Nokia Special Bench Judgment: Could mere performance guarantee for an Indian subsidiary's installation activities give rise toforeign parent company's PE in India?

1. Introduction

The **Special Bench of Income Tax Appellate Tribunal constituted in Delhi in the case of Nokia Networks OY v. JCIT in ITA No. 1963 & 1964/Del/2001 dated 05th June, 2018** has held that the presence of an Indian subsidiary of the foreign company does not give rise to the latter's permanent establishment (hereinafter referred to as 'PE') in India. But, one of the members of the Bench was of the view that the issuance of a performance guarantee by the parent company in respect of the installation activities of the Indian subsidiary company will give rise to the parent company's PE in India. Though, a major part of the decision rendered by the Hon'ble Special Bench was in favour of the taxpayer company, the adolescent view taken by the Bench can be a cause of substantial litigation in a large number of contracts involving many multinational enterprises in respect of offshore supplies and performance guarantees in respect of activities of their Indian subsidiaries.

Thus, the above mentioned decision of the Tribunal seeks our attention and a careful analysis.

2. Relevant Facts

The company M/s Nokia Networks OY, a tax resident of Finland, was engaged in the business of manufacturing and installing advanced communication systems and equipments used in fixed and mobile phone networks. The company established a liason office in India in 1994. Thereafter, the company incorporated an Indian subsidiary in 1995 by the name of M/s Nokia India Pvt. Ltd. At the time when the liason office was in operation, the taxpayer company provided offshore supply services by selling GSM equipments to Indian telecommunication operators. The Indian subsidiary, however, performed installation activities in respect of the said GSM equipments.

The High Court of Delhi in the case oftaxpayer company held that the liason office of the taxpayer company did not give rise to the company's PE in India. The High Court further was of the view that the installation and commissioning work performed by the Indian subsidiary did not give rise to the taxpayer company's PE in India. The High Court, however, concluded that it was appropriate to remit the matter back to the Tribunal for re-examination of certain facts. Thereafter, the Tribunal constituted the Special Bench comprising of three members.

3. Special Bench's Decision

3.1 The Special Bench of the Tribunal pronounced its decision by way of a two to one split verdict. Two members held in favour of the taxpayer company, and one member held against the taxpayer company.As per the decision of the majority members, the Indian subsidiary did not give rise to the taxpayer company's PE in India.

3.2 The Tribunal observed that the taxpayer company's employees had visited India for performing various activities such as network planning, negotiation of contracts and signing of contracts, etc. in the context of the laison office. After incorporation of the Indian subsidiary, all the installation activities and after-sales services were carried out by the Indian subsidiary, namely M/s Nokia India Pvt. Ltd. Since it had been already held by the High Court that the liason office did not give rise to taxpayer company's PE in India, it was not relevant to determine an answer to this question.

3.3 The taxpayer company submitted before the Tribunal that even if there existed a 'business connection' as per the provisions of section 9(1) of the Income Tax Act, 1961, no portion of its income from the offshore supply activities could be brought to tax in India in the absence of performance of any activity in India in respect of such offshore supply.

3.4 Without prejudice to above submissions, the taxpayer company further submitted that as far as the issue as to whether the Indian subsidiary gave rise to taxpayer company's PE in India, the scope of enquiry and examination had to be confined only to the issue concerning the existence of a 'dependent agent permanent establishment'. It was also submitted that during the course of assessment also the tax authorities had not alleged that the Indian subsidiary gave rise to taxpayer company's fixed place PE in India. As for the existence of a dependent agent PE, the taxpayer company submitted that the dependent agent, if any, should have habitually exercised authority to conclude contracts in India in the name of M/s Nokia Networks OY, but at no point of time, the Indian subsidiary had negotiated or concluded contracts for supply of equipment in India by the parent company. It was further brought to the notice of the Bench that the only contracts signed by the Indian subsidiary pertained to the installation activities, which were exclusively executed by the Indian subsidiary only.

3.5 Further, the taxpayer company also contended that the activities of assignment of contracts, network planning and negotiation of offshore contracts held to be of auxiliary nature could not give rise to a dependent agent PE as per Article 5(5) of the India-Finland tax treaty. The taxpayer company also relied on Article 5(8) of the India-Finland tax treaty and also submitted that it could not be regarded as having a PE merely because the Indian company was a subsidiary of the Finland company.

