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# ***Business support/marketing support activities undertaken by Indian subsidiary do not create a PE in India for the foreign company***

June 20, 2018

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## ***In brief***

The Authority for Advance Ruling (AAR)<sup>1</sup>, in a recent ruling held that Indian subsidiary (providing business/ marketing support activities) will not constitute a fixed place permanent establishment (PE) of applicant in India as neither its main business was carried through Indian subsidiary, nor the premises of the Indian subsidiary was at the applicant's disposal.

The AAR also held that the applicant would not constitute a service PE in India as the directors of the Indian subsidiary would not provide any services or technical assistance to the applicant's customers.

With respect to agency PE, AAR held that as per the terms of the service agreement and addendum thereto, the applicant had retained with itself the authority, regarding its main business, to finalise its marketing strategies, to finalise terms of agreements/ contracts directly with customers and to accept or reject offers of customers. The Indian subsidiary would be left only to provide support services rather than act as an agent of the applicant and thus the Indian subsidiary would not constitute an agency PE.

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## ***In detail***

### ***Facts***

- The applicant, a state owned oil company, was a resident of Saudi Arabia. It sold crude oil to Indian refineries entirely from outside India such that the title to such crude oil passed onto customers outside Indian on a free on board (FOB) basis.
- The applicant had established a subsidiary company in India (I Co).
- I Co provided procurement, business and marketing

support services and created awareness about the applicant and its products amongst crude buyers and refineries in India.

- The applicant proposed to set up a support team in I Co which would closely coordinate and extend required support to provide business/ marketing support activities.
- The applicant's own employees, based in Saudi Arabia, would negotiate the contract's material terms and conclude/ sign

contracts with Indian customers.

The I Co would assist in strategic sourcing and registration of major Indian oil and gas equipment manufacturers, EPC contractors, performing engineering and inspection evaluations and plant audits for identified suppliers. Further the I Co would assist the applicant and other group companies with any additional material supply support.

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<sup>1</sup> A.A.R. No. 25 of 2016

### **Issue before the AAR**

Whether the business/ marketing support activities proposed to be undertaken by I Co constituted a PE for the applicant in India under Article 5 of the India - Saudi Arabia Double Taxation Avoidance Agreement (tax treaty), where I Co was compensated on arm's length basis?

### **Revenue's contention**

#### **Fixed place PE**

- The applicant had a PE in I Co, through which it conducted its business by setting up a support team.
- All functions of I Co were under control and management of the applicant and thus the place of business of I Co was fixed place PE of the applicant.
- Analysis of the available details showed that the business of I Co was being carried out in the premises of I Co construing the existence of a fixed place PE in India.

#### **Service PE**

- Activities of I Co was carried out for the purpose of business of the applicant, influenced by services, control and management of non-resident board of directors, thus resulting in service PE of the applicant.
- The proposed addendum mentioned that the officials of the applicant and other affiliates would be visiting India and I Co would arrange meeting of such officials with the Government officials, LPG customers in India and I Co would be coordinating all associated logistics arrangements as well.
- Accordingly, service PE would

come into existence.

#### **Agency PE**

- I Co, through its board of directors, carried on business functions of the applicant.
- Thus, I Co habitually exercised in India the authority to control contracts in the applicant's name and also habitually obtained orders in India. Hence, the applicant constituted an agency PE in India.

### **Applicant's contention**

#### **Fixed place PE**

- Mere existence of subsidiary company in India or rendering of services by I Co to the applicant on a principle-to-principle basis, did not result in fixed place PE.
- Further, mere rendering of services by I Co to the applicant could not be regarded as the premises of the I Co was at the disposal of the applicant.
- The fact that I Co was rendering services to the applicant was irrelevant in absence of fulfilment of fundamental conditions.
- Further as per the tax treaty place of business in India used for procurement of goods by the applicant is expressly excluded from fixed place PE.

#### **Service PE**

- The essential ingredients for creation of service PE was not present in the service agreement and the addendum thereto.
- No services were proposed to be rendered by the applicant to anyone in India. On the contrary, the services was to be rendered by the I Co to the

applicant.

- Further, no services was proposed to be rendered to any customer of the applicant in India<sup>2</sup>, in fact, the applicant was only receiving services.
- In addition, the director of the I Co residing outside India was not an employee of the applicant and hence, it could not be said to have rendered any services to any customer of the applicant in India.
- Accordingly, no service PE could possibly be said to have existed.

#### **Agency PE**

- The pre-requisite elements for creation of agency PE was not present in the service agreement and the addendum thereto.
- Further the clause in the proposed addendum specifically precludes I Co to have acted as an agent or even entered into negotiations.
- Services proposed to be rendered by I Co was required to have created awareness about the applicant through various channels and essentially partaken the nature of image protection and intelligence gathering which under no circumstances tantamounted to agency activity.
- The concept of "obtaining orders" was explained in protocol to India – US tax treaty to mean orders which straightaway bind the foreign enterprise the moment they were accepted by the Indian entity. However, in the present case, I Co was specifically debarred by the proposed addendum from engaging in any such activity.

