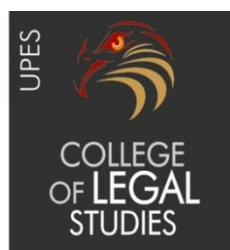


**BUSINESS CONNECTION AND PERMANENT
ESTABLISHMENT**

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*This dissertation is submitted in partial fulfillment of the degree of
B.A. LL.B. (Hons.)*



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CERTIFICATE

This is to certify that the research work entitled "**Business Connection And Permanent Establishment**" is the work done by **Aman Agrawal** under my guidance and supervision for the partial fulfillment of the requirement of **B.A. LL.B. (Hons.) degree** at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

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DECLARATION

I declare that the dissertation entitled “**Business Connection And Permanent Establishment**” is the outcome of my own work conducted under the supervision of **Prof. Charu Srivastava**, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

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TABLE OF CONTENTS

CONTENTS

1. Introduction
 - 1.1 Introduction of Business Connection
 - 1.2 Introduction of Permanent Establishment
 - 1.3 Introduction of Double Taxation Avoidance Agreement
2. Permanent Establishment
 - 2.1 Meaning of PE
 - 2.2 Concept of PE
 - 2.2.1 Basic rule of PE
 - 2.2.2 Specific Inclusion of PE
 - 2.2.3 Construction rule for PE and Service rule for PE
 - 2.2.4 Specific Exclusion for PE
 - 2.2.5 Agency in PE
 - 2.2.6 PE in case of Insurance Business
 - 2.2.7 Absence of Arm's Length Relationship
 - 2.2.8 No PE by virtue of Relationship
 - 2.3 Case Studies
 - 2.4 Types of Permanent Establishment
 - 2.4.1 Fixed Place PE
 - 2.4.2 Agency PE
 - 2.4.3 Service PE
3. Business Connection
 - 3.1 Meaning of Business connection
 - 3.2 Principles of Business Connection

- 3.2.1 Continuity
 - 3.2.2 Real and intimate connection
 - 3.2.3 Attribution of profits
 - 3.2.4 Common Control
 - 3.2.5 Business connection includes professional connection
- 4. Double Taxation Avoidance Agreement
 - 4.1 About DTAA
 - 4.2 Agreement Between the Republic of India And Australia for the Avoidance of Double Taxation
 - 4.3 Convention Between the Republic of India and the United Kingdom for the Avoidance of Double Taxation
 - 4.4 Convention Between the United States of America and the Republic of India for the Avoidance of Double Taxation
- 5. Implication of Business Connection and Permanent Establishment in New Economic Scenario
 - 6. Conclusion
 - 7. Bibliography

Abbreviations

1. PE – Permanent Establishment
2. BC – Business Connection
3. DTAA – Double Taxation Avoidance Agreement
4. OECD - Organization for Economic Cooperation and Development
5. UN – United Nations
6. USA – United States of America
7. Sec. - Section
8. Art. - Article
9. ITA – Income Tax Act
10. POEM - Place of Effective Management
11. CIT – Commissioner of Income Tax

Table of Cases

1. Motorola Inc Vs. Deputy Commissioner of Income Tax.....[(2005) 95-ITD-269(SB)]
2. Deputy Director of Income Tax Vs. SET Satellite (Singapore) Pvt. Ltd.....[(2007) 106-ITD-175]
3. ABN Amro Bank Vs. Income Tax Appellate Tribunal..... [97-ITD-89]

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CHAPTER - 1

INTRODUCTION OF BUSINESS CONNECTION AND PERMANENT ESTABLISHMENT AND DOUBLE TAXATION

Introduction of Business Connection

Income Tax Act, 1962 is defining the term of Business connection under section 9 of the act. There they clear up and create limitation on the extent of or the range of its different understandings or explanations. Business Connection is well prepared and old recognized method for deciding or figuring out tax money owed which is impressive or forcing on people or causing an inconvenient situation on the non-resident. A business connection includes all relations those relating with non-resident but possibly going to pay tax, such relations are a relation between a business done by a non-resident, which create such money made or good things received or gain and; b some activities in India that are adding or giving to the earning of these money made or good things received or gains. A business connection is arising through the relations between a non-resident of India and a resident of India, if they all continue with business together and if the non-resident earns money made or good thing received in respect of income that is known as business connection.

The term of business connection is very large related and related to emotions term in the idea of Permanent Establishment. If there is no connection between a resident and a non-resident into any business establish in India, the resident may not be called as a Permanent Establishment of non-resident, and the resident is possibly going to be tested or evaluated of the income of the business as per the act. So when there is no connection between resident and the non-resident, then the non-resident cannot be held responsible to pay taxes in India arising out of business connection. Business connection has such wide and not certain scope of import and export. It's having a different expression from the business as defined under the Act. So Business Connection is being understood or explained by different people in charge in their own words under different situations. The Business Connection in India is under the subject matter of law-related people in charge for understandings or explanations.

Some of the examples on business connection are really based on decided case laws are:

- A main or branch office of the business in India for the buy and selling of goods or moving to others.

- An agent were assign to a position in India by non-resident for the work done in well-thought-out and happening over and over again in a predictable way in buying of raw materials or other things, and for sale of the goods which related with non-resident.
- In India beginning and building on a factory for the purpose of converting or developing the raw material into the selling goods in in other countries through exporting.
- In India creating a less important thing or company owned by another company or sister company for the purpose of selling the goods or products, developed or produced by the non-resident parent company.
- In business connection there must have such related to managing money help or corporation between a resident company and a non-resident company.

Introduction of Permanent Establishment

The prospectus of Permanent Establishment has been received by India and other nations. Because of business relations, it creates so much pressure on the concern government for hint or result or effect of the tax money or money income creates in a Country. The Permanent Establishment is a tool for measuring the right of a nation to collect tax on the money made or good things received of a company or business which involves a resident of other country, this tool is normally used in cross border business and taxability of the income created.

Permanent Establishment could define in a fixed place of business in that they can continue their work or activities partially or completely. In the fixed place of business the work or activities continue in the foreign nation and by their residence and no any main authority involve. So for preparation and giving help to the business in respect of permanent establishment is very important, because of this the idea of fixed place of business excluded from the definition of Permanent Establishment.

Permanent Establishment is defined under Article 5 of the Double Tax Avoidance Agreement. Under the Double Tax Avoidance Agreement, the contracting States has right to charge tax on the business money made or good things received of a thing or business of other contracting State's thing or business, if the thing or

business continues on its business in the tax charging state through a Permanent Establishment. Permanent Establishment is mainly described into the six major parts:

- I. Management Place or Place of Effective Management (POEM),
- II. Fixed place of Permanent Establishment,
- III. Construction of Permanent Establishment as like building site or construction,
- IV. Installation or group of people or device made up of smaller parts project of Permanent Establishment there judging requirements is length of time of each installation project,
- V. Service under Permanent Establishment,
- VI. Dependent service business or government unit or power or functioning of Permanent Establishment.

The idea of Permanent Establishment is the major issue in the agreement between countries based international money-related law. There we have three model conventions, they are, 1) UN Model (United Nations Model), 2) OECD (Organisation for Economic Cooperation and Development) Model, and 3) US (United States of America) Model¹, they use the idea of permanent establishment as the main instrument to charge tax legal control over a foreigner's business activities.

Introduction of Double Taxation

Double taxation² is rises or comes up because of corporations are considered as different legal things or businesses. Corporations pay their taxes on their once-a-year income or money made or good thing received, as like an individual do. When companies are paying dividends to shareholders and partners, those dividends payments arising income-tax things you owe or things you're responsible for or disadvantages for the shareholders and partners who buying and owning them, even though the buying and owning of the dividends were already taxed at the related to people who are in charge of a big company.

So double taxation is a something you owe or something you're responsible for or disadvantage over the businesses or projects or company forced on people or caused an inconvenient situation by the more than one countries. For avoidance of the

¹ Rajesh Dhawan, Analysis of the word 'Permanent Establishment', Tax guru complete tax solution <http://taxguru.in/income-tax/permanent-establishment-parti.html>

² http://www.investopedia.com/terms/d/double_taxation.asp

double taxation there a lot of countries try to make good changes in their law and try to make an agreement with the countries. In that big picture India made agreements with 123 countries for avoidance of the double taxation and through these conventions they succeed in avoiding the double taxation and also increase in the more permanent establishment. India trying to increase the investment in his market and making more liberalize in the competition of the goods.

CHAPTER - 2

PERMANENT ESTABLISHMENT

Meaning of Permanent Establishment

Permanent Establishment is defining as a fixed place of business or activities by foreign businesses or companies continue their activities of businesses or companies are partially or completely carried on. This fixed place of business or activities must be the place of business or activities of foreign businesses itself and not the local businesses.

In the hope of or future of International picture or situation there two basic rules or ways of thinking of taxation are followed by the residence based taxation, and b the source based taxation. Most of the major countries, including India, charge taxes on their resident's all income under residence based taxation; and they charge tax on non-residents' income sourced in that country under source based taxation.

When a company located in one country gain income or money made or good thing received from sources of another country, the possibility of double taxation may rises or comes up because of one country may charge tax on that income from the source of way of thinking or basic truth or rule, while the other country may charge tax on the residence way of thinking or basic truth or rule. Normally, in the source based taxation, the Source Country is charging the right to tax on the income arising in there or within that. Whereas the Residence Country also charge taxes on the income on the residence based taxation. The Residence Country is trying to make lesser effect of double taxation through either by way of not having to pay tax or by way of tax credit.

