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Brief

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Dependent Agent Permanent Establishments: Does Arm's-Length Remuneration Prevent Further Profit Attribution?



CONTEXT

The Indian Income Tax Appellate Tribunal (ITAT) Ruling in *BBC Global News Limited* highlights the limits of relying on arm's-length remuneration to resist further profit attribution to a dependent agent permanent establishment (DAPE).

Where the transfer pricing analysis does not adequately capture the functions actually performed by the Indian entity, the taxpayer may face renewed scrutiny of both the agent's remuneration and the profits attributable to the foreign enterprise's PE.

For UAE-based multinational groups operating through overseas associated enterprises, the ruling highlights the importance of assessing arm's-length remuneration and PE profit attribution together, while identifying and addressing potential overlaps between the two.

The key question: Does arm's-length remuneration automatically prevent further profit attribution to a DAPE?

Not necessarily. Under the Supreme Court of India's decision in Morgan Stanley & Co. Inc. (2007), the Court recognized that where the Indian associated enterprise is remunerated at arm's length for all relevant functions performed and risks assumed, further profit attribution to the foreign enterprise's PE may not be warranted.

However, this protection depends on the completeness of the underlying functional analysis. In BBC Global News, the Tribunal considered that the Indian entity performed activities beyond those reflected in the transfer pricing study, limiting the taxpayer's ability to rely on the Morgan Stanley principle to resist further profit attribution.

Case Background

- The dispute concerned the attribution of profits to the Indian DAPE of BBC Global News Limited, a UK-resident enterprise operating the BBC World News channel and website.
- An attribution rate of 8.75%, established through a Mutual Agreement Procedure (MAP) resolution for earlier years, had been applied in subsequent assessment years.
- Following a survey identifying additional activities, the Indian Tax Authorities proposed attribution at 15% of relevant Indian advertising revenue.

Indian Income Tax Appellate Tribunal's Decision

- The Indian Tribunal did not accept that the historical attribution rate and arm's-length remuneration were conclusive, given the activities identified by the tax authorities that were not adequately reflected in the transfer pricing study.
- The Tribunal considered the 15% rate excessive and restricted attribution to 12% of the relevant Indian advertising revenue.
- The decision underscores that the Morgan Stanley principle is fact dependent: the functional analysis must reflect the actual conduct and activities of the Indian entity.
- The case highlights the need to assess transfer pricing remuneration and PE profit attribution in a coordinated manner.
- The Tribunal also directed the tax authorities to verify and quantify the relevant credit for taxes already paid by the Indian associated enterprise, highlighting the importance of avoiding overlapping taxation.

Beyond Arm's-Length Remuneration: A Coordinated Approach to PE Profit Attribution

The BBC Global News ruling raises an important question:

How should multinational enterprises determine whether additional profits remain attributable to a DAPE when the local associated enterprise has already been remunerated at arm's length?

A coordinated approach requires more than demonstrating that the local entity earns an arm's-length margin. Multinational enterprises should first establish whether the transfer pricing analysis adequately captures the functions performed, assets employed and risks assumed by the local entity.

They should then separately assess the profits attributable to the foreign enterprise's PE under the applicable treaty framework, considering whether any economically significant functions, assets or risks give rise to additional attributable profits.

Crucially, the two analyses should be reconciled to identify and prevent any unjustified duplication of profits attributable to the same economic contributions.

This involves identifying the remuneration already recognised under the intercompany arrangements, determining whether any residual profits are properly attributable to the PE, and assessing the availability of relief where overlapping taxation arises.

While the appropriate attribution methodology will depend on the applicable treaty and specific facts, such a coordinated analysis provides a more defensible basis for determining whether additional PE profits arise and for addressing potential double counting.

Transfer Pricing and PE Attribution: Practical Implications

1. **Documentation Matters:** The FAR analysis should capture the functions actually performed, assets used and risks assumed, rather than relying solely on the contractual description of the Indian entity's role.

2. **Reassess the Facts:** Changes in local activities, decision-making authority or commercial responsibilities may require the transfer pricing analysis and PE position to be revisited.

Transfer Pricing and PE Attribution: Practical Implications *(Continued)*

3. Morgan Stanley Is Conditional: Arm's-length remuneration may not be sufficient to preclude further PE profit attribution where the underlying analysis omits relevant functions or risks.

4. What Taxpayers Should Do:
a. Document actual conduct and decision-making in India.
b. Align intercompany agreements with the functions performed in practice.
c. Review DAPE exposure alongside transfer pricing outcomes.
d. Revisit the FAR analysis when functions evolve.
e. Reconcile the arm's-length remuneration of the local associated enterprise with the profits attributable to the foreign enterprise's PE, identifying potential overlaps and assessing available mechanisms for relieving double taxation.

Conclusion

The BBC Global News ruling is a reminder that the protection associated with Morgan Stanley depends on the substance and completeness of the underlying transfer pricing analysis.

Arm's-length remuneration is an important starting point, but it is not a substitute for accurately delineating the actual activities undertaken by the Indian entity. Where material functions or risks are omitted, the taxpayer may face a challenge both to the adequacy of the remuneration and to its claim that no further profits should be attributed to the foreign enterprise's DAPE.

For multinational enterprises, the message is clear: transfer pricing documentation should do more than substantiate a margin. It should accurately explain the commercial reality of the business, establish how functions and risks are allocated, and provide a defensible basis for reconciling the Indian entity's remuneration with any profits attributable to a DAPE.

Ultimately, a robust and contemporaneous functional analysis is essential not only to support arm's-length remuneration, but also to substantiate PE profit attribution and mitigate the risk of overlapping taxation.

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