3.6 As regards the allegations of the tax authorities that the Indian company had performed marketing and after-sales services on behalf of the foreign parent company, it was submitted by the taxpayer company that those activities were performed by the Indian subsidiary company under a separate and independent contract, after charging a remuneration at cost plus 5% markup. It was also one of the contention that the onus rested upon the tax authorities for establishing the fact that the Indian subsidiary gave rise to a PE of the parent company in India.

3.7 The Tribunal in addition to examining the existence of a dependent agent PE also considered it appropriate to examine as to whether the Indian subsidiary gave rise to a fixed place PE of the taxpayer company in India. In this context, the Tribunal was of the view that the word 'through' in Article 7(1) of the India-Finland tax treaty was of great significance, as it enlarged the scope of a fixed place PE, in as much as even if a fixed place of business did not belong to an enterprise, it could still be regarded as the enterprise's fixed place PE if the space was made available at the enterprise's disposal. In this regard, the Tribunal also referred to the **Apex Court's decision in the case of Formula One World Championship Ltd. v. CIT (2017) 394 ITR 80**.

3.8 The Tribunal observed that as regards the tax authority's allegation regarding the continuance of the Manager of the Indian liason office to be the Managing Director of the Indian subsidiary company, when the person was the Country Manager of the liason office, he had signed certain contracts, at which time the Indian subsidiary company did not even exist. After incorporation of the Indian subsidiary company in 1995, there was no evidence that the person had signed any contract on behalf of the parent company. The Tribunal also noted the fact that the person was the Managing Director of the Indian subsidiary from January 1, 1996 to July 31, 1999 and, during that period, he did not sign any supply contract with any of the Indian customer. The Tribunal also found that all the

installation contracts signed by the Indian subsidiary were independently executed with the customers on principal to principal basis.

3.9 The Tribunal noted that whenever taxpayer company's employees visited India for networking, negotiating offshore supply contracts, etc., the company's employees had provided certain administrative support services in the form of telephone, fax, convenience, etc. As per the tax authorities, this triggered the 'force of attraction rule' under Article 7 of the India-Finland tax treaty, and gave rise to the taxpayer company's PE in India. The Tribunal, however, blatantly rejected this proposition of the tax authorities. The Tribunal noted that the Indian subsidiary did not place any office premises at the disposal of the parent company's employees, and hence, the 'disposal test' was not satisfied. Also, there was no evidence to the effect that such employees used the office of Indian subsidiary for the purpose of the business of foreign parent company. In view of above, the Tribunal concluded that the Indian subsidiary did not give rise to the taxpayer company's fixed place PE in India in accordance with Article 5(1) of India-Finland tax treaty.

3.10 As regards the issue regarding the existence of a dependent agent PE under Article 5(5) of the India-Finland tax treaty, the Tribunal observed that the entire offshore supply contract was exhibited by the foreign parent company from outside India only. There was no evidence to recommend that the Indian subsidiary had negotiated or concluded these offshore supply contracts on behalf of the taxpayer company. The Tribunal also found that the Indian subsidiary neither had any authority to conclude these offshore supply contracts, nor had booked any orders on behalf of the foreign parent company. Thus, the Indian subsidiary company was an independent entity carrying out activities of installation, technical support services, etc. on principal to principal basis, and it did not undertake the offshore supply of equipment.

3.11 The Tribunal also opined that the allegation that the contracts were signed in India and the parent company's employees had attended meetings in India was of no relevance for the determination of the existence of a fixed place PE in India.In view of above, the Tribunal concluded that the taxpayer company did not have a dependent agent PE in India.

3.13 As regards the adolescent view of one of the members of the Special Bench, the Indian subsidiary gave rise to the taxpayer company's PE in India. This view was significantly influenced by the fact that the taxpayer company had provided performance guarantee in respect of the quality of the installation work of the Indian subsidiary. With due respect, however, it is difficult to reconcile with this view because of the findings given by the Tribunal with regard to existence of a fixed place and an agency PE in the case of taxpayer company.

4. Conclusion

The above mentioned decision of the Special Bench of ITAT Delhi is a very important judicial precedent. Though the majority decision was in favour of the taxpayer company, the minority view taken by one of the members of the Bench could be a cause of substantial litigation in a large number of cases involving many multinational enterprises in respect of offshore supplies and performance guarantees in respect of the activities of Indian subsidiaries.