

HC: Delhi HC tears apart Dept's three-pronged 'PE' trap for Caterpillar; Explains PE law

May 31, 2024

Progress Rail Locomotive Inc.(Formerly Electro Motive Diesel Inc.) [TS-374-HC-2024(DEL)]

Conclusion

In a judgment with far reaching implications, Delhi HC, in a 115 pages ruling quashes re-assessment proceedings against Caterpillar Group's Indian subsidiary which was initiated on the basis that the production unit of the wholly owned subsidiary constitutes a Fixed Place Permanent Establishment, in the alternative a Service PE as well as a Dependent Agent Permanent Establishment (DAPE); Dealing extensively with the case facts & provisions of India-USA DTAA, HC holds as untenable the view of IT Dept. to place the petitioner in all 3 conceivable silos vis-a-vis PE - i.e. Service PE, Fixed Place PE & DAPE; On perusal of reasons by AO w.r.t Service PE, HC observes that it becomes apparent that this conclusion is based solely on the visit of employees of the petitioner and their travel itineraries having been discovered, which according to the Court, cannot be countenanced as being sufficient to render a finding with respect to Service PE; HC further observes that the reasons cited by Revenue to hold that the Indian subsidiary constituted a DAPE as also a Service PE, were "self-contradictory" ; As regards the Fixed Place PE being alleged by Dept., HC after a deep dive into various SC judgments (Vishakhapatnam Port Trust, Formula One World Championship, Samsung Heavy Industries) as also OECD, Klaus Vogel Commentary on this aspect, concludes that no part of the premises of the subsidiary in Noida or Varanasi has been placed under the exclusive or significant 'control' or 'disposal' of the Petitioner Caterpillar Group; Further applying the principles laid down by Apex Court in landmark cases (Morgan Stanley, E-funds, UAE Exchange Centre etc.) to the facts at hand, HC holds that the activities undertaken by the Indian subsidiary do not appear to travel beyond being 'preparatory' or 'auxiliary'; HC observes " It is pertinent to note that both entities do not appear to have been established with a commonality of general purpose... " ; As regards DAPE, HC observes that there is not an "iota of evidence" to show that the Indian subsidiary stood conferred with the authority to conclude contracts and habitually engaged in acting in discharge of that authority; Explaining the holding-subsidiary company relationship, HC holds that " 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... " ; HC additionally notes 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.; As regards collaboration between holding & subsidiary co., HC observes that while collaborative activity may contribute to productivity of Caterpillar Group, it does not however constitute a significant part of the core business activity of the petitioner; In conclusion, HC on finding that the opinion formed by the AO on the issue of PE is 'perverse' & 'untenable', quashes reassessment proceedings against the petitioner.:HC DEL

Decision Summary

The judgment was delivered by the Division Bench of the Delhi HC comprising Justice Yashwant Varma and Justice Purushendra Kumar Kaurav

Senior Advocate Arvind Datar along with Advocates Rubal Bansal Maini and Prakhar Pandey appeared for the Assessee while the Revenue was represented by Advocates Sunil Agarwal, Shivansh B. Pandya, Utkarsh Tiwari and Amaan Ahmed Khan

Key Observations of HC:

1. 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".
2. "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."
3. 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.
4. 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.
5. 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.
6. 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.
7. 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.
8. 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.
9. 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.

10. 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.
11. 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.
12. 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. 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.
13. 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.

Case Law Information

Taxpayer Name

- Progress Rail Locomotive Inc.(Formerly Electro Motive Diesel Inc.)

Judicial Level & Location

- High Court Delhi

Appeal Number

- W.P.(C) 12405/2019

Date of Ruling

- 2024-05-28

Ruling in favour of

- Assessee

Section Reference Number

- Article-5 of the DTAA between India and USA

Nature of Issue

- Agency PE / DAPE
- Fixed place PE
- Service PE

Judges

- Justice Yashwant Varma
- Justice Purushaindra Kumar Kaurav

Counsel for Tax Payer

- Mr. Arvind Datar
- Rubal Bansal
- Prakhar Pandey

Counsel for Department

- Mr. Sunil Agarwal, Advocate
- Shivansh B. Pandya
- Utkarsh Tiwari
- Amaan Ahmed Khan