SC ruled that no PE of a foreign company can be formed in India where its Indian subsidiary is performing support services, which enables such foreign company to render services to its client abroad

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In brief

The Supreme Court of India (SC)[1] held that support services performed by an Indian subsidiary, which enables the foreign company to render information technology (IT) and IT-enabled services to its client abroad, will not create a permanent establishment (PE) of the foreign company in India.

The SC held that an Indian subsidiary did not create a fixed place PE of its foreign company in India unless the premises of the subsidiary were at the disposal of the foreign company. The SC also negated the possibility of service PE in India on the ground that none of the customers of the foreign company received any services in India. In relation to agency PE, the SC held that it has never been the case of the revenue that an Indian subsidiary was authorised to or exercised any authority to conclude contracts on behalf of the foreign company. The SC further held that even if the foreign company is held to have a PE in India, the transaction between the foreign company and its Indian subsidiary being at arm's length, no further profits can be attributed in India. Further, that the Mutual Agreement Procedures (MAP) agreement for an earlier year could not be considered as precedent for subsequent years.

In detail

Facts in brief

- A Group Inc. and B Corporation, USA (hereinafter, collectively referred to as "AB USA") were resident companies in the USA. AB USA was in the business of providing ATM management services, electronic payment management, decision support and risk management and global outsourcing and professional services (IT and IT-enabled services) to its customers outside India. AB USA were assessed to tax in USA on their global income.
- C Private Limited (C India) was a company resident in India. It provides various support services to AB USA in relation to its IT and IT-enabled services. C India was taxed in India on its global income, in accordance with the provisions of the Income-tax Act, 1961 (Act).
- The Revenue contended that the income of AB USA should also have been taxed in India as they had PE in India in the form of C India, to which income from provision of IT and IT-enabled services could be attributed.

[1] Civil Appeal No. 6082 of 2015 Dated October 24, 2017

Arguments made

Revenue's contentions	AB USA's contentions
Fixed place PE – In terms of Article 5(1) of the India- USA tax treaty, the Revenue contended that AB USA had a fixed placed PE in India in the form of C India.	
• 40% of employees of the entire group was employed in India. • AB USA had call centres and software development centres in India. • AB USA was performing only marketing activities in India and its contracts with clients was assigned or sub contracted to C India. • The master service agreement between AB USA and the C India gave complete control to AB USA over personnel employed by C India. • C India functioned through the proprietary database and software of AB USA, which is provided to C India free of cost. • The corporate office of C India housed an "International Division" comprising the president's office and a sales team servicing C India and group entities. • The president's office primarily oversees operations of C India and other group entities. The president's overall reporting was to AB USA. • The physically located premises in India was at the disposal of AB USA with the degree of permanence required, namely, for the entire year. • Reliance in this regard was placed on the decision of the SC in the case of Formula One World Championship Limited.[2]	• For establishing a fixed place PE, it should have been a place at its disposal, i.e., AB USA must have had the right to use the premises for their own business, which was not made out in the facts of the case. • The Transfer Pricing Officer (TPO) accepted the arm's-length pricing between AB USA and C India. Even if a fixed place PE was found, once the arm's length price was paid, AB USA goes beyond the dragnet of Indian taxation. • Further, the mere fact that a 100% subsidiary could be carrying on business in India did not mean that the holding company would have had a PE in India.
Service PE - In terms of Article 5(2)(l) of the India-USA tax treaty, the Revenue contended that AB USA had a service PE in India, as the employees of C India were under the control and supervision of AB USA.	
• Most of the employees of the group are in India. • The president's office manages the operations of C India and A group entities, and the employees of these entities report to the president. The president's overall reporting was to AB USA. • AB USA had call centres and software development centres in India. • AB USA was performing marketing activities in India and its contracts with clients was sub-contracted to C India. • C India personnel assigned to work with AB USA or customers located in the United States shall be	• The tax officer (TO) did not allege that such PE existed. • No services were provided to customers in India, as all their customers exist outside India. • Only the Indian company employed personnel engaged in Indian operations and that AB USA may indirectly control such employees was only to protect their own interests. • The activities of C India was independent business activities on which taxes were levied under the Act.

[2] Formula One World Championship Ltd. v. CIT (2017)(SCC Online SC 474)

Revenue's contentions	AB USA's contentions
directed by AB USA or by C India supervisor acting at the direction of AB USA. • AB USA shall be the sole judge of performance and capability of A personnel and may request the removal of one or more of A personnel from the project. • Employees of C India were working under the control and supervision of AB USA. • Two employees of AB USA were seconded to C India and their activities went beyond just stewardship activities.	
Agency PE - In terms of Article 5(4) and 5(5) of the India-USA tax treaty, the Revenue contended that AB USA had Agency PE in India in the form of C India.	
• The Revenue argued that a dependent agent PE was made out under Article 5(4) and 5(5), there being a concurrent fact finding of the Commissioner of Income-tax (Appeals) and Income-tax Appellate Tribunal. • Since AB USA failed to furnish information when sought for, an adverse inference was drawn and the burden of proof shifts to AB USA.	• The TO never alleged an Agency PE, and therefore, no factual foundation for the same has been laid.
MAP – The Revenue relied on the MAP resolution arrived at by AB USA for earlier years, wherein the existence of PE was accepted	
• Admission made by AB USA under MAP proceedings will be binding for the subsequent years.	• The MAP procedure availed for the assessment years in question could not be said to be binding for subsequent years, as they were without prejudice to the contention of A that they do not have a PE in India.

