



**16<sup>TH</sup> NANI PALKHIVALA MEMORIAL TAX MOOT  
COURT COMPETITION, 2020**



**IN THE HIGH COURT OF JUDICATURE AT MADRAS  
(Ordinary Original Civil Jurisdiction)**

IN APPEAL NO. \_\_\_\_\_ OF 2020

IN THE MATTER OF:

The Income-tax Act, 1961 and the Double Taxation Avoidance Agreement  
entered into between India and the United States of America

And

IN THE MATTER OF:

Section 260A of the Income-tax Act, 1961

And

IN THE MATTER OF:

Order dated 24<sup>th</sup> October, 2019 by the  
Income-tax Appellate Tribunal, Chennai,  
in relation to levy of tax on income earned outside India by the Non-Resident  
Appellant

**M/S TROFI INC.... APPELLANT**

**VERSUS**

**COMMISSIONER OF INCOME TAX ... RESPONDENT**



## MEMORANDUM OF APPEAL

The Appellant prefers this Appeal against the order dated 24<sup>th</sup> October, 2019 passed by the Income-tax Appellate Tribunal (hereinafter referred to as “**the Tribunal**”) holding that the Appellant, a non-resident, is subject to Income-tax in India under the Income-tax Act, 1961 (hereinafter referred to as “**the IT Act**”) read with the Double Taxation Avoidance Agreement (hereinafter referred to as “**DTAA**”) between India and the United States of America (hereinafter referred to as “**USA**”).

### **I. STATEMENT OF FACTS:**

1. The Appellant, Trofi Inc. (hereinafter referred to as “**Trofi USA**”), is a company incorporated in Silicon Valley, USA. Around 2005, Trofi USA had developed a proprietary mobile platform, ‘Essen’, which enables restaurants to host the menu of food items being offered by them. Essen was initially developed to enable restaurants in the USA to publish their menu, promotional offers, special dishes, reviews of customers, etc. for a monthly fee. Trofi USA spent significantly on advertisement to create a huge customer base for Essen. Over a period of time, Essen was upgraded to enable customers to place order food through the said mobile application, and Trofi USA enabled delivery of the food through delivery partners engaged by it.
2. After being very successful in the USA, Trofi USA sought to offer similar services to restaurants operating in India. Before commencing its operations in India, Trofi USA undertook the following activities:



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- a. A leading consulting firm was engaged to study the Indian restaurant industry, customer behaviour, preferences, etc. The consulting firm provided a detailed region-wise report, after spending 6 months on the project.
- b. Trofi India Pvt Ltd (hereinafter referred to as “**Trofi India**”) was incorporated in India as a subsidiary of Trofi USA. Under a business support service agreement entered into between Trofi India and Trofi USA, Trofi India was required to:
  - i. Promote Essen as a product amongst restaurants in India, by holding events in collaboration with restaurant associations, personal meetings with hoteliers, etc.
  - ii. Communicate the standard terms of the service that would be offered by Trofi USA through Essen, to the restaurants which show interest in the services.
  - iii. Ensure that the interested restaurants satisfy the standard criteria (in relation to cleanliness and hygiene, compliance with food safety laws, etc.) set by Trofi USA.
  - iv. Advertise opportunity to individuals to engage as delivery partners for Trofi USA and communicate the standard terms of engagement to persons interested.
  - v. Ensure that the individuals who show interest satisfy the standard criteria (in relation to communication skills, background, etc.) set by Trofi USA
- c. Once Trofi USA convinces a restaurant about the potentials of engaging with Trofi USA through Essen, the business development team of Trofi USA directly communicates with the representatives of the restaurants



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to negotiate the final terms of service and consideration. The negotiations are carried out over video conference or skype. The final agreement for service is signed between Trofi USA and the restaurant in India. The restaurant signs the service agreement in India and then posts it to Trofi USA, which signs the agreement in the USA.

- d. Once Trofi USA shortlists persons who can be engaged as delivery partners, the business development team of Trofi USA directly communicates with such persons to negotiate the final terms of service and consideration. These negotiations are also carried out over video conference or skype. The final agreement for service is signed between Trofi USA and the delivery partner. The delivery partner signs the service agreement in India and posts it to Trofi USA, which signs the agreement in USA.
3. Essen was made available for download to restaurants, delivery partners, and customers from 01<sup>st</sup> September 2012. The business model worked in the following manner throughout the year:
- a. The restaurant would upload its menu of food items and their prices through the mobile application.
  - b. The Essen development team would present the menu in an aesthetic manner on the Essen application for viewing by the potential customer.
  - c. The customer can browse the menu on Essen application on his mobile and place an order for food item from the restaurants registered on Essen.
  - d. The order would automatically be communicated to the restaurant and the delivery partner nearest to the restaurant, through Essen. The





