www.pwc.in

Sharing insights

News Alert
22 April 2014

pwc

Use of hotel rooms for the purpose of business could result in a permanent establishment

In brief

In a recent ruling[1], the Mumbai Income-Tax Appellate Tribunal ("the Tribunal"), has analysed the emergence of a Permanent Establishment ("PE") for a foreign company by virtue of rendering certain services to its Indian customers. The Tribunal held that the foreign company constituted a PE through the hotel rooms used by its personnel when in India, notwithstanding the fact that the location of the top management was based outside India. On attribution, the Tribunal principally upheld the allowability of expenditure on the basis that the beneficial provisions of the tax treaty would supersede the provisions of the domestic law.

Facts

- The taxpayer ("the Company") is a company registered in Mauritius. It received income from its Indian customer, that is, M/s Godfrey Philips India Ltd ("GPI") towards rendering of certain services. The services included the formulation as well as the implementation of the Performance Index Programme ("PIP") for improving the management performance quotient of GPI by enhancing operating parameters such as reducing costs, improving work methods and services, providing efficient management control, etc, in respect of the business carried out by GPI.

- The personnel of the Company were sent to India to carry out the services under the contract with GPI. However, the place of management of the

[1] Renoir Consulting Ltd *v.* Dy DIT (IT) [TS-211-ITAT-2014(Mum)]

Company was situated in Mauritius. The implementation programme was to be carried over three phases, aggregating to 80 weeks.

AY 1997-98

- The Assessing Officer ("AO"), while passing the assessment order for the Company, held that the taxpayer constituted a PE in India, on the basis of contracts with GPI and accordingly, income from GPI was taxable in India.

- Upon appeal by the taxpayer, the Tribunal referred the matter back to the AO's file along with the ancillary issue of allowance of expenditure.

- In the set-aside proceedings, the AO as well as the CIT(A) were of the view that a PE existed for the taxpayer in India. On the expenditure claimed, the CIT(A) enhanced the disallowance on both direct as well as indirect expenses, based on documentation provided by the taxpayer and relying upon a comparable case.

AY 1999-2000

- In the assessment order, the AO had disallowed salary expenses under section 40(a)(iii) of the Income-tax Act, 1961 ("the Act") and head office expenses restricted to 5% as per section 44C of the Act. The CIT(A) held that both the sections would not apply to a non-resident who could seek refuge under the beneficial provisions of the India-Mauritius Double Taxation Avoidance Agreement ("DTAA").

- Aggrieved by the CIT(A)'s order, both, the taxpayer as well as the Revenue approached the Tribunal on the question of existence of PE and allowability of expenditure respectively. AY 1997-98 and 1999-2000 were taken up together owing to similarity of issues.

Issue before the Tribunal

- The key issue before the Tribunal was whether, based on the facts and circumstances of the case, the taxpayer could be said to have had a PE in India.

- Whether the expenditure claimed by the taxpayer was allowable since the taxpayer had failed to provide relevant evidences.

Taxpayer's contentions

- The activities being carried out in India were essentially preparatory or auxiliary services, excluded under Article 5(3) of the India-Mauritius DTAA.

- The Company was managed by the board of directors based out of Mauritius which gave directions to deputed personnel, and were the sole drivers and arbiters of the implementation process. Though the contracts were executed in India effectively, the taxpayer's place of management was situated in Mauritius where the entire decision-making powers were located.

- There was no fixed place of business at the Company's disposal in India since the meetings, discussions on the progress, performance and implementation of the project, were normally conducted at different venues, and as such, there was no fixed place of business.

- Reliance in this regard was placed on the Andhra Pradesh High Court ruling in the case of **Visakhapatnam Port Trust**[2] and the ruling of Mumbai Tribunal in the case of **Airlines Rotables Limited**[3].

- In the absence of a PE, the income arising out of the activities carried out in India should not be taxed in India, as per the provisions of the India-Mauritius DTAA.

[2] CIT *v.* Visakhapatnam Port Trust (1983) 144 ITR 146 (AP)
[3] Airlines Rotables Ltd *v.* Jt DIT(IT) (2011) 44 SOT 368 (Mum)

Revenue's contentions

- There was a place of management in India, the power of which was vested within the teams deputed for rendering services to GPI.

- All activities relating to the work of the Company were carried out in India which could be inferred from the huge claim of expenses incurred in India. In such a case, hotel rooms where the personnel stayed in India must be regarded as their place to carry out activities in India and the hotel(s) must be considered the "fixed place".

- On the basis of the above contention, the Revenue contended that the taxpayer constituted a fixed place PE in India and the income received from GPI towards rendering of such services was subject to tax in India.

Tribunal ruling

- The Tribunal noted that in general, a fixed place PE had the following elements built therein: the *situs* test (there must be a fixed place), *locus* test (located in a certain territorial area), *tempus* test (should last for a certain period of time), *ius* test (certain right to use the fixed place) and business activity test (activities performed must be of a business character).

