendering services through its employees to MSAS. Therefore, the Department is right in its contention that under the above situation, there exists a service P.E. in India (MSAS).'

Secondment to Subsidiary and Service PE

In *Centrica India Offshore Pvt. Ltd. vs. Commissioner of Income-tax (2014) 364ITR336,* the overseas group entities of Centrica PLC are stated to be in the business of supplying gas and electricity to consumers across U. K. and Canada. The overseas entities outsource their back office support functions-for instance, debt collections/consumers' billings/monthly jobs to third party vendors in India, *etc.* To ensure that the Indian vendors comply with quality guidelines, the assessee company (subsidiary company) was established in India. It was to act as service provider to these overseas entities. Thus, the assessee company entered into service agreement with overseas entities to provide locally based interface between those overseas entities and Indian vendors. The scope and range of services so provided in terms of those agreements/understanding are : (i) management assistance for outsourced supplies in India and facilitating efficient interface back to U. S. business of Centrica Plc ; (b) ensure that outsourced suppliers adhered to best practices and share them on e-2-e on optimal basis ; (c) expert advice on widening scope of potential services in India to target work force through greater control and such other services as may be requested by Centrica Plc from time to time. The assessee therefore entered into agreements for secondment of employees from the overseas entities for a fixed tenure. The employees

so seconded continued to remain on the payroll of the overseas entities which paid and disbursed their salaries. The assessee thereafter reimbursed such salary costs to the overseas employers.

In this entire arrangement therefore, more than anything else, the presence of seconded employees in India is felt to serve the interest of the overseas entities. In other words, their performance in India was only to yield to the interest of the parent company. The seconded employees held full responsibility upon them for final output of service. They were to oversee subsidiary's operations as per the requirements of overseas entities and to be overall responsible to the parent for subsidiary's activities and functions. Under this situation, the seconded employee acted more under the direct control and supervision of the parent company so that what is actually remunerated by the assessee to the parent company is not salary but consideration for provision of services of seconded personnel. And because they acted for parent company, their presence constituted service permanent establishment in India.

Advance Ruling P. No. 8 of 1995, In Re (1997) 223ITR416

The LG case somehow affirms the AAR 1996 ruling in which it is held that when a subsidiary performs services for its foreign parent, it constitutes a "service PE". The ruling further states that for ascertaining the position in this regard, *the exact working of the subsidiary, the correspondence between the subsidiary and the principal and the mode of their functioning and operations would have to be examined in toto*. As in LG case, only survey could only reveal the exact working of the subsidiary and then it was found that the foreign parent was carrying on business operation in India through a permanent establishment.

In this case, the applicant was a company incorporated in Switzerland, a trader in goods and commodities on an international basis and intending to trade with India. It proposed to set up a subsidiary company in India to provide consultancy services from India to the applicant-company for use outside India. The facts in this case further envisaged proposed agreements for: (a) secretarial and clerical assistance to complete documentation of tenders, contracts and subsequent documentation required to enable the Indian customers who had purchased commodities from the Swiss company overseas, to obtain delivery of the said commodity on its arrival in India; (b) assistance in responding to global tenders floated by Indian organisations, which entailed providing information and submitting tenders within the parameters laid down by the applicant; and (c) follow-up of tenders and signing of contracts. The foreign parent would retain the Indian subsidiary as consultant on a non-exclusive basis for a year, to be automatically renewed, and the Indian subsidiary was at all times to act on instructions from the applicant and would not have any authority to accept orders on behalf of or bind the foreign company.

i. The AAR in this case held that the expression "business connection" means something more than a business. It presupposes an element of continuity between the business of the non-resident and the activity in the taxable territory. A stray or isolated transaction would normally not be regarded as a business connection. Business connection may take several forms; it may include carrying on part of the main business or activity incidental to the non-resident through an agent or it might merely be a relation between the business of the non-resident and the activity in the taxable territory which facilitates or assists the carrying on of that business. A relation to be a "business connection" must be real and intimate and through or from which income must accrue or arise, whether directly or indirectly to the non-resident. Such a business connection could be spelt out on the terms of the agreements in question. Though the term of the agreements in question was initially for one year and liable to termination at short notice, it was envisaged also that, unless so terminated, it should continue indefinitely, automatically renewed at the end of each year. Though the subsidiary was not to render services exclusively to the applicant, it was

Ordinarily, hiring of labour by the subsidiary from the associated enterprise does not constitute it a permanent establishment of the parent company vide *Director of Income-tax vs. e-Funds IT Solution (2014) 364ITR256*. In the LG case, however it was found that much of the hiring of senior heads is done by the holding company. This fact establishes the dependence of the subsidiary upon its holding company for day-to-day management of affairs of the business in India.

bound to render all services for the applicant as stipulated in the agreement. There was a term of "confidentiality" included in the agreements, which also placed considerable restrictions on the capability of the subsidiary in rendering like service to other parties. The scope of work in the proposed agreements included not only clerical and secretarial assistance but supply of information in respect of global tenders, by the subsidiary to the applicant and *vice versa*; signing and submitting of tenders on behalf of the applicant, although stated to be within the parameters fixed by the applicant; negotiating the terms of the tender with the tendering authority, again within the parameters laid down by the applicant; and follow-up of the tenders and finally signing the agreements. The business activity or the business relationship between the applicant and the subsidiary would not be based on any stray transaction but would be a continuous process in respect of the series of purchase and sale transactions undertaken by the applicant in India and in all such transactions the subsidiary would do the work as stated in the four agreements. Such an intimate and continuous relationship would constitute a "business connection" for purposes of Section 9(1)(i). The subsidiary would have to undertake such substantial and important commercial activities systematically and continuously for the applicant as to justify an inference that the applicant would be deriving income through or from a "business connection" in India.

ii. That in terms of the definition of "permanent establishment" in Article 5.2(l) of the Agreement for the Avoidance of Double Taxation between India and the Swiss Confederation and in the background of the stated facts and the proposed four service agreements between the applicant and the subsidiary company, there would be a permanent establishment of the applicant in India.

iii. That for ascertaining whether Articles 5.4 and 5.6 of the Agreement of the Avoidance of Double Taxation between India and the Swiss Confederation applied, the exact working of the subsidiary, the correspondence between the subsidiary and the principal and the mode of their functioning and operations would have to be examined in toto. The quantum of work done, the services rendered, the contracts undertaken for outsiders, i.e., other than the principal and companies controlled by the principal would have to be examined to determine whether the subsidiary was an agent having independent status or not in terms of the paragraph. At this stage, however, since the total activities which would be carried on by the subsidiary company in India could not be ascertained, it might be difficult to come to a conclusion as to the extent of activities of the subsidiary company which would be in the nature of services rendered to the applicant or its other controlled companies. For these reasons, the subsidiary would have to be considered to be a permanent establishment of the applicant unless it had significant independent activities on its own or on behalf of persons other than the applicant and unconnected with it.

Food for Thought

The survey findings in the L. G. Case of 2014 and facts finding in AAR ruling No. 8 of 1996 both mark importance to intimate and continuous flow of transactions in every year since inception between the subsidiary and holding company as they establish a business connection between the two. Also, parent company in either of the case contributed far greater role in the running of the day-to-day operations of the main business of the subsidiary through employment of expats and that the expats and other personnel deputed therefore not just rendered stewardship functions but participated in the running of business of the subsidiary and consistently reported to the parent company. Likewise, the subsidiary which when rendered services to the parent company on regular basis did not limit itself to routine clerical and secretarial functions but also ventured into supply of information in respect of global tenders; signing and submitting of tenders on behalf of the applicant within the parameters fixed by the applicant; negotiating the terms of the tender with the tendering authority, again within the parameters laid down by the applicant; and follow-up of the tenders and finally signing the agreements all of which are undertaken not based on any stray transaction but as a continuous process in respect of the series of purchase and sale transactions undertaken by the applicant in India all of which point to the presence of PE in India. ■