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- restaurant would prepare the food, which would be collected by the delivery partner and delivered at the address provided by the customer.
- e. The restaurant would raise an invoice on the customer for the price of the food (which the restaurant decides), and for delivery charges (which is pre-determined under an arrangement between the restaurants and Trofi USA).
  - f. As a pre-condition for communicating the order of the customer to the restaurant, the customer would electronically transfer the charge (which would include the price for the food and delivery charges) to the INR account maintained by Trofi USA with Citi Bank, which was opened with the permission of RBI. The agreements between (a) Trofi USA and the restaurants, (b) Trofi USA and delivery partners, and (c) Essen usage agreement between the customers and Trofi USA, entitled Trofi USA to collect the consideration for sale of food and delivery charges from the customers on behalf of the restaurants and the delivery partners.
  - g. At the end of each week, Trofi USA would transfer (a) the net proceeds of sales made by each restaurant through Essen, after deducting 20% service charge, and (b) delivery charges collected from the customers after deduction 20% facilitation fee, to the bank account of the restaurants and the delivery partners respectively. The transfers would be made by Trofi USA electronically, from USA.
4. Trofi USA incurred huge expenditure on promotion of Essen across India. The viability of the business model depended upon enrolling large number of users for the application across all the geographical locations. Trofi USA had entered into agreements with leading advertisement agencies in India to



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promote Essen on print and electronic media across the country, apart from putting up out of home advertisements across busy roads, shopping malls, airports, etc. Trofi USA had spent around Rs. 500 Crores and Rs. 750 Crores on advertisement of Essen in India during Financial Year 2012-13 and 2013-14 respectively.

5. In a matter of two years, Essen was able to make significant inroads into India. Summary of Trofi USA's operation in India is tabulated below:

S No	Particulars	Amount in Rs Crores (except otherwise mentioned)	
		2012-13	2013-14
A.	Total Transaction value	2,000	10,000
B.	Commission earned from restaurants	400	2000
C.	Facilitation fee earned from delivery partners	30	150
D.	Essen modification expenses incurred in USA (salary cost of application development team)	750	200
E	Other direct costs incurred in USA (professional fee paid to consultants)	750	100
F	Advertisement expenses incurred in India	500	750
G	Cost plus mark-up paid to Trofi India	200	300
H	Profits from Essen India [B+C] – [D to G]	(1,770)	800
I	Total number of restaurants registered as on the last day of the year	40,000	1,25,000
J	Total number of delivery partners	25,000	1,00,000
K	Number of actual users (in Thousands)	10,000	50,000

6. On 1st January, 2017, the Additional Commissioner of Income-tax, International Taxation (hereinafter referred to as the “Assessing Officer”) issued notices u/s 148 of the IT Act for the Assessment Years 2013-14 and



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2014-15, to Trofi USA, at its registered office in USA, on the ground that the income of Trofi USA has escaped assessment in India, and requiring Trofi USA to file a return of income in India. Trofi USA responded to the notice, inter alia, stating as follows:

- a) That the entire income is derived from Essen platform, which is developed and stored outside India. Trofi USA renders standard services to interested users, being the restaurants, delivery partners and customers from outside India. The services having been rendered from outside India, and not being in the nature of royalty or fee for technical services, cannot be said to be taxable in India. Given that income is earned from rendering of services outside India, no part of the income accrues or arises in India.
  - b) That Trofi USA does not have any physical presence in India. No employee of Trofi USA ever visited India nor does Trofi USA has any business connection in India.
  - c) That in any case, Trofi USA does not have a Permanent Establishment in India and hence, Trofi USA cannot be subjected to tax in India under Article 5 of the DTAA between India and USA.
7. The Assessing Officer rejected the contentions of Trofi USA and held that:
- a) Though Trofi USA developed Essen outside India and stored the entire application outside India, the users of the application are in India. The income is not earned from mere development of the platform, but from the users who are located in India. Hence, the income would be deemed to accrue and arise in India.
  - b) For the same reasons, Trofi USA would be regarded as having a business connection in India.





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- c) The income earned by Trofi USA from India is consideration received for use of a secret process by the restaurants, delivery partners as well as the customers of the restaurants, and hence the income would be regarded as ‘royalty’ within the meaning of Section 9(1)(vi) of IT Act as well as Article 12 of the DTAA. Hence, the income would be taxable on gross basis u/s 115A of the IT Act, without granting any deduction.
- d) The taxable income of Trofi USA in India, u/s 115A of the Act would thus be Rs. 2,000 Crores for Assessment Year 2013-14 and Rs 10,000 Crores for Assessment Year 2014-15.
- e) Without prejudice, Trofi USA would be regarded as having a Permanent Establishment in India as contemplated under (i) Article 5(1) – as each mobile phone on which Essen has been installed would be regarded as a fixed place of business of Trofi USA; (ii) Article 5(1) – as the office premises of Trofi India would be regarded as Permanent Establishment of Trofi USA as Trofi India is effectively carrying on the business of Trofi USA in India; (iii) Article 5(2)(i) – the restaurants from which the food is sold would be regarded as premises used as sales outlet of Trofi USA; (iv) Article 5(2)(1) – Trofi USA is providing sales promotion services to the restaurants, order procuring services to the delivery partners, and delivery services to the customers. All of these services are rendered in India and hence Trofi USA would be having a Service PE in India.
- f) In any case, the definition of Permanent Establishment used in DTAA and meaning given to that phrase in Commentaries were formulated at a time when e-commerce was not thought of. Considering the objective of the concept of Permanent Establishment, the phrase would include any form of revenue generated from India, giving the phrase an ambulatory meaning.





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- g) On a protective basis, the gross receipts of Trofi USA in India, u/s 28 of the Act, would be Rs. 2,000 Crores for Assessment Year 2013-14 and Rs 10,000 Crores for Assessment Year 2014-15.
- h) In determining the taxable income of Trofi USA, the expenditure incurred by it cannot be regarded as deductible expenditure in view of Section 40(a)(ia) of the IT Act. Even assuming that the payment to restaurants, delivery partners, Trofi India and advertisement agencies would be deductible because the recipient of income has paid taxes in India on the sums received by them, the expenditure on salary paid to the development team in the USA and consultants in the USA, is not deductible.
8. Trofi Inc had filed an appeal against the assessment order before the Commissioner of Income-tax (Appeals), who held that the income was not in the nature of royalty or fee for technical services. However, the order of the Assessing Officer treating Trofi Inc. as having Permanent Establishment in India was upheld. Computation of income by the Assessing Officer was also confirmed.
9. Trofi Inc then filed an appeal before the Income-tax Appellate Tribunal, Chennai. No appeal was filed by the Assessing Officer against the order of the Commissioner of Income-tax (Appeals). In the second appeal, Trofi USA had taken the following additional arguments:
- The business receipts of Trofi USA from India shall only be Rs 430 Crores and Rs 2,130 Crores. The sums collected by it for and on behalf of the restaurants and delivery partners cannot be treated as the income of Trofi USA.



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- b. Trofi USA was not liable to deduct tax on the consideration paid by it as salary cost of application development team and professional fee paid to consultants, as the recipient of income were unaware as to whether their efforts would result in income to Trofi USA from India. The expenditure is therefore deductible even if tax is not deducted thereon.
  - c. That in any case, the customers who ordered food on Essen had paid the alleged income to Trofi USA and hence, u/s 195 of the IT Act, the tax ought to be collected from the customers who paid the income to Trofi USA.
  - d. That in any case, even assuming Trofi USA has a business connection/ Permanent Establishment in India, it had incurred losses in both the years, and hence, no tax can be collected from Trofi USA.
  - e. Even if Trofi USA is regarded as having a Permanent Establishment in India, given that all the transactions are at Arm's Length Price, no additional income can be regarded as accruing to Trofi USA in India.
10. The ITAT dismissed the appeal filed by Trofi USA holding that:
- a. The source of income of Trofi USA is not the Essen Application developed by it, but the users in India. The source of the income earned by Trofi USA is partly located in India.
  - b. The gross receipts taxable in India would be Rs. 2,000 Crores for Assessment Year 2013-14 and Rs 10,000 Crores for Assessment Year 2014-15. The mere fact that the sums are collected on behalf of a third party would not result in the sums received not being income of Trofi USA. The sums paid to the restaurants and delivery partners would be allowed as deductible expenditure, subject to fulfilment of other conditions prescribed in the IT Act.



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- c. Trofi USA would have a Permanent Establishment in India on the following counts:
- i. Article 5(1) – as each mobile phone on which Essen has been installed would be regarded as fixed place of business of Trofi USA. In any case, ‘place of business’ refers to the geographical location. If the mobile application is the means of carrying on business, the geographical location where the applications are used would be the fixed place of business of Trofi USA. The whole State can be a fixed place of business of Trofi USA.
  - ii. Article 5(1) – the office premises of Trofi India would be regarded as Permanent Establishment of Trofi USA as Trofi India is effectively carrying on the business of Trofi USA in India.
  - iii. Article 5(2)(i) – the restaurants from which the food is sold would be regarded as premises used as sales outlet of Trofi USA,
  - iv. Article 5(2)(1) – Trofi USA is providing sales promotion services to the restaurants, order procuring services to the delivery partners and delivery services to the customers. All these services are rendered in India and hence Trofi USA has a Service PE in India.
- d. Trofi USA was liable to deduct tax at source on the consideration paid by it to its consultants for development of Essen Application, as the consideration was paid for income earned from a source in India. Trofi USA was not liable to deduct tax at source on the salary paid to its employees in USA, as the employment was exercised outside India.





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- e. The fact that Trofi India was remunerated at Arm's Length would not result in Trofi USA being absolved from additional taxation in India. The operations carried out in India are not restricted to the functions of Trofit USA.
- f. The individual customers were not liable to deduct tax at source at source u/s 195 of the IT Act, given that the food was used by them for personal consumption. The Statute would not have contemplated every individual to deduct tax and comply with cumbersome procedural requirement of deduction of tax.

### **II. SUBSTANTIAL QUESTIONS OF LAW:**

The Appellant submits that the following substantial questions of law arise from the Order of the Tribunal:

- (i) Whether, on the facts and in the circumstances of the case and in law, was the Tribunal right in holding that Trofi USA had a Permanent Establishment in India, under Article 5(1) and Article 5(2) of the DTAA between India and USA?
- (ii) If the answer to Question (i) is yes, i.e. if Trofi USA is regarded as having a Permanent Establishment in India, was the Tribunal right in holding that Trofi USA ought to have deducted tax at source on the consideration payable by it to its consultants for development of Essen Application, and consequentially right in holding that the expenditure on which tax was not so deducted is not allowable as deduction u/s 40(a)(ia) of the Act?
- (iii) If the answer to Question (i) is yes, i.e. if Trofi USA is regarded as having a Permanent Establishment in India, was the Tribunal right





in holding that, despite Trofi India having been remunerated at Arm's Length, Trofi USA would be subjected to additional taxation in India?

- (iv) Whether, on the facts and in the circumstances of the case and in law, was the Tribunal right in holding that the gross receipt from business of Trofi USA is the amount received by it from the customers and not the amount earned by it from the restaurants and delivery partners?
- (v) Whether, on the facts and in the circumstances of the case and in law, was the Tribunal right in holding that the customers who purchased goods through Essen Application are not liable to deduction of tax at source u/s 195 of the Act?

### III. GROUNDS OF APPEAL:

That the Appellant seeks to challenge the impugned order passed by the Tribunal on the following grounds:

- A. The phrase 'Permanent Establishment' postulates physical presence of a non-resident on Indian soil. The presence of independent personnel, namely, delivery partners, restaurants and Associated Enterprise which has been remunerated at Arm's Length, cannot be regarded as physical presence of the non-resident in India. These places are place of business of the respective persons and not that of the non-resident Appellant. The Appellant does not have any right to use the place belonging to the parties.
- B. It is true that electronic commerce is a completely new form of business. The DTAA entered into by India with the USA did not contemplate



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measures for bringing profits from such transactions to tax. Recourse under law to bring profits from electronic transactions to tax is by amending the Treaty and not extending the application of the Treaty in the name of interpretation.

- C. Once it is not disputed that the alleged persons through whom business of the Appellant non-resident was carried out in India, were remunerated at Arm's Length, the question of attributing additional profits in the hands of the Appellant non-resident does not arise.
- D. The expenses incurred for development of Essen were incurred outside India. The external professional who were engaged by the Appellant non-resident could have had the knowledge that the application was to be used for earning income from India. The question of whether the income is earned from India itself is an issue in dispute. Therefore, the Appellant non-resident could not be held to be in default for non-deduction of tax on consideration paid to third party consultants.
- E. Section 195 of the Act creates a strict liability on every person making a payment of any income to a non-resident to deduct tax at source on the income so paid. The section, unlike Section 194C or 194J of the Act, does not create a distinction between the services being availed by a person carrying on business and an individual availing the services for personal consumption. The onus was on the payer of the income to deduct applicable taxes on the alleged income paid to the non-resident Appellant. The Assessing Officer shall be directed to recover the taxes from the customers who paid the income to the Appellant non-resident and not from the Appellant.



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**IV.** The Appellant reserves the right to alter, modify or amend the grounds of appeal raised hereinabove.

**V.** The Appellant submits that the Appeal is filed within the time prescribed.

**VI.** The Appellant states that the Appellant is assessed to tax at Chennai. Thus, this Hon'ble Court has jurisdiction to try, entertain and dispose-off the present appeal.

**VII.** The Appellant states that the Appellant has paid the court fees of Rs.10,000.

**VIII.** The Appellant prays that:

- a. This Hon'ble Court may be pleased to admit the present appeal and after considering the aforesaid substantial questions of law to allow the appeal;
- b. This Hon'ble Court may be pleased to set aside the impugned order and decide the issues in favour of the Appellant;
- c. For costs of and incidental to this appeal; and
- d. This Hon'ble Court may be pleased to grant such further and other relief as it may deem fit.

*Note: The Appeal has been admitted on all the questions and has been fixed for final hearing.*