

# Solar days are relevant for determination of service PE under the India-Saudi Arabia tax treaty

October 13, 2017

## In brief

In a recent decision, the Bangalore Income-tax Appellate Tribunal (Tribunal) has held that solar days as against man days, are relevant for determination of threshold for service Permanent Establishment (PE). Further, the Tribunal has held that in the absence of the Fees for Technical Services (FTS) Article in the India-Saudi Arabia Double Taxation Avoidance Agreement (tax treaty), the income would be taxed as per the residual 'other income' clause in the tax treaty.

## In detail

### Facts

The taxpayer<sup>1</sup> was a company based in Saudi Arabia. During the year under consideration, the taxpayer rendered certain services in India through four of its engineers who were present in India for a period of 90 days.

### Issues before the Tribunal

- Whether the presence of engineers of the taxpayer in India constituted a service PE of the taxpayer as per Article 5(3)(b) of the India - Saudi Arabia tax treaty
- Whether the fees received by the taxpayer for the services rendered by it would qualify as "royalty" or "FTS" under the Income-tax Act, 1961 (the Act) and the tax treaty

- Whether in the absence of any specific article for taxability of FTS in the tax treaty, the income would be taxable as per the provisions of the Act

### Revenue's contentions

- The payments received by the taxpayer from India would qualify as royalty as per the Act and the tax treaty, and accordingly it was taxable at 10%.
- The taxpayer had a PE in India as per Article 5(3)(b) of the tax treaty. Man days were to be considered and not solar days for deciding the existence of PE in India
- Reliance was placed on the decision of the ITAT in the case of ABB FZ-LLC<sup>2</sup> as per which a service PE of the taxpayer was constituted by rendering of services

through virtual modes such as emails, internet etc.

### Taxpayer's contentions

- The payments received by the taxpayer from India was in the nature of FTS and not royalty and in the absence of any specific Article in the tax treaty on the taxability of FTS, the same shall be taxed in Saudi Arabia as "other Income" under the tax treaty.
- Further, for the determination of service PE, solar days was relevant and not man days. The taxpayer placed reliance on the decision of the Mumbai Tribunal in the case of Clifford Chance<sup>3</sup>.

### Tribunal's decision

- The Tribunal, relying on the decision of the Mumbai Tribunal in the case of

<sup>1</sup> IT(TP) A No. 1104 (Bangalore) 2013 dated 28 September 2017

<sup>2</sup> ABB FZ-LLC v. DCIT ITA Nos. 1103 of 2013 & 304 of 2015 (Bangalore) dated 21 June 2017

<sup>3</sup> Clifford Chance v. DCIT [2002] 82 ITD 106 (Mumbai)

Clifford Chance<sup>3</sup> held that solar days were relevant for determination of service PE as against man days.

- Multiple counting of the common days was to be avoided so that the days when two or more employees were present in India together, they were to be counted only once.
- The Tribunal distinguished its earlier decision in the case of ABB FZ- LLC<sup>2</sup> wherein the Tribunal held that services were rendered virtually by way of email, internet, VC, etc., as against the facts of the present case wherein engineers were physically present for performance of the services and the invoice was also raised by the taxpayer on the basis of man hours.
- The stay in India of the taxpayer by the presence of its

engineers was only 90 days and since it was less than 182 days as required under Article 5(3)(b) of the tax treaty, there was no service PE of the taxpayer in India.

- In respect of income not specifically covered under any Article, such income should be taxable under the residual Article on “other income” under the tax treaty which provides for taxability in the state of residence only. Reliance was placed on the decision of the Madras High Court in the case of Bangkok Glass Industry<sup>4</sup>.
- With respect to whether the income qualifies as royalty or FTS, in absence of the exact details of the work done by service engineers in India, this issue was remitted back to the revenue for determination.

### ***The takeaways***

- This decision reiterates that consideration of solar days as against man days would be relevant for computing the threshold for a service PE in India.
- In absence of the “FTS” clause in the tax treaty, the receipts would fall under Article 22 of the tax treaty i.e. the residual clause. This ruling would provide some cushion to the taxpayers in litigation, where the revenue wishes to tax the receipt as per provisions of the tax law in absence of specific clause in the tax treaty.

### ***Let's talk***

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

---

<sup>4</sup> Bangkok Glass Industry Co. Ltd v. ACIT [2013] 257 CTR 326 (Madras)

## ***Our Offices***

### ***Ahmedabad***

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

### ***Hyderabad***

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

### ***Gurgaon***

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

### ***Bengaluru***

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

### ***Kolkata***

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

### ***Pune***

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

### ***Chennai***

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

### ***Mumbai***

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

### ***For more information***

Contact us at  
[pwctrs.knowledgemanagement@in.pwc.com](mailto: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](http://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](http://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](http://www.pwc.com/structure) for further details.

©2017 PwC. All rights reserved

## ***Follow us on:***



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2017 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.