Concept of Permanent Establishment

The idea of Permanent Establishment is the most important issue which are solving in the agreement between countries based on international economic law. In this idea of Permanent Establishment there three models of conventions are signed by more than two, but not a lot of nations. The model of conventions are, (a) UN (United Nations) Model³, (b) OECD (Organisation for Economic Cooperation and Development)

³ UN News, United Nations Model Double Taxation Convention between Developed and Developing Countries,

<http://www.un.org/en/development/desa/publications/double-taxation-convention.html>

Model⁴, and (c) US (United States of America) Model⁵, that are use Permanent Establishment as the main instrument to imposing over a non-resident's business activities.

As per to the idea of Permanent Establishment, the money made or good things received of a business or thing of one Contracting Nation Parties are taxable in the other nation, then only if the business or thing maintains a permanent establishment in the later nation and only to the extent that income or money made are main part-related to the Permanent Establishment. A legal idea of Permanent Establishment is a co-operation between source nation and residence nation for purposes of forcing on people taxability on business profits. The term must be understood as to arrive at that degree of money-based penetration⁶, which according to agreement between countries parties gives a good reason for in a nation treating of a foreign person in the same way as domestic people. Profits is main part of a Permanent Establishment, in the Source State are either given permission to do or not do something in Residence State or the Residence State allows recognition of taxes paid by the Permanent Establishment on such money made, so the tax legal control by the Residence State is to be moved from one place to another to the Source State, where the businesses or thing needs to file his return of income and follow the domestic tax laws.

In a landmark case of CIT V. Visakhapatnam Port Trust⁷, that case decision on the subject of “Permanent Establishment”, the Andhra Pradesh High Court has observed that:

“The words “Permanent Establishment” postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another, which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a

⁴ OECD Model Tax Convention on Income and on Capital: An overview of available products, <http://www.oecd.org/ctp/treaties/oecd-model-tax-convention-available-products.htm>

⁵ United States Model Convention, <http://www.treasury.gov/press-center/press-releases/Documents/hp16801.pdf>

⁶ Definition of Penetration, The Economic Times, <http://economictimes.indiatimes.com/definition/penetration>

⁷ CIT V. Visakhapatnam Port Trust, [(1983), 144-ITR-146 (AP)]

virtual projection of the foreign enterprise of one country onto the soil of another country⁸.”

That means the permanent establishment makes the existence of such element show that the permanent nature of foreign entity or enterprises in the other entity or enterprises which can show the fixed place of business in that country where the business activity took place. In that concept there must be some near projection of the other nation’s enterprises over the soil of the nation where the enterprise’s business took place.

The UN Model not only confirms the idea of Permanent Establishment but they also provide supplements it with the new idea of a “fixed base” this is going to be use in the situation of professional services or other works of an self-regulating character.

A. Basic rule of Permanent Establishment: -

Article 5(1) of the UN Model, 2011⁹ defines PE as “a fixed place of business through which the business of an enterprise is wholly or partly carried on”. This is what commonly called to as a ‘basic rule of Permanent Establishment’.

The existence of a Permanent Establishment is determined through the applying of following tests¹⁰: -

- Objective Test: -

Objective tests can be use in two ways; firstly, there should be a “place of business” and secondly, the place of business in terms of location should be “fixed”. Generally, a place of business would assume that a place but it is not just a place, but a place together with necessary objects, which would be essential in carrying on business activity of such entity. There can be considered that a place of a business could exist at the time even if there no employees or worker are work there. As in this example, any equipment like pipeline, assembled electronic machine,

⁸Ibid, refer Para 53 of the case, <http://indiankanoon.org/doc/865397/>

⁹ United Nations New York, Department of Economic & Social Affairs, Model Double Taxation Convention between Developed and Developing Countries, http://www.un.org/esa/ffd/documents/UN_Model_2011_Update.pdf

¹⁰Rajesh Dhawan, Analysis of the word ‘Permanent Establishment’, Tax guru complete tax solution <http://taxguru.in/income-tax/permanent-establishment-parti.html>

vending machines, telephone exchange, etc. that equipment installed in a place and they can function and operate without the need of any employee or worker could make a Permanent Establishment. Those other necessary conditions for a Permanent Establishment are prescribed in Article 5(1) of the OECD Model¹¹.

The management place is requiring an existence of a place of work in respect to establish a Permanent Establishment, because the management works should be operated from such fixed places. In easy words, for creating of a Permanent Establishment, there physical presence is necessary. So in the result of this test there must need a place of business for doing work but it does not include any physical assistance to the work, but in the other hand for the managing of work of the business there must be an presence of physical assistance.

- Subjective Test: -

In the normal rule there the place of business should be that place of the non-resident enterprise, not anyone else place. The basic requirement says that the place of business must be there the disposal of the enterprise took place. As a consequence, what manner is the right to use the place, and the manner in which such right has been secured, whether the place is purchased or on lease?

The right to use could be in the manner of legally right to use and factually right to use. For its disposal the enterprise should have the location or facilities. This provides surety that the place does not have any problem relating with carrying on the business of the enterprises and they do their business without any obstruction. As in this example, a chartered accountant or an Advocate were going to use their services for their client, there is no certainty that they have the rightful place for the disposal of the matter, it is not likely to be considered as his Permanent Establishment. This point is noticeable that mere user of a place of business is not be enough to make up that place as a Permanent Establishment, because that is not a legal right. However, it can happen if the chartered accountant or an advocate is entering into an arrangement with their client that they going to use his premises for completing the assignment, such place where they work may be considerable to have Permanent Establishment.

¹¹ supra note 5

In case of test of permanence, the business place must have a permanent place there no any other situation lies within the ambit of this test. In the Permanent Establishment the place which is going to use does not have a temporary nature. Although there the purpose is valid at the time of business were set up that the place of business is fixed for long time then it can form a Permanent Establishment. Even if the activities of business are suspended within a small time.

The term “permanence” can be define as the place of business for such time is not definite it can be use till business activity is stopped. This does not determine that the place of business should in the nature of perpetual. There are no particular time period mentioned in the term permanence. In the several nations that period are six months it is supposed to be enough to make a Permanent Establishment.

- Functional Test:-

For the constituting the Permanent Establishment there must be such equipment in the business are necessary and also they must in the working condition as per the concern government. Only the existence of those equipments on the place is not enough, they must be in working and producing or developing the goods for the business. In the Permanent Establishment the business place must have operating and functional activities.

The activity which is performing on the business place must be the work of the company. This requires 4 different tests which have to be fulfilled for the establishment of Permanent Establishment, these tests are: -

- I. The work commence by the company must be acknowledge business under the local law of the Nation where the work is executed. That work must be different from other income making work or funds.
- II. Still if the work is confidential under the local laws of business, it must be considered as other business work. This provision prescribed under the Article 7 of UN Model Double Taxation Convention, 2011¹² which is describing business profits.

¹² Supra note 10, page no. 139

- III. The work must not be of an introductory or supplementary in nature which is referring into Article 5(4) of the UN Model Double Taxation Convention, 2011¹³.
- IV. The business work should have a particular connection with the business place.

B. Specific Inclusion of Permanent Establishment :-

Specific Inclusion of Permanent Establishment mentioned in the Article 5(2) of UN Model, 2011 particularly includes some main establishments within the Permanent Establishment. These main establishments are:

- I. Management Place;
- II. local office;
- III. place of work;
- IV. industrial unit;
- V. Workshop;
- VI. Mine, oil or gas, pit or any other place of taking out of natural resources;

The establishments mentioned are above through the much example. Consequently, still an establishment which is not prescribe in the list but have necessary requirement might well form a Permanent Establishment.

C. Construction rule for Permanent Establishment and Service rule for Permanent Establishment:-

Under the Article 5(3) of the UN Model, 2011 there particularly includes two types of activities; they collectively with an establishment would form a Permanent Establishment. These both activities use into formation of Permanent Establishment, which are usually notified as ‘construction’ and ‘service’. The rules which are generally going to conclude the existence of the Permanent Establishment are notified as ‘construction rule’ and ‘service rule’. Through those rules, a Permanent

¹³ Ibid, page no. 99

Establishment comes into picture if the company is carrying on the activities as prescribed in the respective rules.

Under Construction rule for Permanent Establishment if a company own a building site, there a construction, assemble or installation job or managerial activities in relation therewith, a Permanent Establishment is coming into existence if there such above mentioned site, project or activities carry on at least for 6 months.

Under Service rule for Permanent Establishment if a company is supplying of services majorly counting the consultancy services from side to side by their employees or other human resources engaged in the supplying of such services, a Permanent Establishment would come into existence if such actions work and continue more than the 6 month but that time does not exceed more than the 12 month period.

D. Specific Exclusion for Permanent Establishment:-

Under the article 5(4) of the UN model, 2011 prescribed such facilities which are not going to use or as an essential part Permanent Establishment if they are certain types of activities found then it cannot form a Permanent Establishment. Those certain activities are mentioned below:

- I. Use of business place for storage or display of goods, and in the OECD model convention amend this and added the delivery with both storage and display.
- II. Maintenance of reserved goods exclusively in the place of business for storage or display.
- III. Maintenance of reserved goods exclusively for the purpose of processing by another enterprise.
- IV. Maintenance of fixed place for buying products or for collecting knowledge.
- V. Maintenance of fixed place of business for carrying out actions of introductory or subsidiary character.
- VI. Maintenance of fixed place of business exclusively for any combination of above activities.