<sup>2</sup> ADIT v. E-Funds IT Solution Inc. [2017] 86 taxmann.com 240 (SC)

- Even if it was stated that where purchase contracts were to be concluded by I Co, it would still not result in creation of PE as “orders” referred to in the tax treaty was ‘sales order’ and not ‘purchase order’. Purchase contracts not relevant to determine agency PE.
- The applicant did not even have an office in India; it procured such services from I Co (and was remunerating the subsidiary for it).
- Further, I Co did not have power or the authority to conclude contracts.

#### **AAR’s ruling**

##### *Fixed place PE*

- The requirements for constitution of fixed place PE are as follows:
  - There should be fixed place;
  - Fixed place is at the disposal of the foreign company;
- The main business of the foreign company is carried on from fixed place; and
- Support services or outsourcing work is not sufficient to make it PE.

#### **Observations and ruling by AAR**

- I Co did not automatically create PE of the applicant in India.
- I Co utilised establishment for own business and provided support services to the applicant, for which it was duly remunerated.
- I Co had not hired personnel of applicant or would hire personnel of the applicant in future when the activities begun.
- The main or core business activities and revenue earning

activity was not carried out by the applicant through I Co’s premises, nor was any premises placed at the applicant’s disposal.

- In light of the above, the applicant could not be said to have a fixed place PE in India.

##### *Service PE*

- The essential features for constitution of service PE was as follows:
  - Service rendered by foreign company;
  - Service rendered in India to customers of foreign company;
- Services rendered through employees of foreign company or other personnel engaged by foreign company; and
- Services rendered for period aggregating to more than 182 days, within a twelve month period.

#### **Observations and ruling by AAR**

- No credibility could be given to the earlier or other entities, their activities or role of their directors at that time, even if the directors were working side-by-side on other concerns of the group, which is usual with large MNCs.
- Role of directors was only for I Co, which provided services to applicant rather than providing services to applicant’s customers.
- Factually, none of the directors of I Co were employees of the applicant. Assuming that, in past, they were employees of the applicant and now rendered any services, they would do so in the capacity of a director of I Co, which was a separate and distinct legal entity.

- The relationship with the applicant in the past and the number of days and period of stay in future would be irrelevant, when they would now be discharging their duties as directors of I Co.
- As directors were participating from outside India, condition of employees/ other personnel being deputed to India to render services to applicant’s customers for more than specified period was not satisfied.
- Clauses of service agreement and addendum thereto, did not permit directors to render any services to applicant such that I Co constituted a PE of the applicant.
- The applicant could not be said to have a service PE in India.

##### *Agency PE*

- The requirements for constitution of agency PE are as follows:
  - I Co authorised or habitually exercises authority to conclude contracts on behalf of the applicant, or habitually obtains orders wholly or almost wholly on behalf of applicant;
  - Activities, if undertaken, should be for business proper of the applicant and not related to day-to-day operations of I Co itself.
  - Whether any clause in agreement allowed or prohibited I Co from undertaking above activities.

#### **Observations and ruling by AAR**

- I Co was separately incorporated legal and taxable entity and it did not

automatically become applicant's PE under the tax treaty.

- Proposed addendum expressly excludes activities such as negotiation, conclusion, securing orders, etc. from being carried out by I Co. Further, another clause of proposed addendum indicated that applicant retained authority to finalise terms of contracts, to accept or reject offers of customers, etc. Thus, I Co would be left to provide support services rather than act as an agent of the applicant.
- As per terms of service agreement and the services to be rendered as per the terms of the agreement, I Co was completely prevented from doing any act that could term

it as an agent of the applicant. Accordingly, it could be said that I Co and applicant were independent parties.

- Thus, applicant could not be said to have an agency PE in India.

#### ***Relevance of arm's length price for PE***

- The fact that transaction between I Co and applicant was at arm's length was irrelevant for determination of PE. It was relevant only for the purpose of determining the amount of profits and gains that would be attributable to the PE, if a PE was first found to exist.

#### ***The takeaways***

- AAR has reiterated an important principle that I Co

of foreign company does not by itself constitute PE of foreign company.

- Unless the foreign company proposes to carry out its main business itself from an establishment in India which is at its disposal, Fixed Place PE is not constituted.
- Further, unless the foreign company renders services through its employees and personnel to customers in India or its I Co acts as an agent of foreign company, I Co would not constitute a service/agency PE of foreign company respectively.

#### ***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

### ***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 Greams 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)

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