The fact of rendering services for a specified period is relevant and not the stay of employees for determining a Service Permanent Establishment; rendering of services which tantamounts to provision of information is taxable as Royalty

July 10, 2017

In brief

In a recent judgement[1], the Bengaluru Bench of the Income-tax Appellate Tribunal (Tribunal) analysed the India-UAE (United Arab Emirates) Double Taxation Avoidance Agreement (tax treaty) and held that an employee's physical presence in India was not relevant in the Service Permanent Establishment (PE) conclusion, but the fact of rendering services for a specified period was relevant. The Tribunal explained that agreement for the services resulting in provision/ sharing of information not available in the public domain was in the nature of royalty.

In detail

Facts

- The taxpayer was a non-resident company incorporated in the UAE. It entered into a regional headquarter service agreement with its Indian counterpart for providing specified services.
- The specified services were provided by the taxpayer mainly from outside India over telephone calls, telephone conferences and e-mail. Further during the year, three employees of the taxpayer visited India for the duration of a total of 25 days.
- The taxpayer was of the view that the services rendered by it to its Indian counterpart were not taxable in India in the absence of a specific clause for fee for technical services (FTS) in the tax treaty. Accordingly, the taxability would fall under Article 22 of the tax treaty, and as the taxpayer did not have a PE in India, the consideration received was not liable to be taxed in India.
- The Tax Officer (TO) held that the consideration received was taxable in India based on the following:
  - In the absence of a specific FTS clause in the tax treaty, the provisions of the Income-tax Act, 1961 (Act), would apply. The services rendered qualified as FTS as per the provisions of section 9(1)(vii) of the Act and, hence, liable to be taxed

[1] IT(TP)A.1103/Bang/2013 & 304/Bang/2015 (Bengaluru Tribunal)

in India.

- Alternatively, most of the services rendered would qualify as royalty as per section 9(1)(vi) of the Act as well as Article 12(3) of the tax treaty and, hence, liable to be taxed in India.

- The Dispute Resolution Panel (DRP) confirmed the view of the TO.

Issue before the Tribunal

Whether the consideration received by the taxpayer by providing specified services in India was liable to be taxed in India?

Taxpayer's contentions

- The taxpayer rendered managerial and consultancy services to its Indian counterpart, and all the services rendered formed part and parcel of the FTS. In the absence of a specific FTS clause in the tax treaty, the taxability would fall under Article 22 of the tax treaty, and as the taxpayer had no PE in India, said consideration was not taxable.

- Alternatively, the services did not qualify as royalty as there was no imparting or alienation of information concerning technical, industrial, commercial or scientific knowledge, experience or skill.

Revenue's contentions

- The nature of services and as per the various clauses in the agreement, suggested that the services rendered by the taxpayer should qualify as royalty under both the Act and the tax treaty. The domain and expert knowledge of the taxpayer was permitted for use by it's Indian counterpart, and the information was parted with/ shared by the taxpayer.

- The taxpayer provided information concerning use of the plan and for technical, industrial, commercial or scientific knowledge, experience or skill, and the services rendered constituted a know-how contract. Further, such information was in the nature of technical knowledge and previous experience acquired by the taxpayer over a period of time and partakes the character of Intellectual Property Right (IPR).

- Alternatively, services rendered qualify as FTS, and in the absence of a specific provision for FTS in the tax treaty, the provisions of the Act shall prevail.

- Further, since the taxpayer had a Service PE in India, the consideration (even if treated as FTS) received was taxable as per Article 7 of the tax treaty.

- Moreover, the taxpayer could not avail the benefit of the tax treaty, as the taxpayer did not possess a valid tax residency certificate (TRC) for the period under question and also did not qualify as resident as per the definition of a resident enunciated in Article 4 of the India-UAE tax treaty.

Tribunal's ruling

Availability of the India-UAE tax treaty benefit

- For availing the benefit of the tax treaty, the twin conditions of income being assessable to tax both in India and in the UAE and furnishing a valid TRC to substantiate the country of residence need to be fulfilled.

- The Tribunal held that the taxpayer could not avail the benefit of the tax treaty, as the above criteria was not fulfilled in the present case:

  – The taxpayer, though incorporated in the UAE, did not hold a valid TRC pertaining to the period under question and hence was not a resident of UAE as per Article 4 of the tax treaty at the time of filing the return of income for assessment years 2010-11 and 2011-12. In addition, the taxpayer failed to demonstrate that it was managed and controlled wholly in the UAE or that it was tax entity of UAE.

  – No documentary evidence was filed to show that income arising out of the services rendered by taxpayer was taxable in the UAE.