E. Agency in Permanent Establishment:-

Under Article 5(5) of the UN Model, 2011 in that there no particular entity has its own acquired establishment than this entity can go with the agency as in the agent over there, it might have a PE through an agent provided the subsequent tests have to satisfy.

- **Objective Tests:-**

This is against the basic rule of the fixed place of business, but in this rule there an agency rule can apply it majorly required the being there of an agent. An agent can be any person, whether he is in working as an individual or a company. That is not compulsory that the agent should belong to the source country of the company or enterprises.

In that rule there clearly mentioned that an agent can make any contract or accomplish it on the behalf of the principle. That given power can be expressed or implied in general or particular or limit to some level. It makes that the action or decision of the agent might bind the principle or enterprise. The authority which was given to him must be related of the enterprise. Generally, making such limitation on benefits of business and negotiation of contracts by the principal cannot be able to form an agency in PE. The authority which is going to be providing to an agent should in the written and in clear understood way otherwise it cannot form any agency. Therefore, if the contract is being signing outside of the Source Country than an agent having the whole authority to negotiate in all parts of the contract in any appropriate manner, that can be binding on the principal or enterprise, then the agent might counter with he have the authority to finalize contract.

Under this Article an agency in PE can be form even there the agent has no right or authority to finalize the contracts. Rather than he can maintains stock of goods and he frequently deliver the goods on the behalf of the enterprise.

- **Subjective Tests:-**

When an agent is working with the principal and follow the entire instruction in the work can also make a PE. The dependency means commercial dependency. The commercial dependency includes an assurance in respect to the

agent's costs, minimum remuneration, etc. in this test there can be a situation where an agent have only one principle and his loyalty towards the principle all the time.

- **Functional Tests:-**

The right to bind the principal have to be for the reasons which are fundamental and important to the principal's business. It's not for executive reasons such as termination of contracts for stationery, lease, place of work, maintenance or manpower contracts.

Simple fact that an agent has the all rightful authority to determine contract as in appropriate manner would result in agency in PE. It is compulsory that the agent habitually put into effect such authority. The word 'habitually' shows that the authority must be used frequently and not just in isolated manner.

F. PE in case of Insurance Business:-

This article 5(6) only describe under the UN Model, 2011 it doesn't have any equivalent provision under the OECD Model Convention. It provides that an enterprise have main business is insurance business it shall be deemed to have a PE in the Source Country if:

- I. It recover all premium in the region of the Source Country; or
- II. If it insures risks located in the Source Country by a person in respect of an independent agent which were referred already in Article 5(7).

G. Absence of Arm's Length Relationship:-

This article 5(7) may provide an exception to agency rule under PE. An enterprise or company is not deemed to have a PE in the Source Country just because of its carries on business in another country through a dealer, common commission agent or any other agent of an independent position if such individual is acting in the regular course of business.

The exception mentioned above would contain the agent who works under the enterprise but also having other responsibilities of other enterprises. But it not apply in a situation where the activities of such individual are dedicated completely or almost completely on behalf of that enterprise and circumstances are made or imposed among that enterprises and the agent in their for profit and for financial relation which change from those which would have been made among the independent enterprises.

H. No PE by virtue of Relationship:-

Under this article 5(8) makes clear that the corporation which controls or is being controlled by a different company which have domicile of the source state would not constitute by itself also company a PE of the other. Therefore, a supplementary company would not form a PE of the holding company merely because of it is maintained by the holding company or a holding company could not form a PE of the supplementary company just because it is controls the supplementary company.

Case Studies

1. Motorola Inc Vs. Deputy Commissioner of Income Tax¹⁴

In this case the parties are (a) Motorola Communication Inc. ('Motorola'), (b) Ericsson Radio Systems AB ('Ericsson') and (c) Nokia Networks OY ('Nokia'). The Income Tax Appellate Tribunal (ITAT) gave judgement on the cases of three telecommunication companies in the light of three different sets of facts.

The decision basically deals with so many issues, which is mainly affect to taxation on non-resident of India. The major issue is that whether the activities of the non-residents, in the facts of this situation, result into a business connection or Permanent Establishment in India, only because of the non-residents had completely gotten over time or purchased less important thing or company owned by another company in India.

In this situation or event, the following important instances of watching, noticing, or making statements by the Court are clearly connected or related:

1. No income is thought of or considered to build up in India to a non-resident from the sale of hardware and software in this case, if such sale is happening outside of India to an Indian purchaser even by the non-resident supplier. He besides with other group of companies has entered into a ready-to-use contract for delivery and installation of equipments in India and the non-resident suppliers assumes the whole responsibility for or blame for the proper putting into use of said ready-to-use contract. In such a situation, as the sale of the equipment is affected market of outside India and the title and the risk in there or within that move from one place to another to the Indian purchaser outside India, there is no business connection in the terms of domestic tax law among the Non-resident supplier and the Indian purchaser.
2. A PE is a fixed place of business of a non-resident of India would exist in India but if one of them can point out to a physical location is the disposal of business the non-resident through which its business is carried on in India. Workers and workers of the non-resident supplier having use of its Indian add

¹⁴Motorola Inc Vs. Deputy Commissioner of Income Tax, [(2005) 95-ITD-269(SB)]

to or addition's office as a substance of right would form a PE of the non-resident supplier in India.

3. The substitution of a connected office in India, of a non-resident. Non-resident does not itself makeup be equal to its PE in India.
4. A completely bought or owned or received additional or helping supplier of a non-resident in India would form its PE in India. If their back and forth or equal between people relationship leads to the difference between these two related to big business things or businesses becoming unclear and a reasonable guessing can be drawn that the additional or helping was a effective projection of the supplier in India.

In the case of Ericsson, the special bench of court stated that it did not have a PE in India; because of there is no fixed place of business in India. And also, there is no 'Agency for PE' as the additional or helping of Ericsson's group of company they could not be said that there 'dependent agent' of Ericsson as it had no right to decide or figure out all contracts on Ericsson's behalf. Also, as the money made or good things received and income in respect of the installation had already been taxed on the Indian additional or helping, the same could not be taxed again and again on supplier of Ericsson.

In the case of Motorola, the facts of the case show that the workers of the Motorola were using the reasons for doing or saying something of the additional or helping. There not only for the work of Motorola continue but also were working for Motorola's Indian additional or helping businesses or projects. In that there Motorola are paying moneys paid for working to his workers in main or additional or helping, but its Indian additional or helping are providing them privileges, which is Motorola pay to the additional or helping with a mark up. The particular bench end without argument that this led to an understanding of deep things of the additional or helping being a display of the activities or works of Motorola in India and for this reason a PE of Motorola could be said to be form in India. On the facts it was still established that the activities or work is continue by the workers of the PE were early and subject to change and additional or helping in nature and as per prescribed under Article 53 e of the DTAA between India and USA, there was a particular keeping out from the law of

a PE by the taking on of such activities or work, the Special Bench of court held that there no PE of Motorola was formed in India.

In case of Nokia, the Special Bench of court decided that its connected office would not form its PE in India because of it was not doing any commercial activities in India. In the fact it was purposely blocked or forbidden by the Reserve Bank of India (RBI) from performed. The case of its additional or helping was different from others, as the facts led to an understanding of deep things of the additional or helping being a display of the activities or work of Nokia in India.

The Special Bench decided that it is not require to be established that there was actually a display of the activities or work of the Non-resident in India. It was good enough that the facts of the case resulted in an understanding of deep things of the additional or helping being a display of the non-resident in India. In The facts which were found to be related to this situation or event by the Special Bench in Nokia's case are set out below:

1. The contracts for the delivery of equipment and software were signed in India by an employee of Nokia's connected office. The almost the same person took up employment with Nokia's Indian additional or helping business or project in the very next day and signed the contracts for the installation also.
2. Nokia had given a responsibility to the Indian operators that it would not reduce its stake in the Indian additional or helping to not more than 51 percent.

2. Deputy Director of Income Tax Vs. SET Satellite (Singapore) Pvt. Ltd.¹⁵

In this case a question rose up that, how the income or makes money or gets something good of a resident of Singapore was to be calculated in a situation where the non-resident had not independent agent in India, while using of the tax agreement between countries between India and Singapore. It was gave opinions about what could or should be done about a situation for the test or evaluated that on the arm's length basis at once the agent was paid, the question on typical and expected any further income or money made or good thing received in India to the resident of

¹⁵ [(2007) 106-ITD-175]

Singapore must not arise at all. The Court null and void this submission and decided that further income or money made or good thing received is testable in the hands of resident of Singapore. In the argument the Court found the following instances of watching, noticing, or making statements on how the income or profit named after or discovered by or caused by a PE is to be calculated:

"The income or profit named after or discovered by or caused by the permanent establishment in the host country, where the tax is charging, the income or profit named after or discovered by or caused by foreign company's processes in the host country, in turn hints the income or profit named after or discovered by or caused by the activities or work carried on by the foreign business or project in the host country. The income or money made or good thing received is the income arrived at by taking into account of money or money income produced by the PE and deducting there from the expenses got or caused by the foreign business or project to make those money or money income. Anyway, it is open to the fronting business or project to state appropriate change for the foreign business or project's overheads and a reasonable charge, on relation of activities of the foreign business or project carried on outside of the host country, by dealing with the foreign businesses or projects as a based on a made-up idea different thing or business."

3. ABN Amro Bank Vs. Income Tax Appellate Tribunal¹⁶

In the case of ABN Amro Bank, a question arise as to whether the bank was able to be picked or able to participate to claim deduction for amounts debited to the money made or good thing received and loss account of the Indian branches representing interest payable to across-the-ocean offices of the bank, while figuring out or calculating the income of its Indian Branches.