SC's decision

Fixed place PE

- The following were relied upon for determining the test applicable for constitution of fixed place PE.
  - The principal test, to ascertain whether an establishment had a fixed place of business or not, was that such physically located premises had to be "at the disposal" of the enterprise.
  - For this purpose, it was not necessary that the enterprise owns or even rents the premises. It will be sufficient if the premises was at the disposal of the enterprise.
  - However, merely giving access to such a place for the purposes of the project would not suffice.
  - The place would be treated as "at the disposal" of the enterprise when the enterprise had right to use the said place and had control thereupon.
- It was held that there must exist a fixed place of business in India, which was at the disposal of AB USA, through which they carried on their business. There was, in fact, no specific finding in the assessment order or the appellate orders that applying the aforesaid tests, any fixed place of business had been put at the disposal of these companies.
- The following observations of the HC were upheld by the SC:
  - C India provided various services and depended upon AB USA for its earning was not the relevant test to determine location PE.
  - C India did not bear sufficient risk was irrelevant when deciding whether a location PE exists.
  - The close association between C India and the taxpayer and application of

functions performed, assets used and risk assumed criteria was not a proper and appropriate test to determine the location PE.

  - C India being reimbursed the cost of call centre operations, plus certain percentage, was not relevant for determining location or fixed place PE.
  - Assignment or sub-contract to C India was not a factor or rule to be applied to determine existence or otherwise of fixed place PE.
  - Whether or not any provisions for intangible software was made or had been supplied free of cost was not a relevant criteria.
  - C India would not become fixed place PE merely because there was interaction or cross transactions between C India and AB USA.
  - Even if foreign entities save and reduce their expenditure by transferring business or back office operations to their Indian subsidiaries, this would not by itself create a fixed PE.
- No part of the main business and revenue earning activity of AB USA were carried on through a fixed business place in India, which had been put at their disposal.
- C India only rendered support services, which enabled AB USA to render services to their clients abroad. This outsourcing of work to India would not give rise to a fixed place PE.
- Reliance on the United States Securities and Exchange Commission Form 10K Report was also misplaced. It was clear that the report spoke of the A group of companies worldwide as a whole, which was evident not only from going through the said report, but also from the consolidated financial statements appended to the report, which showed the assets of the group worldwide.

Service PE

- An enterprise must furnish services within India through employees or other personnel for a service PE to be constituted. In the present case, C India only rendered support services to AB USA.
- Presence of employees in India was relevant under the Double Taxation Avoidance Agreement (tax treaty) but the said employees should have furnished services within contracting state.
- None of the customers of AB USA had received any services in India.
- Mere auxiliary operations that facilitate services rendered by AB USA to its customers was carried out in India.
- Further , in respect of employees seconded, it was held that
  - The seconded employees were working under the control and supervision of C India. The TO did not negate this assertion made by AB USA.
  - The entire remuneration paid to such employees were borne by C India.
  - The TO had not given any finding on whether these employees reported to AB USA or any group companies.

Agency PE

- C India could not exercise any authority to conclude contracts on behalf of AB USA and no other clauses of the tax treaty dealing with the agency PE was applicable.
- Further, as the arms-length conditions was satisfied, no further profit would be attributable, even if there existed an agency PE in India.

MAP

The agreement entered into by AB USA under MAP pertained to disputes in earlier assessment years and could not be considered as a precedent for subsequent years.

The takeaways

The SC decision brings out certain guidelines for determination of existence or otherwise of the PE of a foreign company in India, which are as under:

- The principal test, to ascertain whether an establishment has a fixed place of business or not, is that such physically located premises have to be “at the disposal” of the foreign company.
- No fixed place PE can be established if the main business and revenue earning activity of the foreign company are not carried on through a fixed place in India, which has been at the disposal of the foreign company.
- Based on the facts of a case, a FAR analysis may not be the appropriate test to determine location PE.
- The mere fact that a 100% subsidiary may be carrying on business in India does not mean that the holding company would have a PE in India.
- If any customer were rendered services in India, whether resident or non-resident, a service PE would be established.

- If arm's-length conditions were satisfied, no further profit would be attributable, even if there exists a PE of a foreign company in India.
- The MAP resolution arrived for a year cannot be considered as a precedent for subsequent years.

Let's talk

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

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