Interplay between Article 22 – Other Income and Article 7 – Business Profits

- Income that did not specifically fall under Article 6 to Article 21 of the tax treaty falls in residual Article 22 of the tax treaty. Further, any income if also not covered under Article 7 would fall under Article 22; otherwise, Article 22 would become redundant.

- Based on the above, examination of activities of the taxpayer *vis-à-vis* specific clauses of the tax treaty was required before resorting to Article 22 of the tax treaty. In addition, it shall be important to examine if the taxpayer had a PE in India in terms of Article 5 of the tax treaty.

Permanent Establishment

- It was clarified that the condition of having a fixed permanent place of business under Article 5(1) was not attracted for PE under Article 5(2), which was an independent clause.

- It was not the stay of employees for more than nine

months that was required to be satisfied, but it was the fact of rendering services or activities for a period of nine months within a 12 month period that was required to be satisfied for the conclusion of a Service PE.

- Presence of three employees only for 25 days resulted in a PE, as the services could be rendered without the physical presence of employees, especially considering that in the present age of technology, services, information, consultancy, management, etc., could be provided using various virtual modes such as e-mail, internet, video conference, remote monitoring, remote access to desktop etc., through various software.
- Based on the above, it was held that the taxpayer had a Service PE in India, which would be relevant if the activities did not fall under any Article of the tax treaty.

Royalty

- It was held that it was not a case of 'rendering of any services' but a mere sharing of information, which squarely falls within the ambit of the definition of 'royalty' under Article 12(3) of the India-UAE tax treaty, based on the following:
  - The service agreement gives opportunity to the Indian counterpart to use information pertaining to the industrial/ commercial/ scientific experience belonging to the taxpayer (not available in the public domain);
  - This information did not already exist but was supplied by the taxpayer after its development or creation to the Indian counterpart;
  - The taxpayer had given the Indian counterpart access to various secrets, confidential information, IPRs and other information acquired by it from its past experience;
  - There also exist specific provisions concerning the confidentiality of such information;
  - The taxpayer had done very little after giving the Indian counterpart access to this information; moreover, no evidence of actual rendering of services was provided by the taxpayer;
  - Visits of the officials of the taxpayer were only for the purpose of providing access for using information pertaining to the industrial/ commercial/ scientific experience belonging to the taxpayer and to enable the Indian counterpart to commercially exploit it.

FTS

The Tribunal did not examine this issue.

Conclusion

- It was held that information provided by the taxpayer was in the nature of a know-how contract and was covered under the definition of royalty under both the Act and Article 12(3) of the India-UAE tax treaty and not under the residual clause.
- Based on the above, the consideration received by the taxpayer was taxable in India.

The takeaways

- The Bengaluru Tribunal has re-emphasised that it is the substance/ content/ terms and conditions/ nature of services rendered that is of paramount importance to ascertain the real intent of the parties and the nature of mutual obligations of the parties. Mere nomenclature of the agreement is not decisive.
- For constituting a Service PE in India, the physical presence of the employees in India is not of much relevance, and rather the period of rendition of services is important, which does not seem to lay down the correct principles for the interpretation of a Service PE.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

Our Offices

Ahmedabad

1701, 17th Floor, Shapath V,
Opp. Karnavati Club,
S G Highway,
Ahmedabad – 380051
Gujarat
+91-79 3091 7000

Bengaluru

6th Floor
Millenia Tower 'D'
1 & 2, Murphy Road, Ulsoor,
Bengaluru – 560 008
Karnataka
+91-80 4079 7000

Chennai

8th Floor
Prestige Palladium Bayan
129-140 Greams Road
Chennai – 600 006
Tamil Nadu
+91 44 4228 5000

Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th
Floor, Road No. 10, Banjara Hills,
Hyderabad – 500034,
Telangana
+91-40 44246000

Kolkata

56 & 57, Block DN.
Ground Floor, A- Wing
Sector - V, Salt Lake
Kolkata – 700 091,
West Bengal
+91-033 2357 9101/
4400 1111

Mumbai

PwC House
Plot No. 18A,
Guru Nanak Road(Station Road),
Bandra (West), Mumbai – 400 050
Maharashtra
+91-22 6689 1000

Gurgaon

Building No. 10, Tower - C
17th & 18th Floor,
DLF Cyber City,
Gurgaon – 122002
Haryana
+91-124 330 6000

Pune

7th Floor, Tower A - Wing 1,
Business Bay, Airport Road,
Yerwada, Pune – 411 006
Maharashtra
+91-20 4100 4444

For more information

Contact us at
pwctrs.knowledgemanagement@in.pwc.com

About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 223,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at www.pwc.com.

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR (Gurgaon), Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit www.pwc.com/in

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity. Please see www.pwc.com/structure for further details.

Follow us on: