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**In Nokia Networks OY*
case, the majority view of
Delhi Tribunal Special
Bench is that Indian
subsidiary does not
constitute a PE in India**

**ITA Nos. 1963 & 1964/DEL/2001*

Issue no: GBT/13/2018

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Facts of the case

- Nokia Networks OY [assessee] is incorporated under the laws of Finland and is engaged in the manufacture of advanced telecommunication systems and equipment (GSM Equipment) which are used in fixed and mobile phone networks; and trading of telecommunication hardware and software.
- The assessee had established a liaison office [LO] in India in 1994, which had carried out only advertising activity. The assessee used to sell equipment that were manufactured in Finland, to Indian telecom operators, on a principal-to-principal basis under independent buyer-seller arrangements and also entered into certain contracts for installation.
- After the incorporation of the subsidiary, Nokia India Pvt. Ltd. [NIPL] in 1995, the existing installation contracts were assigned to NIPL and thereafter all installation activities were carried out by NIPL under separate agreements with Indian telecom operators.
- For AY 1997-98, the assessee did not file its return of income in India. Subsequently, the assessee filed a return in response to the notice issued under section 142(1) of the Income-tax Act, 1961 [the Act]. In the return of income, it did not offer any income taxable in India on the basis that it did not have a Permanent Establishment [PE] in India under India-Finland tax treaty. It also claimed that there was no business connection in India as goods were sold to Indian customers on a principle-to-principle basis.
- In the assessment order passed, both the LO and NIPL were held to constitute a PE of assessee in India. 'Installation PE' was also constituted on the basis that the assessee had supported NIPL in discharging its obligation under the installation contracts.
- The Assessing Officer [AO] attributed 70% of the total revenue to sale of hardware and remaining 30% towards supply of software, and taxed it as royalty. Out of the 70% of the revenue attributed to sale of hardware, the AO determined 40% as the income from supply of hardware and attributed 30% of such profits to the PE.
- The AO also taxed notional interest from vendor financing and delayed payment as per the specific clause in the offshore supply contract.
- Accordingly, additions in relation to the following incomes were made by the AO:
 - Profit on sale of hardware;
 - Profit on licensing of software; and
 - Interest income
- The matter travelled up to the Tribunal wherein a Special Bench was constituted along with other appeals of Motorola Inc. and Ericsson radio systems. However, the assessee as well as the Revenue were aggrieved by the order passed by the Tribunal and therefore both the parties preferred an appeal before the High Court.
- The High Court decided in favour of the assessee that the LO did not constitute a PE in India, nor did it have any business connection in India. The High Court also held that the income from supply of software could not be treated as royalty, whereas the other issues were remanded back by the High Court to the Special Bench of the Tribunal for fresh consideration on account of factual inaccuracies in the order of the lower authorities.

- The Special Bench, while analysing the scope of adjudication of grounds remanded back by the High Court, identified that in relation to this issue, four contracts have been referred to by the lower authorities. Out of these contracts, the Special Bench observed the scope of dispute to be with reference to supply of equipment contract between the assessee and Indian customers.

Issues under consideration

- Whether the subsidiary of the assessee (NIPL) would constitute business connection or PE of the assessee in India.
- If the answer to the above question is in the affirmative, can there be any attribution of profits on account of signing, network planning and negotiation of offshore supply contracts in India, and if yes, the extent and basis thereof.
- Whether notional interest on delayed consideration for supply of equipment and licensing of software is taxable in the hands of assessee as interest from vendor financing?

Ruling of the Tribunal

- The Tribunal has answered all questions sent to it by the High Court, in favour of the assessee.

Fixed place PE

- The Tribunal observed that there has been no categorical and specific findings by the lower authorities that there exists any fixed place PE *qua* the Indian subsidiary i.e. NIPL.
- The Tribunal further observed that, as held by the Supreme Court in the Formula One ruling, the '*disposal test*' is paramount while analyzing fixed place PE under Article 5(1).
- In the present case, the fixed place PE does not get established at all by making reference to providing of telephone, fax and car facility to employees of assessee visiting India.
- The High Court has accepted that after incorporation of NIPL, the assessee has not carried out any other activity other than offshore supply, and therefore any activity performed by NIPL under the independent contract cannot be reckoned to constitute a PE. Further, the assessee has not performed any activity under the independent contract of NIPL and its customers, from which it has received or accrued any income in India or through an asset in India. NIPL entered into installation contract directly with the customer (although guarantee was given by the assessee), the income from which was offered to tax in its hands.
- The Tribunal has held that even otherwise the activities carried out by employees of the assessee travelling to India i.e. network planning, negotiation and signing of contracts are in the nature of preparatory and auxiliary in nature and thus there

could not be any fixed place PE as there is a specific exclusion for such activities under the tax treaty.

- With regard to Revenue's contention on virtual projection, the Tribunal has observed that that the concept of virtual projection flows from a fixed place; and that such concept is alone not relevant but has to be seen in relation to fixed place or any other concept of PE. Virtual projection does not mean that even without a fixed place, virtual projection itself will lead to an inference of a PE. In the present case, as there is no establishment of a fixed place, the virtual projection itself cannot be held to be a factor for creation of PE.
- On the contention of the Revenue that the employees of the assessee were seconded to NIPL and thus it constitutes a PE, it was held that these facts may be relevant while analyzing service PE; however, there is no concept of service PE in the tax treaty.

Agency PE

- The Tribunal observed that the qualified character of agency PE is authorization to act on behalf of somebody so as to conclude the contracts.
- In the present case, there is no material on record that NIPL has negotiated or concluded any contract of supply of equipment on behalf of the assessee which binds the assessee.
- Further, the marketing support agreement is an independent agreement between the assessee and NIPL, for which NIPL is remunerated at arm's length; and activities of this agreement do not even remotely relate to supply of equipment. Thus, the question of NIPL exercising any authority to conclude contracts on behalf of the assessee does not arise.
- On the Revenue's contention that the assessee has given guarantee to Indian customers that it will get the installation contracts executed by NIPL, it is observed that such guarantee has no significance for determination of agency PE; because such contention may be relevant in a situation of composite contract which is absent in the present case.

Subsidiary PE

- The Tribunal further held that subsidiary cannot be reckoned to constitute PE, merely because it is controlled by the assessee.

Business connection

- Once the question in relation to PE is answered, the Tribunal observed that issue of business connection under the Act has become academic.
- In the context of LO, the High Court has decided that there is no material or evidence on the basis of which it can be said that LO is a business connection of the assessee in India and it does not constitute PE of the assessee in India. Similarly, in relation to supply of offshore equipment, which has been done outside India, the High Court has decided that such activity cannot be held to be taxable in India. The Tribunal accordingly held that these principles will *mutatis mutandis* apply to NIPL as well, as there is no material change in the facts.

Notional interest income

- In relation to the interest income, the Tribunal has held that no income can be said to accrue to the assessee on account of delayed payments as neither was there any corresponding liability on any of the debtors, nor the assessee had claimed any entitlement on such an interest.

Dissenting member view

- The dissenting member of the Special Bench has rejected the assessee's plea against the existence of business connection and the existence of PE. The member is of the view that when a subsidiary company is merely an *alter ego*, or virtual projection of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company, it must be treated as a PE of the parent company in India.
- As NIPL is treated as a PE, the member has also answered the question in relation to attribution of profits, against the assessee. However, marginal relief is granted by reducing the quantum of profits attributable to the PE.

Conclusion

- The Tribunal has ruled in favour of the assessee by holding that it has neither a PE in India nor any business connection in India and as a result, the question of attribution does not arise.
- The above judgement would support taxpayers to clarify the issue of PE or business connection in India as it has followed the principles laid down by the Supreme Court on this issue in the right perspective.

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