- Based on the factual matrix of the taxpayer, kind of work being done by the personnel deputed in India and examination of the agreements entered into between the taxpayer and GPI, the Tribunal noted that the taxpayer's claim of the services being preparatory and auxiliary in nature was completely inconsistent with the *modus operandi* followed.

- The Tribunal also clarified that the fixed place could well constitute a PE despite such user being proscribed to use it for carrying on business. Also, a fixed place PE was not confined to a place where the top management and key personnel of the Company were located.

- In the instant case, some place was always at the disposal of the taxpayer or its employees during the entire period of their stay in India, and the personnel could not be working in a vacuum. The Tribunal accordingly held that the hotel, where the taxpayer's personnel stayed, also served as their work place, since the communications, which formed a major part of their work, as well as the communication facilities were provided by the hotel itself.

- Reliance on the rulings in the case of **Visakhapatnam Port Trust**[2] and **Airlines Rotables Ltd**[3] (supra) by the taxpayer was distinguished on facts and law by the Tribunal.

- Thus, ruling in favour of the Revenue, the Tribunal held that the taxpayer had a fixed place PE in India through the use of hotel room(s) for carrying out business activities.

Other issues

- On attribution, the Tribunal referred to the Apex Court ruling in the case of **Morgan Stanley**[4] and held that economic nexus was an important aspect of the principle of attribution of profits, and remanded the matter back to the AO.

- The Tribunal noted that the claim of the expenditure was restricted since the taxpayer had failed to produce the relevant evidence. The assessee's plea that the records being old, could not be traced and furnished, was not accepted by the Tribunal since the taxpayer was in appeal right from the passing of the assessment order in the first instance.

- With regard to the disallowance of expenditure under section 40(a)(iii) of the Act and restriction of the head office expenditure under section 44C of the Act, the Tribunal noted that the ground was covered in the taxpayer's favour by a co-ordinate bench ruling in the assessee's own case and also supported by the CBDT Circular No.333 of 1982.

[4] DIT(IT) *v.* Morgan Stanley & Co (2007) 292 ITR 416 (SC)

Conclusion

- While PE is a factual concept and is dependent upon the factual matrix of each case, the legal proposition brought out by this ruling can have wide ramifications for other foreign companies sending their personnel to India. Even in the absence of a service PE clause in the relevant treaty, mere presence of such personnel in India can be deemed to constitute a fixed place PE.

- The clarification provided by the Tribunal on the aspect of what constitutes a "fixed place PE" appears to be in line with the OECD Model Tax Convention.

- The Tribunal has clarified that any fixed place with a commercial connotation could constitute a fixed place PE. The location of the management is not relevant in this regard.

- On attribution, the Tribunal has principally upheld the allowability of expenditure under Article 7 of the India-Mauritius DTAA. However, the computation thereof would need to be backed up by documentary evidence.

About PwC

PwC helps organisations and individuals create the value they're looking for. We're a network of firms in 157 countries with more than 184,000 people who are committed to delivering quality in Assurance, Tax and Advisory services.

PwC India refers to the network of PwC firms in India, having offices in: Ahmedabad, Bangalore, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, please visit www.pwc.in.

*PwC refers to PwC India and may sometimes refer to the PwC network. Each member firm is a separate legal entity. Please see www.pwc.com/structure for further details.
Tell us what matters to you and find out more by visiting us at www.pwc.in.

Our offices

Ahmedabad President Plaza, 1st Floor Plot No 36 Opp Muktidham Derasar Thaltej Cross Road, SG Highway Ahmedabad, Gujarat 380054 Phone +91-79 3091 7000	**Bangalore** 6th Floor, Millenia Tower 'D' 1 & 2, Murphy Road, Ulsoor, Bangalore 560 008 Phone +91-80 4079 7000	**Chennai** 8th Floor, Prestige Palladium Bayan 129-140 Greams Road, Chennai 600 006, India Phone +91 44 4228 5000	**Hyderabad** #8-2-293/82/A/113A Road no. 36, Jubilee Hills, Hyderabad 500 034, Andhra Pradesh Phone +91-40 6624 6600	**Kolkata** 56 & 57, Block DN. Ground Floor, A- Wing Sector - V, Salt Lake. Kolkata - 700 091, West Bengal, India Telephone: +91-033 - 2357 9101/4400 1111 Fax: (91) 033 - 2357 2754
Mumbai PwC House, Plot No. 18A, Guru Nanak Road - (Station Road), Bandra (West), Mumbai - 400 050 Phone +91-22 6689 1000	**Gurgaon** Building No. 10, Tower - C 17th & 18th Floor, DLF Cyber City, Gurgaon Haryana -122002 Phone : +91-124 330 6000	**Pune** GF-02, Tower C, Panchshil Tech Park, Don Bosco School Road, Yerwada, Pune - 411 006 Phone +91-20 4100 4444	For more information contact us at, pwctrs.knowledgemanagement@in.pwc.com	