The Court decided:

1. The suggestion or possible plan of action of law is well settled that nobody can make money made or good thing received out of self nor can trade with self nor earn from self¹⁷.

¹⁶ABN Amro Bank Vs. Income Tax Appellate Tribunal, [97-ITD-89]

¹⁷ Sir Kikabhai Premchand vs. CIT, [(1953) 24-ITR-506 (SC)]

2. No deduction was ok to say or do since the local law does not allow any deduction of the payment of expense to self. It does not assume the interest receipt from self through a branch or PE as its income and charges it to tax¹⁸.
3. As there is only one test or evaluation in the case of the test or evaluatee bank both for the money made or good thing received earned by the PE as well as the income earned by the head office in India. The result would be that on one hand, an expense by way of payment of interest by PE to head office would be OK to say or do as a deduction and on the other, the receipt by the head office from PE would have to be charged to tax because the interest has been earned by, and risen up or become visible and built up to the head office in India¹⁹.

¹⁸ Betts Hartley Huett & Co. Ltd., [(1978) 116-ITR-425 (Cal)]

¹⁹ Ram Lal Bechai Ram vs. CIT, [(1946) 14-ITR-1(All.)]

Types of Permanent Establishment

Through the basic concept of PE it is rotate around the fixed place of business. It may also extend to take in an agent who is legally apart from an enterprise or company and also rendering of services in India through a foreign entity. The Double Taxation Avoidance Agreements go through by India be familiar with the following major types of PE for a foreign enterprise in India:

1. Fixed Place PE

The Permanent Establishment can be set up through the fixed place where they can start their business activity. In the Fixed Place PE there some requisite must follow by the companies, they are: -

- Fixed place of business
- Business of the foreign enterprise is wholly or partly carried on through such place
- Degree of permanence

2. Agency PE

The Permanent Establishment can be set up through the agency. There an agency were set up in other country and agent were appoint for doing the work on the instruction of the principle or the head of the business who appointing him for such work. In the agency the there all work or activities done by the agent, all on the behalf of the principle so all liability is arise on the principle. The agent can work as independent but on limited activities as on deciding the terms of contract or for the completion of contract. For the agency the agent has to fulfil such requisites: -

- Authority to conclude contracts on behalf of Foreign enterprises
- Secures orders wholly or almost wholly on behalf of foreign enterprise
- Regularly delivers goods from the stock of good maintained.

3. Service PE

Some of the PE was establish for providing services to the source country, for this they can establish such establishment in source country. In that they pay for such services to the source country that is included in the Service PE. For that they have to complete such requisites: -

- Foreign enterprise furnishes or performs services in India other than included services i.e. royalties and fees for technical services.
- Through this employees or other personnel for specified period.

CHAPTER - 3

BUSINESS CONNECTION

Meaning of Business connection

In the Indian reporter of PE, they are called as BC. It has very wider in suggestion and has been much successfully used by the money or money income people in charge for forcing on people tax the money made or good things received on the not resident of India. In spite of being referred to the ITA, the word is not defining till the Finance Act, 2003 come into the existence. It inserted many of the hidden explanation to sec. 9 of the ITA, 1961. The meaning of the word PE was prescribed in sec. 92F (iii a) of the Finance Act, 2002. This meaning is related only on the reassigning of pricing needs and is a complete and thorough definition.

Definition: -

The word BC is talk about in Sec. 9(1) (i) of the ITA, which is producing again below the context:

The subsequent profits shall be thought to increase or happen in India: -

- (i) all profits accruing or arising, whether it is directly or not, from side to side or from any other business connection in India or ...

Explanation 1—for the reason of that clause is —

- (a) in the situation of a business of which all the functions are not followed in India, the profits of the business are desired under this clause to raise or take place in India can be only in prescribed part of the profits as is sensibly characteristic to the activities followed in India ;
- (b) in the situation of a not resident of India, no profits shall be supposed to raise or took place in India to person by activities which are limited for the buying of materials in India for the purpose of export;
- (c) in the circumstances of a not resident of India, being a person occupied in the activity of running a news organization or of issuing newspapers, magazines or journals, no profits shall be supposed to raise or take place in India to him by activities which are limited to the compilation of news and sights in India for broadcast out of India;
- (d) in the situation of a not resident of India, being—
 - (1) an individual who not be a resident of India ; or

- (2) a company which is not have one partner who is a resident of India or who is citizen in India ; or
 - (3) a firm which is not having any shareholder who is a resident of India or who is citizen in India,
- (ii) no profits may be supposed to raise or take place in India to such person, company or firm from side to side or from activities which are restricted to the shooting of any cinematograph pictures in India ;

Explanation 2.—for the elimination of suspicions, it is hereby affirmed that “BC” shall contain any business activity followed by a person who, performing on place of the not resident of India,—

- (a) he has and regularly movements in India, an authority to bring to a close contracts on place of the not resident of India, except his performance are inadequate to the buy of materials or products for the not resident of India; or
- (b) he has no such power but usually upholds in India a reserve of materials or products from which he frequently distributes materials or products on place of the not resident of India; or
- (c) he usually safes instructions in India, primarily or completely for the not resident of India or for that not resident of India and other not residents of India managing, forced by, or topic to the similar ordinary control, as that not resident of India:

Present that such BC is not including any business activity followed through a dealer, general chargeable agent or any other agent having an self-governing status, if such dealer, general chargeable agent or any other agent having an self-governing status is acting in the regular way of his business.

Further that where such dealer, general chargeable agent or any other agent works primarily or completely on behalf of a not resident of India or on behalf of such not resident of India and other not residents of India which are forced by the prime not resident of India or have a managing importance in the principle not resident of India or are topic to the same general control as the main not resident of India, he not to be believed to be a dealer, general commission agent or an agent of an self-governing status.

Explanation 3.—where a business is followed in India by a person consigned in the clause (a) or the clause (b) or the clause (c) of expl. no. 2, just a great deal of profits as is characteristic to the activities followed in India may be supposed to increase or happen in India.

As per sec. 9(1) (i) of the ITA any profits collected by either directly or not, by or from numerous BC in India, would be hypothetical to raise or take place in India and subsequently they could be tax pay in India. On the other hand the word "BC" is not being straight explained in the ITA. For that purpose the Bombay High Court in the case Blue Star Engg. Co. (Bom) Pvt. Ltd. v CIT²⁰, decide that since the word BC admits of no accurate meaning of the answer of the question asked must not be self-governing upon the demanding facts of every circumstances. So different High Courts in a lot of cases²¹ have also stated that there is no exact meaning of the word "BC" and the government has purposely selected words those have broad understanding without any parliamentary meaning.

So there is no thoughtful form there in which a BC exists. On the instruction of the Supreme Court in a landmark case of CIT v R D Aggarwal & Co²² there the bench stated that:-

"A business connection might acquire quite a few forms: it might include forwarding a part of the main business or activity secondary to the major business of the not resident of India by an agent, or it might just be a relative among the business of the not resident of India and the activity in India, which make easy or assists the forwarding of that business."

The significance of the word 'BC' can be distinct with the help of certain case laws as under:-

Perhaps the oldest case defining the word BC has been determined by the Rangoon High Court. In the major case of CIT v Visalakshi Achi²³ the court's examination as follows:

²⁰Blue Star Engg. Co. (Bom) Pvt. Ltd. v CIT, [1969] 73 ITR 283 (Bom) following the principle laid in CIT v R D Aggarwal & Co. [1965] 56 ITR 20, 24 (SC)

²¹Bangalore Woollen, Cotton & Silk Mills Co. Ltd v CIT [1950] 18 ITR 423 (Mad); CIT v Evans Medical Supplies Ltd. [1959] 36 ITR 418 (Bom); Jethabhai Javeribhai v CIT [1951] 20 ITR 331 (Nag)

²²CIT v R D Aggarwal & Co, Reported in [1965] 56 ITR 20, 24

The appearance of “BC” has to indicate something, which creates profits or grown and not a simple situation or circumstance which is positive to the creation of profit. The word "business" have to the meaning point towards in sec. 2 (13) of the ITA, and the word "connection" have to used in the intellect of "that with which one is linked".

The Bombay High Court in the case of CIT v National Mutual Life Association of Australia²⁴ settled that all that is essential belongings for a BC to existence, they must be:

- (i) an industry in India;
 - (ii) a connection among not resident of India or company and that 'business'; and
- That the not resident of India or company has received any profits in the course of such connection.

Principles of Business Connection

There are a lot of factors, which require being protect under deliberation while accepting whether a BC surviving in an exacting situation or not. The landmark judgment of the Andhra Pradesh High Court in G V K Industries Ltd v ITO²⁵ bring together the percentage of dissimilar from other judgments and settled the subsequent principles of BC:

- (i) Whether there is a BC among an Indian person and a not resident of India is a varied matter of fact and matter of law which have to be unoccupied on the facts and circumstances of each circumstances;
- (ii) The expression of 'BC' is a great deal wide to recognize of any correct meaning on the other hand it has a amount of well recognized qualities;
- (iii) The genuine meaning of 'BC' is the survival of lock, genuine, temperate association and regularity of attention among the not resident of India and the Indian person;

²³ CIT v Visalakshi Achi, reported in [1937] 5 ITR 448

²⁴ CIT v National Mutual Life Association of Australia, [1933] 1 ITR 350, 361 (Bom)

²⁵ G V K Industries Ltd v ITO, reported in [1997] 228 ITR 564

- (iv) Where there is categorize or administration or funds or important holding of fairness shares or sharing of profits by the not resident of India of the Indian person, the situation of principle (iii) must be fulfilled;
- (v) For structure of 'BC' there must be durability of movement or process of the not resident of India with the Indian party and a not cleared or remote transaction is not enough to set up a BC.

