



SATURDAY INTERNATIONAL TAX GYAN !!!

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SITG No. 239

Hyatt International Southwest Asia Ltd. VS ADIT

PE must be treated as a distinct and independent entity for taxation purposes. Profits attributable to a PE are taxable irrespective of the global financial performance of the enterprise

04.01.2025



Facts of the Case

- ❖ The assessee Hyatt International-Southwest Asia Ltd. incorporated in UAE.
- ❖ The company had a Permanent Establishment (PE) in India and revenue contended that profits attributable to the PE were taxable in India.
- ❖ The assessee had suffered a loss in relevant assessment year and filed his income tax return declaring nil income. It relied on the judgement of Delhi high court in case of Nokia solutions and Networks OY.

Assessee's Contention

- ❖ The assessee contended that its global operations resulted in a net loss and, therefore, no income or profits could be attributed to the PE in India.
- ❖ Assessee wanted to rely on the earlier ruling in case of Nokia Solutions and Networks OY [2023] 147 taxmann.com 165, where it was held that if the global entity suffered losses, no profits could be attributed to the PE.
- ❖ Assessee contended that income should be attributed to the PE based on global profits, not doing so contradicted the DTAA provisions, therefore company will not be liable for pay tax in India.

Revenue's Contention

- ❖ Revenue argued that the PE in India should be treated as a separate and independent entity, as per Article 7 of the DTAA.
- ❖ Profits attributable to the PE should be determined independently, regardless of the global profits or losses of the enterprise.
- ❖ Revenue contended that Article 7 mandates that calculation should be undertaken on the basis that the PE is a separate enterprise and is operating independently of the enterprise of which it may be a PE, therefore attribution method should consider only the activities carried out by the PE in India, and not the global financial performance.

Legal provisions

Article 7 of India-UAE DTAA:

1. 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 is attributable to that permanent establishment.

2. Subject to the provisions of paragraph (3), where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Legal provisions

Article 7 of India-UK DTAA:

3. In determining the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the tax laws of that State.

Ruling

- ❖ The Hon'ble High court has overruled the judgement in case of Nokia Solutions and Networks OY [2023] 147 taxmann.com 165 (Delhi) [02-12-2022] stating that a PE must be treated as a separate entity for taxation purposes.
- ❖ The Hon'ble High court also state that global profits or losses should not influence taxation of the PE. Instead, it held that profits attributable to the PE must be computed independently based on activities undertaken in India.

Ruling

- ❖ The Hon'ble High court stated that Article 7 allows taxation of PE profits independently, and losses at the global entity level do not exempt the PE from tax liability.
- ❖ Although clause 1 of the article talks about profitability at entity level but clause 2 specifically talks about profit attributable to PE as a separate entity.
- ❖ Hence, the PE can have a profitability even if entity has a loss at global level.

Our Comments

- ❖ Hon'ble High court has very clearly distinguished between the entity profit at global level and profit of PE in the source country.
- ❖ Hence, profit ratio of PE needs to be calculated separately and the profit ratio of entity cannot be blanketly apply to the PE.
- ❖ Further, Article 7 gives power to source country to charge tax on income of the PE. However, if the entity on the overall level have a loss but PE earns profit then in such case there could be a scenario that the tax paid in source country cannot be claimed as tax credit in resident country and accordingly same would become a loss for the company.
- ❖ In the above case can the company claim such tax as an expense in it's financials at entity level?

Section/Article	Article 7 of DTAA
DTAA/Country	India UAE DTAA
Court	High Court of Delhi
Date of decision	19-09-2024

Note: Case law name in **Red**- in favor of the revenue, **Green**-In favor of the Assessee, **Orange** = Partial



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