

Presence of affiliates in India and a peripheral role played by them did not constitute PE in India

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In brief

In a recent ruling¹, the Chennai Bench of the Income-tax Appellate Tribunal (Tribunal) has held in the facts of a case that the presence of affiliates in India and a peripheral role played by them does not constitute permanent establishment (PE) in India.

In detail

Facts

- The taxpayer¹ was an Indian company. It took loans from A Limited and B Limited (collectively referred as “Mauritius entities”) on which interest was paid.
- The Indian affiliates of the Mauritius entities stood as guarantors in respect of the loan granted and further assisted in the groundwork pertaining to loans,
- The taxpayer paid interest without withholding tax relying on Article 11(3) of India-Mauritius Double Taxation Avoidance Agreement (tax treaty).
- The Tax Officer (TO) held that the interest income was taxable in India, as the Mauritius entities had a PE in India in the form of its Indian affiliates. The Indian affiliates were treated as a PE of the Mauritius entities

as the loan agreements were signed in India and the Indian affiliates stood as guarantors.

- Consequently, disallowance was made under section 40(a)(i) of the Income-tax Act, 1961 (Act) for non-withholding of tax on the interest payments.
- The Dispute Resolution Panel (DRP) confirmed the view of the TO.

Issue before the Tribunal

Whether tax was required to be withheld on interest paid to Mauritius entities?

Revenue’s contentions

- The Indian affiliates constituted PE of Mauritius entities in India; therefore, interest income was taxable in India.
- The benefits under Article 11 of the tax treaty was not available, as the Mauritius entities were not the

beneficial owner of interest income.

Taxpayer’s contention

Interest income was exempt in the hands of Mauritius entities under Article 11(3) of tax treaty, and hence, tax was not withheld.

Tribunal’s ruling

Agency PE

- The Indian affiliate did not have the authority and it did not habitually exercise the authority to conclude contracts in the name of the Mauritius entities. Had this been the case, there would not have been even a need for the contracts to be signed by Mauritius entities.
- The Indian affiliates were not dependent agents and it was not the case that it was acting exclusively or almost exclusively for the Mauritius entities.

¹ [2017] 81 taxmann.com 5 (Chennai Tribunal)

- Based on above there was no Agency PE.

Fixed place PE

- The three criteria embedded in the definition of a Fixed Place PE were reinforced—physical criterion, i.e., existence of physical location, subjective criterion, i.e., right to use that place and functionality criterion, i.e., carrying out of business of the foreign company through that place.
- The above criterion was not fulfilled in the present case:
 - Mere occasional use of office of Indian affiliates without a right to use the

facilities of such place did not result in a PE.

- The Mauritius entities were not carrying out any business through the offices of the Indian affiliates.

Income attributable to PE

- Even in case of a PE, only profits attributable to the PE was taxable.
- Mere existence of the PE could not lead to the conclusion that the entire interest income belonged to the PE.

Conclusion

The interest income was not

taxable in India. Accordingly, no tax was required to be withheld and no disallowance under section 40(a)(i) of the Act was justified.

The takeaways

The Chennai Tribunal has reinforced the three basic tests of physical criterion, subjective criterion and functionality criterion for the existence of Fixed Place PE in India.

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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