We are available to talk about some of these principles are declared by the model and also in deep research to them in view of preceding judicial decision. The principles which we are discussing herein are:

A. Continuity

In order to describe BC, one of the very most important features would be make a decision of whether the action or operation under contemplation is an exclusive operation or whether it is engaged out by the not resident of India in a common way, which set up an ingredient of association.

In that background we talk about circumstances determined by the Supreme Court²⁶ in this observe, the abridged facts of that circumstances are as under:

A is a Ltd. company purposed in the UK, obtained a revolving and merging treat at Pondicherry. A Ltd. co. had chosen another company at Madras as its symbolized agent for the purpose of its industry in India. In an existing evaluation year, A Ltd. co. does not complete any sales of enclosure or cotton manufactured by it in India, but all necessary gadgets for creating cotton for the factory acquired at Pondicherry were complete by the agents in Madras. There no other acquires were made beside any other agency. The main matter under reflection was whether A Ltd. co. is able to say that they have a BC in India.

In this context, there the state of affairs decision of the Supreme Court referred. The Supreme Court observed that:

- The activity or work followed by the Madras unit for A Ltd. co. was not in the natural world of a remote operation of gets of unrefined materials. In these facts or conditions that surround someone, an ordinary service business or government unit or power or functioning was written down in Madras for the

²⁶ Anglo French Textile Co Ltd v CIT reported in [1953] 23 ITR 101 (SC)

buy of the whole unrefined materials extremely important for put together or group together across the ocean and the agent was particular chosen because of his skill, reputation and experience in the ground of trade. The word of the service business or government unit or power or functioning totally set up that the body in Madras was following an activity or work in the area of almost the same as the business of a supervision service business or government unit or power or functioning in India of the across-the-ocean company and the last thing just mentioned completely and totally had an organization with the service business or government unit or power or functioning. When there is a state of existing forever of business association between the person in Madras who helps to make the money made or good things received and the person outside Madras who collects or understands the money made or good things received, such association does contain or make up a BC.

- Some of the clearly connected or related laws on this way of thinking or basic truth or rule of uninterrupted, constant quality is summarized below.
- A particular transaction would not fall within the extent of or the range of the BC. If a producer of a motor car in England or America sells it to a client in India, there is no hesitation a BC in relation to that sale among the manufacturer and the purchaser, and the producer probably makes a money made or good thing received, but no one would propose that in respect of the money made or good thing received on that particular transaction he is legally responsible to pay British India an income-tax. There must be some voter or part of firm and steady nature or lasting nature or strength in the relationship among the parties, and in each facts or conditions that surround someone individual has to look at the very accurate facts of the facts or conditions that surround someone to watch or notice or celebrate or obey whether it come within the extent of or the range of the sec.²⁷
- If the transactions are increase over the whole year and run into quite a lot of lakhs, it will not be easy, if not impossible, to argue against the end or end result that such buying-related activities do make up or be equal to business activities.²⁸

²⁷ CIT v Metro Goldwyn Mayer (India) Ltd [1939] 7 ITR 176 (Bom)

²⁸ Jamnadas Brij Mohan V CIT [1962] 46 ITR 233 (All)

- Existence of an agent is not necessary and where there is happening over and over again in a predictable way and uninterrupted, constant quality of activities, there is a BC.²⁹
- Raw material needed or demanded by a foreign company was bought something for money by its agents in British India continuously for more than two but not a lot of years. The sale go ahead or move forwards of the manufactured materials were collected by them in British India and were credited in their books to the account of the company as they acted also as bankers. They met all the expense out of the collections in their hands, paid for the instances of buying something for money, and made also other payments referred to in the managing agents' accounts. They were given power to make final decisions with reference to the instances of buying things for money as to when to buy, where to buy and at what rate. The instances of buying something for money of materials continuously to meet the needed things of manufacture in the mills needed or demanded skill and judgment and that is only vested in the managing agents. Practically the whole management of the business was left to the agents and though it is said that they had an office also at Bangalore it is clear that most of the activities connected with the management of the business at Bangalore were carried out in British India. In view of the above, it was not very hard to hold that the foreign company did have a BC in India.³⁰
- It is not the length of time during which the connection has survived but the nature of the connection which would define whether a BC within the meaning of this sec. has been established or not. A course of many dealings within a short time having a little bit of uninterrupted, constant quality about them would be good enough to establish a BC.³¹
- To make up or be equal to a BC some uninterrupted, constant quality of relationship between the person in India who helps to make the money made or good things received and the person outside India who receives or realizes

²⁹ Bikaner Textile Merchants Syndicate Ltd v CIT [1965] 58 ITR 169 (Raj)

³⁰ Bangalore Wollen, Cotton & Silk Mills Co Ltd v CIT [1950] 18 ITR 423, 433 (Mad)

³¹ Bikaner Textile Merchants Syndicate Ltd v CIT [1965] 58 ITR 169 (Raj); A P Damodara Shenoy v CIT [1954] 26 ITR 650 (Bom)

the money made or good things received, is necessary. Where all that has happened is that a few transactions of instances of buying things for money of raw materials have happened in India and the manufacture and sale of materials have happened outside India, the money made or good things received arising from such sales cannot be considered to have happen out of a BC in India. Where, however, there is a regular service business or government unit or power or functioning established in India for the instances of buying something for money of the whole raw materials needed or demanded for the purpose of manufacture and sale in other countries and the agent is chosen by reason of his skill, reputation and experience in the line of trade, it can be said that there is a BC in India so that a part of or amount of the profits named after or discovered by or caused by the instances of buying something for money of raw materials in India can be given out equally under the explanation (a) to sec. 9(1)(i).³²

B. Real and intimate connection

In order to have a BC, there must be a real and intimate connection between the activity carried on by the not resident of India outside India and the activity carried out in India. Further, such activity must be one, which adds or gives to the earnings of makes money by the not resident of India in his business. In this big picture, the case of CIT v. R. D. Aggarwal & Co.³³ is thought of as a hugely important case. In the case of R D Aggarwal & Co, the facts were as under:

R Ltd, a company located in Amritsar, carried on business as importers and commission agents of not resident of India exporters. R Ltd communicated orders interviewed people or talked to people by them from dealers in Amritsar to the not residents of India for acceptance. If a contract resulted and price for materials bought something for money was paid by the Amritsar dealer to the not resident of India exporters, the test or evaluations became entitled to commission changing. R Ltd carried out its activities as only agents of certain not resident of India exporters and as representatives for certain other not resident of India exporters. The issue was whether

³² Circular No 23, dated July 23, 1969, issued by the Central Board of Direct Taxes ("CBDT")

³³ CIT v. R. D. Aggarwal & Co., 56 ITR 20 (SC)

the relationship between R Ltd and the not resident of India exporters could be thought of as a BC.

In this situation it was held that none of the activities of the not resident of India exporters, such as getting raw materials, manufacturing, sale or delivery of materials happened in India. R Ltd only got or obtained orders from people who sell things in Amritsar for instances of buying something for money of materials from the not residents of India. R Ltd did not have the authority to even accept the offers for the not residents of India. Some commercial activity was definitely carried on by the test or evaluations in the matter of getting orders, which resulted in contracts for sale by the not residents of India of materials to people who sell things at Amritsar. Hence, this could in no way result in a BC of R Ltd with the not residents of India within India.

Certain other clearly connected or related situation laws in respect of 'real and intimate connection' are summarized below:

- BC definitely would be a commercial connection but all commercial connections will not necessarily make up or be equal to BC within the meaning of the idea unless the commercial connection is really and very deeply or very closely connected with the business activity of the not resident of India in India and is contributory to the earning of money made or good things received in the said trading activity.³⁴
- To confirm with the needed things of the expression "BC" it is necessary that a common thread of back and forth or equal between people interest must run through the fabric of the trading activity carried on outside and inside India and the same can be described as real and intimate connection. The commonness of interest may be by way of management control or related to managing money control or by way of sharing of money made or good things received. It may come into existence in some other manner but there must be something more than mere transaction of instances of buying something for money and sale between principal and principal in order to bring the transaction within the area of authority or knowledge of BC.³⁵

³⁴ Blue Star Engg. Co. (Bom) (P) Ltd v CIT [1969] 73 UTR 283, 291 (Bom)

³⁵ CIT v Hindustan Shipyard Ltd. [1977] 109 ITR 158, 170 (AP)

Further, in order to have a BC in India, the not resident of India should have had carried out at least some activities in India which show that the Indian connection yields money made or good things received for the not resident of India.

- In a situation, there was no well-thought-out instances of buying something for money of materials in the taxable land areas owned or controlled by someone, and neither was any service business or government unit or power or functioning employed for selective instances of buying things for money. There was also nothing to show that the test or evaluated was able to make higher margin of money made or good things received on account of instances of buying things for money in taxable land areas owned or controlled by someone. It was held that since no "activities" were carried out by the test or evaluated in India either by itself or through an agent, the legal rules or food and supplies of sec. 9 of the ITA were not related and there was no reason for giving out equally of any profits named after or discovered by or caused by the instances of buying things for money produced or made happen by the test or evaluated in India.³⁶
- The legal rules or food and supplies relating to BC have no application unless according to the known and accepted business ideas or plans and usages, the particular activity is thought of as a clearly visible or clearly understood business operation. Activities, which are not well defined or are of a casual or far apart from others character, would not normally fall within the ambit of this rule. In the instant situation, the raw materials were bought something for money in an organized way and usually through an established service business or government unit or power or functioning having special skill and smart ability in selecting the materials to be bought something for money and fixing the time and place of instances of buying something for money. Such activity appears to be well within the import of the word 'operation'.³⁷
- An exporter of tobacco had selected or hired M/s Toshuku Ltd, a not resident of India, as an agent to sell the exported tobacco in Japan for which it was entitled to commission. Even though no part of marketing operation was carried out in India the money or money income treated the commission

³⁶ CIT v Jiyajeerao Cotton Mill Ltd [1979] 118 ITR 72 (Cal)

³⁷ Anglo French Textile Co Ltd v CIT [1953] 23 ITR 101 (SC)

money made or good things received as increased or risen up or become visible in India as they had either increased or risen up or become visible through and from the BC in India that existed between M/s Toshuku Ltd and the exporter in India. In this case, the Supreme Court held that the not resident of India agent did not carry on any business activities in India. The receipt in India of the sale go ahead or move forwards of tobacco remitted or caused to be remitted by the purchasers from in other countries did not amount to an operation carried out by M/s Toshuku Ltd in India as thought about by clause (a) of the explanation to sec. 9(1)(i) of the ITA. Hence, the money or money income was not right in treating the commission money made or good things received as increased in India.³⁸

C. Attribution of profits

Under the circular of the CBDT is also instrumental circular in defining the attribution of money made or good things received in cases where BC might exist in the original positionation of trade with not resident of India things or businesses. It states that sec. 9 of the ITA does not try to bring into the tax net the money made or good things received of a not resident of India, which cannot reasonably be attributed to activities carried out in India. Even if there be a BC in India, the whole of the money made or good thing received building up or arising from the BC is not supposed to increase or happen in India. It is only that part of or amount of the money made or good thing received, which can reasonably be attributed to the activities of the business carried out in India, which is responsible under the ITA.

The circular also clears up different issues on whether any money made or good things received should be attributed to India where a BC might exist due to certain transactions. These situations are discussed below:

- Not resident of India exporter selling materials from in other countries to Indian importer: -

The Circular states that no something you owe or something you're responsible for or disadvantage will happen on collection-related basis to the not resident of India on the

³⁸ CIT v Toshuku Ltd [1980] 125 ITR 525 (SC)

money made or good things received made by him where the transactions of sale between the two parties, are on a principal-to-principal basis. The circular goes further to answer the question whether in the above type of situations there is any something you owe or something you're responsible for or disadvantage of the not resident of India under sec. 51a of the ITA, on the basis of receipt of sale go ahead or move forwards, including the money made or good thing received in India. Related to this, the circular states that if any of the following are the only activities carried out by or for the not resident of India in India, such receipts would not be taxed in India:

1. If the not resident of India makes over the shipping documents to a bank in his own country which discounts the documents and sends them for collection to the bankers in India, who present the sight or nuisance draft to the resident importer and deliver the documents to him against payment or acceptance by the last thing just mentioned;
2. Even if the shipping documents are not discounted in the foreign country, but are handed over in India against payment or acceptance.
 - Not resident of India company selling materials from in other countries to its Indian less important thing or company owned by another company

The Circular when dealing with the issue of whether the dealings between a not resident of India parent company and its Indian less important thing or company owned by another company can at all be thought of as being on a principal-to-principal basis. This issue happens since the former would be in a position to exercise control over the affairs of the last thing just mentioned. Related to this, the Circular states that if the transactions:

- Are actually on a principal-to-principal basis;
- At an arm's length; and

The less important thing or company owned by another company company functions and carries on business on its own, instead of functioning as an agent of the parent company,

The mere fact that the Indian company is a smaller company owned by the not resident of India company will not be considered a valid ground for calling for or using sec. 9 of the ITA for testing or evaluating the not resident of India. The Circular

further states that where a not resident of India parent company sells materials to its Indian less important thing or company owned by another company, the money made or good things received from the transaction will not be supposed to increase or happen in India under sec. 9, gave or given that:

1. The contracts to sell are made outside India;
2. The sales are made on a principal-to-principal basis and at arm's length; and
3. The less important thing or company owned by another company does not act as an agent of the parent.

In the same way or in that way, the mere existence of a "BC" arising out of the parent less important thing or company owned by another company relationship nor will the fact that the parent company might exercise control over the affairs of the less important thing or company owned by another company lead to the attribution of any money made or good things received in India if a transaction is on a principal to principal basis.

- Sale of plant and machinery to an Indian importer on section basis

Where the transaction of sale and instances of buying something for money is on a principal-to-principal basis and the exporter and the importer have no other BC, the fact that the exporter allows the importer to pay for the plant and machinery in sections will not, by itself, make or give the exporter possibly going to tax on the ground that the money made or good things received is supposed to happen to him in India. The Indian importer will also not, in such a situation, be treated as an agent of the exporter for the purposes of test or evaluation.

Rule 10 of the Income tax Rules, 1962 lays out the methods for definition of money made or good things received in the situation of not residents of India. It gives wide powers to the testing-related officers and prescribes one of the following methods that can be followed for attributing money made or good things received to the Indian BC of a not resident of India:

- (i) at such percentage of the turnover so building up or arising as the testing-related officer may consider reasonable;

- (ii) at such percentage that the worldwide money made or good things received bears to the worldwide turnover, as applied to receipts building up or arising in India; or
- (iii) in such manner as the testing-related officer may think of or consider good.

D. Common Control

Where the Indian thing or business and the not resident of India thing or business are both held by the same person, or have common control, then the not resident of India would be thought of as having a BC in India. This way of thinking or basic truth or rule has been held by the Privy group of people who advise or govern in an old case³⁹. In that situation, an Indian bank and a foreign bank were controlled by the same people. The main function of the foreign bank was to finance the Indian bank. The loans advanced by the foreign bank to the Indian bank represented a large part of the capital of the foreign bank. The flow of business between the two banks was secured by the complete common control exercised over the business of both banks so that the loans could be made without security and for blurry or unknown periods. The loans in question were made outside India through the foreign branches of the pertaining to each person or thing banks and were repayable outside India, but the moneys were used by the Indian bank in this country. On these facts it was held that a BC existed in India between the two banks.

E. Business connection includes professional connection

The expression business in the word "BC" does not mean trade or manufacture only. It is being used as including within its scope jobs or lines of work, jobs and calling from a fairly long time. In the big picture in which the expression 'BC' is used in sec. 91 of the ITA there is no warrant for giving a restricted meaning to it, excluding 'professional' connection from its range.

This issue came up before the Supreme Court⁴⁰, in that case, a firm of managers or people who ask for business at Calcutta was instructed by certain managers or people who ask for business in London who were acting for a German corporation. On their instructions the managers or people who ask for business in India kept or held a lawyer-related of London in the suit pending before the Calcutta

³⁹ Bank of Chettinad Ltd v CIT [1940] 8 ITR 522

⁴⁰ Barendra Prasad Roy v ITO reported in [1981] 129 ITR 295

High Court. The lawyer-related argued the situation for 15 days and went back to London. The issue, which rose up, was whether there was a BC and whether the money made or good things received was taxable? The Supreme Court held that there was a "BC" between the firm of managers or people who ask for business and the lawyer-related. There was a common connection between the Indian manager or person who asks for business and the lawyer-related which was real and intimate and not a casual one and that the lawyer-related earned the fee arguing the situation in India only due to that connection, and hence a BC existed.

However, here it is interesting to note⁴¹ on BC as under:

"There is no warrant for a extending the idea or belief of business connection to include a professional connection, b related to or looking at or thinking about the presentation of argument in a single case as making up or being equal to a business connection; c finding a business connection to exist between the lawyer-related and the Indian managers or people who ask for business who neither briefed him nor paid him any fees, and d holding that any money made or good things received rose up to the lawyer-related from the possible business connection with the Indian managers or people who ask for business. Neither on way of thinking or basic truth or rule nor on something important that came before is the Court's judgment supportable on any of the four points. The fact that under the general law, the word "business" is wide enough to cover a job or line of work is not a good reason for related to or looking at or thinking about the expression "business connection" as including a professional connection, especially in a height which has completely used in different places - including the very head of money made or good things received "money made or good things received and gains of business or profession" - the words "business" and "profession" representing clear or separate and different ideas.⁴²"

⁴¹ Late Mr Palkhivala, as reproduced in the "Income Tax Laws" by Kanga and Palkhivala, Eighth Ed.

⁴² K Thomas Verghese (Dr.) v CIT [1986] 161 ITR 21 (Ker)

CHAPTER – 4

DOUBLE TAXATION AVOIDANCE **AGREEMENT**

Double Taxation Avoidance Agreement

Double Taxation Avoidance Agreement (DTAA) is a tax treaty that India has done with 123 other nations. In the simple and understood language, there they describe regulation for a Non-resident of India is, if they are resident in any of those 123 nations and is paying taxes on the income acquired in that country, then they are entitled for a lower deduction of tax on income acquired in India in that financial year.

These agreements are providing the rights of taxation to India in respect of the income of the nature of interest, dividend, royalty and fees for industrial services to the nation of residence. Though, the source country is also given the right of taxation so in the source country has to be limited to the rates as per agreed in the agreement. The rate of taxation is on the receipts by the person without deduction of expenses.

In the Double Taxation Avoidance Agreement there so many countries have taken part. The agreement of avoidance of double taxation with the Government of Republic of India, currently sign by 123 nations. There some major countries are also sign on the agreement as like Australia, United Kingdom and United States of America etc. These countries have their own domestic law for taxation but for solving these problems relating overseas business, they found the Double Taxation Avoidance Agreement.

This agreement basically provides jurisdiction over the business working around the world. In those agreements there they agree upon such conditions which is commonly use in the countries but in different ways. In those agreements they decide such rules are use in the paying taxation as per appropriate.

There some important agreements between India and other country mentioned, they are: -

A. AGREEMENT BETWEEN THE REPUBLIC OF INDIA AND AUSTRALIA FOR THE AVOIDANCE OF DOUBLE TAXATION

This agreement took place between Government of Republic of India and Government of Australia, for the avoidance of double taxation imposing on companies those are engaged in the business among the jurisdiction of India and Australia. This agreement form because for prevention of fiscal evasion with the respect to the taxes on the income or profit acquired by the companies through either India or Australia situated at another places.

This agreement was signed among the Government of Republic of India and Government of Australia on the date of 30th December of 1991. Before that both countries sit together on the same table and take notes over the each other's legislation on imposing tax. In India the section 90 of the Income Tax Act, 1961 and section 24A of Companies Sur Tax Act, 1964, confers the legislation and provide implication over the Indian jurisdiction. Central Government give direction to the provision of the said agreement for implication in the territory of Union of India.

The DTAA between India and Australia consists of 29 articles decided through the mutual consent. In this agreement such point mainly discussed they are: -

1. Personal Scope: - In this agreement they discussed on that the resident of either India or Australia are include in that agreement and they are bound to follow the rule prescribed under this agreement.
2. Tax covered: - This point is mention in the article 2⁴³ of this agreement. In both states they cover different type of taxes in their local legislation relating with the taxation. In Australia there such taxes impose on the income from any type of business and the resources taxes are impose on the off shore projects relating to the exploration. In India there income taxes impose on the surcharges. Sur tax imposed on the chargeable profits of the companies. This article covers both substantial and similar taxes were imposed by the any contracting country. They notify other country when they are imposing such substantial charges.

⁴³ Agreement for avoidance of double taxation and prevention of fiscal evasion with Australia, 1992

3. Territory: - In that agreement there is many territories defined by the contracting states. There Australia defines his territory for implication of the taxation treaty, he Includes Norfolk Island, Christmas Island, Cocos Island, Asmore and Carties Island, Heard and MacDonald Island, and Coral sea Island. In the other hand India define his territory as in territorial sea of India, air space, and any other maritime zone which were clearly describe in the statute of Indian law. This territory clearly define in the article 3(1)(a)⁴⁴.
4. Year of Income: - For the imposing of such taxes there must be clear about the tax imposing time. In India the previous year is count as a financial year and that make it a year of income⁴⁵.
5. Residence: - Person, who held liable under this agreement for tax liability, must have the residency of one of the contracting state. In any case there no residency arises of that person then he deemed to be having residency of either state. There person have no permanent residency of either state then his solely relation with the state are assume to have residency. In other situation, if a person have both state residency then the close relation of the business to one of the state are consider as a resident state of that person. This residence is defined and clarifies under the article 4 of this agreement.
6. Permanent Establishment: - PE must be established for implication of this agreement. PE means “a fixed place of business through which the business of an enterprise is wholly or partly carried on”. That means there must be a fixed place where a person or enterprise can start their business or activities.
7. Income from real property: - According to this agreement there the income must arise from the property, which was really situated at any one of the contracting state. The real property is defined differently in both of the contracting states. In Australia there the real property is defined as the land and income arises from this property are lease of land or any other interest which arises from this property. This income should be received in the variable or fixed payment system then this income consider under the Federal Law of the Australia.

⁴⁴ ibid

⁴⁵ As per the Income Tax Act, 1961

In the other hand in India there income from the real property were held liable to pay taxes to the Indian authority. In the real property they include all the accessory relating to the immovable property and all the general laws covered the landed the property and income arising out of it. It must include the all variable and fixed mode of payment. In is arising out of land is must be direct use of land.

8. Business Profit: - in this regards both sate government decide that the profit arising out of the business of an enterprise through PE than this profit are consider as under the liability to pay tax. Generally, tax on this profits are payable at the source country but in case of PE than according to this agreement the more appropriate state has right to collect tax.

In this agreement there both government include many more point which can held liable for paying tax over them to the contracting state. They are mentioned below: -

- (i) Ships and Aircraft (Article 9);
- (ii) Dividends (Article 10);
- (iii) Royalties (Article 11);
- (iv) Alienation of Property (Article 12);
- (v) Independent personal services (Article 13);
- (vi) Dependent services (Article 14).

There in this agreement some points are make an exemption for paying tax to the contracting state. But they held liable to pay taxes on their main resident state and accordingly there law. They are mentioned below: -

- (i) Pension and Annuities (Article 18);
- (ii) Government Service (Article 19);
- (iii) Professor and Teachers (Article 20);
- (iv) Students and Trainees (Article 21);
- (v) Director's fees (Article 16);
- (vi) Entertainers (Article 17).

For avoiding the double taxation an enterprise must have register itself to the concerning Government of the either contracting states. They must present the all

relative documents regarding to their establishment in the respective state and the other contracting state and notify that which government has right to impose taxes over them. So for avoidance of double taxation in PE and business connection the enterprise must follow the rule as mentioned in the agreement.

**B. CONVENTION BETWEEN THE REPUBLIC OF INDIA AND THE
UNITED KINGDOM FOR THE AVOIDANCE OF DOUBLE
TAXATION**

This agreement signed between the Government of United Kingdom of Great Britain and the Government of Republic of India. They were entering into this agreement on the day 26th of December, 1993 and that day also consider as the commencement of the agreement. In that agreement they mutually agree upon the 31 Article. In that agreement both state through the consent of each other issue all necessary notification through the official gadgets.

In this agreement there some point were discuss very deeply for avoidance of double taxation. Through that agreement they define such rules that are only use by the one of the countries. Through this agreement they made so many doubts clear and they made specify all rule and their applicability. In this agreement they deal: -

1. Scope of convention: - this agreement is applying on the residents of both states. Person should have the residence of the one state or both. This convention extends to the territorial sea, Exclusive Economic Zone (EEZ) or continental self. This convention includes every person who works under the jurisdiction of either country.
2. Tax covered: - both nations have their own laws on the taxation. In United Kingdom there tax is imposing on Income, Corporation, Capital Gain, and Petroleum Revenue. These taxes are normally imposed on the resident of the nation, but in that situation they also include the person who resident of contracting state. In India there taxes are impose on the income and include any surcharge thereon.
3. Territory: - in this agreement both nations define their territories to each other. In the context of UK there they include Great Britain and Northern Ireland and India define his territory as in the Republic of India.
4. Fiscal year: - in India there fiscal year of tax are calculated as previous year started from 1st of April to 31st March. At the end of the year there the calculation of submitting tax over and new was start. But in UK there the year starts on 6th of April and end on the 5th of April in following year.

5. In that article they clearly define the person. Person means as per the agreement between UK and India any individual, company, body of person, and any other entity liable to pay taxes are understood as a Person.
6. Competent Authority: - in this agreement they clarify that in which state they have authority for imposing the tax over the person. In UK their competent authority is Commissioner of Inland Revenue or authorized authority. In India their competent authority is Ministry of Finance in Central Government and Department of Revenue.
7. Fiscal domicile: - for paying the taxes there must be the resident of the either contracting state. Resident of contracting state means, any person who governs under the law of state and held liable to pay tax for reasons of domicile, residence, place of management, place of incorporation, any other similar nature.
8. PE: - for paying taxes in the contracting state there must be PE situated over there. PE means the fixed place of business where the activities of business are wholly or partly carried on. Through the PE this agreement are applicable on the person who involves in and over the activities those arises liability to pay taxes to the concern country.
9. Income from Immovable Property: - in this agreement they decide the method of imposing the tax and decide to go with the Immovable Property. In that the property situated in the country. That term immovable property include live stock, land, equipment use in the agriculture etc. and through these they are imposing the tax over the property.

In this agreement⁴⁶ they decide that when the contracting state liability arises to impose taxes over the person. There some situations are mentioned where the contracting state can implicate the tax liability, they are: -

1. Business profit (Article 7);
2. Air transport (Article 8);
3. Shipping (Article 9);
4. Associated enterprises (Article 10);
5. Dividends (Article 11);

⁴⁶ Convention between India and UK about the double taxation avoidance agreement

6. Interest (Article 12);
7. Royalties and fees for technical service (Article 13);
8. Capital gain (Article 14);
9. Independent personal services (Article 15).

In that agreement⁴⁷ they discuss above the all the matter where the person held liable to pay taxes in contracting state. But most of the situations are also there where the person does not arise its liability to pay tax in the contracting state, they are: -

1. Dependent personal service (Article 16);
2. Director's fees (Article 17);
3. Artists and Athletes (Article 18);
4. Government Remuneration and Pension (Article 19);
5. Pension and Annuities (Article 20);
6. Student and Trainees (Article 21);
7. Teachers (Article 22).

For completion or applicability of this agreement, there person have to follow the rules for his personal benefits. He has to notify about his all activity relating to the business and overseas relations. Because in this business connection or PE there both country has right to implicate the tax policy over them, so avoiding double taxation by the person has to follow this agreement and for implication of this agreement he has to notify to both nations and specify that which nation has right to implicate it.

⁴⁷ Ibit no. 47

**CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND
THE REPUBLIC OF INDIA FOR THE AVOIDANCE OF DOUBLE
TAXATION**

This convention took place within the Government of United States of America and the Government of Republic of India. This agreement comes into force on the day of 18 of the December, 1990 with consist of 31 article signed by the both state's government. This agreement's article 30 stated that the agreement come into force as per section 90 of the Income Tax Act, 1961 and section 24A of the Companies (Profits) Surtax Act, 1964. In the context the section 44A (b) of Wealth Tax Act, 1957 and section 44(b) of the Gift Tax Act, 1958 clarifies the implication of the article 28 of this article in the Union of India.

This agreement stated so many points which are more related with the taxation and clear that much definition and points which can have different meaning in the both contracting nation. Those points are: -

1. General Scope: - In that agreement they clarify that this convention are providing the rights to implicate the tax policy of contracting states. There a person is held liable to pay tax if he working or doing the activity of business. This convention covers the citizenship of the person of either of the State.
2. Tax covered: - in this convention they found that both contracting states have different tax policy for their resident. In United State of America there income tax imposes through the Internal Revenue Code and the exercise taxes are imposed on the insurance premium. In India there income tax imposes through the Income Tax Act, 1961 and they include all the surcharges imposing on the income tax.
3. Territory: - they define their territory as per international relations and they both include in their territory the air space and the maritime zone. In both contracting state they agree upon to follow the international parameters to calculate their territory.
4. In that agreement they use the "person" as in the relation to an individual, an estate, a trust, a partnership, a company or body of corporate⁴⁸.

⁴⁸ Convention between the USA and India for avoidance of double taxation, article 3 (1) (e)

5. In the evaluation of the tax on the enterprise they follow the fiscal year. In the fiscal year there they follow the previous year as per the concern of the Income Tax Act, 1961.
6. Residence: - In the concerning about taxes imposition their main thing is to find out the tax payer is resident of which country. The resident of the contracting state means the person is liable to pay tax in other nation because of domicile, place of management, place of business and other relating reason.
7. PE: - In this agreement they also define the PE⁴⁹ as other agreement. PE is necessary to have place in this agreement and for its implication. In the PE there must have the fixed place of business.

In this agreement they discuss all points and include such types of income which are include in the payment of tax in the contracting state. Those types which have liability to pay tax in the contracting state are: -

1. Business Profit (Article 7);
2. Shipping and Air Transport (Article 8);
3. Associated Enterprises (Article 9);
4. Dividends (Article 10);
5. Interest (Article 11);
6. Royalty and Fees for included services (Article 12);
7. Gain (Article 13);
8. Permanent Establishment Tax (Article 14);
9. Independent Services (Article 15);

There such more types of income mentioned through the agreement. Those types are not bound to pay tax in the contracting state, those are: -

1. Remuneration and Pension in respect of the Government Services (Article 19);
2. Private Pension, Annuities, Alimony and Child Support (Article 20);
3. Income earned by Entertainers and Athletes (Article 18);
4. Dependent Personal Services (Article 16);
5. Director's Fees (Article 17);

⁴⁹ Ibid, article 5

6. Payment received by students and apprentices (Article 21);
7. Payment received by professor, teachers, and research scholars (Article 22);
8. Other income (Article 23);

These types of income are defined under this agreement and both governments are agreeing upon them. For avoidance of the double taxation the enterprise or person should be aware about it. He has to notify the appropriate government that he is involving in the situation of PE or Business connection. So government can issue such notification of taxation accordingly this agreement and inform the other appropriate authority for not imposing the additional tax upon him.

These are the main convention regarding the Avoidance of Double Taxation. There are many agreements happen with India relating this point and all are based on these conventions because they are consider and more often similar to every agreement. Because they basically define the types of income and the territorial jurisdiction, they are very common their reference took from these conventions.

CHAPTER – 5

IMPLICATION OF BUSINESS CONNECTION AND PERMANENT ESTABLISHMENT IN NEW ECONOMIC SCENARIO

Implication of Business Connection and Permanent Establishment

In the present time there are so many companies are establishing and due to the popularity in their local region they are try to expend their work all over the world. They decide to go other nation and try to establish their entity for expending their business. In those situations there a lot of countries are imposing taxes for establishing their business over there. Expending the business to other nation is very great thinking and good choice for making profit.

In the expending their business overseas it is benefit for the nation and the person itself. But due to expending the business they have to follow that nation rules, because every nation have their own rule according to their environment as like in Mauritius there investment are getting low so their government reduce their taxes and inviting the investors for investing in the country.

For establishing business to other place there so much complication arises. In that there they have to follow their establishment rules than they have to make profit according to nation's environment and last they have to pay all the necessary taxes as per the concern government. There most important thing is arise that when the establishment done and production start and they are making profit out of it, than they have to pay taxes over there and also in their own nation. In this type of establishment an entity is suffering from the double taxation in the source based nation and the other resident based nation, for avoiding these taxes the entity try to confuse both nation and sometime commit such offence which is very wrong.

So for the avoidance of the double taxation the entities generally not try to expend there business and they just continue their business at the resident nation. This is very harmful to the economic because without expending the business they cannot make such competition in the market and introduce new things market. For this the governments of big nations they come together and sit around and decide to make such reform in the law and try to promote these entities to come forward and establish where ever they want to establish.

Through this reform they make open market for all the entities. They can easily set up their business easily any appropriate place. Through the permanent

establishment there a lot of competition arises in the market and this is good for the source nation and also for the resident nation.

For reducing the double taxation they made rules and agree upon such rules follow by the other countries and make a unique form of code known as a “Double Taxation Avoidance Agreement”. In that agreement the countries sit together and decide to implication of tax policy over the enterprise situated in the source nation but basically based on other nation. In the double taxation there an opportunity is provide to the enterprise to pay tax here he want to pay tax.

In the end of the discussion there business connection and the permanent establishment is very good for the health of the new economic market. Because of this they can expand their business and bring the new reform in the economy of that country where they are going to establish. There all the country try to avoid the double taxation and the make promote to the business over the tax liability. So because of this business connection and permanent establishment the market got competition.

Comparative Analysis

In the concept of PE and Business connection there are a lot of similarities, like: -

1. There both needed to a establishment out of their resident country.
2. In both situations they have to make profit or income arises out of their establishment.
3. In the case of PE they need a fixed place of business and in the business connection they need a connection with the established business.
4. For PE the international laws are available and for the Business connection local laws will apply in the concern of the enterprise situated at.
5. In the permanent establishment and business connection there they can use an agency as their representation.
6. In the PE and Business Connection there entity or enterprise must have residency of other contracting state.
7. They must fall under the criteria of other state’s law and they have to be held liable for pay taxes there.

8. In the PE and the Business Connection there they basically need to have a relation with such country, where they starting their business activity.
9. In Business Connection and PE to earn income or profit from the source country.

There are some requirements arise when the Business Connection and PE were establishing in the other country, they are: -

1. For establishing the Business Connection they have to take permission regarding the connection through the concern government.
2. In that permission they have to show all the relevant data to the country like their investment and the profit share in the connection.
3. They have to show their work purpose and take appropriate permission from the authority are getting involve in the concern subject.
4. They have to show their residency of the state or either any connection with the state for establishing.
5. They have to present all the data regarding the business activity to the state.
6. They have to follow the security measures regarding the environment and others as per the concern nation prescribed.
7. They have to follow the rule of tax of the country and provide all relative data as per the appropriate authority asked.

Chapter – 6

Conclusion

Conclusion

PE means the fixed place of business, in that there a person who establish his business in the other country and making profit out of it and earn in his resident country. There major issue arise that which country has right to implicate the liability of tax over the person who involves in the PE activity.

In the other hand there a concept of business connection are in many nation. There an enterprise has relations with the other nation's enterprise and have fix the profit share in against the service providing. In that prospect there liability arises on that enterprise to pay tax to the concern government.

As per my concern there in the Business Connection and PE are very complicated terms. In that term there a person who have the residency of the other state and he do his business activity in the other state. In that term there complication arises that he makes the profit or income in the other state and getting in the residency state. So major point is that which country have right to impose tax liability over the person. For solving this problem there so many agreement were made between the governments of countries. They decide on such term which more benefit for the both of the countries.

But in those agreements they do not specify which government has particular right to implicate the tax over the enterprise. As per my concern there they should mention the policy and the fixed rate of tax. They have to visit the enterprises and audit their work and as per their work they have to charge certain rate of the tax implicating. Government have to provide the certain liberty in the tax to the PE and they have to make such rule that can beneficiary to the PE and Business Connection.

For the security of the PE and its market they have to make a single international rule through the meeting of the government of the countries. They must mention the basic rule and the rate of taxes which can impose by the parties of this committee.

So for increasing the market of the PE and Business Connection they must use liberal rule and provide the appropriate help to the enterprises and promote to this type of business. In PE they need the environment for establishing their business, so

government have to make such type of environment for the PE. The government has to make survey in own market and others countries market for their need and take appropriate steps for fulfilling their need.

So in the end of the report I reach on this conclusion, there in the market of the world of different things there must be the existence of PE is necessary because though this the competition in the market is becoming healthy and the economy of the country get stable and improving. For the economic concern relating to the country there they must have policy relating to PE and they must provide relative environment for the business activity.

Chapter - 7

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