

Transaction processing services provided to India customers – AAR rules that permanent establishment exist on multiple grounds

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In brief

Recently, the Authority for Advance Rulings (AAR)¹ has *inter alia* held that the presence of a card interface processor² (CIP), and the presence of a global card network³ of a Singapore entity (applicant) constituted a permanent establishment (PE) of the applicant in India under Article 5 of the India-Singapore Double Taxation Avoidance Agreement (tax treaty). Further, the income from services rendered for use of such CIP and global card network for processing card payments would be attributable to tax in India notwithstanding significant operations occur outside of India.

In detail

Facts

- The applicant, a tax resident of Singapore, was in the business of providing transaction processing and payment related services pertaining to credit cards/debit cards.
- The applicant entered into a license agreement (agreement) with Indian banks and financial institutes (customers) for the provision of transaction processing services relating to authorisation, clearing and settlement of card transactions.
- As per the agreement, the applicant in addition to transaction processing fees was also receiving following charges (a) *assessment fees* – fees for building and maintaining the network that governs the authorisation, clearing and settlement process; and (b) *miscellaneous fees* – fees for the provision of other ancillary services for transaction processing.
- In a typical card transaction, a cardholder presents its card to a merchant for payment. The merchant swipes the card through which the information relating to the transaction is forwarded to a bank, which in turn forwards this information to the cardholder's bank *via* the CIP and global card network provided by the applicant.
- The key elements involved in such typical processing are detailed as under–
 - The global card network used a CIP, which was a special purpose equipment installed at the premises of Indian customers.
 - The CIP was owned by the applicant's Indian subsidiary.
 - CIP undertook preliminary validation of information in India, at the point of authorisation.

¹ AAR No. 1573 of 2014

²It is explained that "processor" is in the size of a standard personal computer and was placed at the customers locations in India.

³ A communication network that serves the needs of customers globally, for setting up and maintaining a set of rules that govern the authorisation, clearing and settlement process for every payment transaction.

- Thereafter, the raw data was encrypted and sent outside India using application software (software) for detailed processing, clearing and settlement.
- An overseas associated enterprise compiled net position using management software, to arrive at the final position for the banks involved.
- The final position was then informed to a banker in India for passing necessary entries in the bank accounts of the cardholder's bank and merchant's bank.
- The applicant's parent entity had a liaison office (LO) in India. As a part of global restructuring⁴, all functions, assets, risks (FAR) of the LO were transferred to a newly incorporated Indian subsidiary.

Key issue⁵ before the AAR

Whether the applicant had a PE in India under Article 5 of the India-Singapore tax treaty in respect of the services for using the global network and infrastructure to process card payment transactions for Indian customers?

Applicant's contentions

- There was no PE in India and the functions performed by the CIP and global card network was preparatory and auxiliary in nature.
- The global card network was located outside India, consisting of server and related equipment. The existence of equipment within

India was a fraction of the equipment and the network which existed outside of India.

- The applicant did not own the related networks in India (transmission towers, leased lines, etc.).
- Settlement of all transactions was completed outside India through data centres located outside India.
- The task carried out by the banker in India was an insignificant part of the entire settlement function and entirely at the instructions of the applicant.
- The Indian subsidiary was performing only preparatory and auxiliary activities.
- The erstwhile LO was admitted as PE only under mutual agreement procedure settlement under the tax treaty, and the PE was not upheld by any court in India. Further, the applicant's parent entity had specifically declared in its tax returns that it had no PE in India.
- The Indian subsidiary performed only marketing support services in India and was not involved in conclusion of the contracts on behalf of the applicant.
- The employees of the applicant visiting India carried out only stewardship activities and did not render any services to the customers.

Revenue's contentions

- The applicant constituted a fixed place PE in India in the form of CIP, global card network, premise of banker in India, as well as its Indian subsidiary.

- The applicant constituted dependent agent PE owing to the activities carried out through its Indian subsidiary.
- The applicant constituted service PE on account of the presence of its employees in India for more than 90 days.

AAR's ruling

Fixed place PE

- Considering the facts of the case, the presence of the CIP, global card network, Indian subsidiary and banker in India would constitute fixed place PE in India.
- CIP and network: The fixed place test was satisfied, as the CIP and global card network remained at a particular site in India.
 - Even though the applicant claimed that it did not have the ownership in the CIP, the ownership factor was not relevant to determine PE, if other tests were satisfied.
 - It was sufficient to have control over the CIP. Such a control was regarded as 'at the disposal' of the applicant, as the Indian subsidiary did not exercise any rights of owner on such processor, and all risk and mitigation functions were handled by the applicant.
 - Though the CIP was not involved in all three stages⁶ of the transaction processing, the involvement at initial stage would create PE, as without it, the initial validation and authorisation would not

⁴ The Revenue had also contended that restructuring was a colourable device to reduce tax liability in India, however, such argument was rejected by the AAR.

⁵ The Revenue had also contended that part of the revenue received by Applicant was royalty as well as FTS. The AAR upheld the Revenue's contention on royalty and rejected the argument on FTS.

It was, however, held that this revenue would be effectively connected to the PE. This has not been discussed in detail in this alert.

⁶ Authorisation, clearance and settlement

happen. Thus these services were regarded as not being preparatory or auxiliary in nature.

- The CIP in India performed preliminary verification and encryption of data using the related network of transmission tower, leased lines, fibre optic cable, internet, etc. Such related network in India performed transmission of data, which was significant activity in the context of overall functions of transaction processing, and not merely preparatory and auxiliary.
- Further, the related network in India was secured by the group to prevent fraud and enhance security. Thus, this too was at the disposal of the applicant.
- Banker in India: Constituted fixed place PE in India, as significant activity of the transaction process (more than 90 percent of the actual movement of funds) was performed from its office –
 - The settlement was not done outside India as the net position was already known to banks in India and the banker posted the entries in India.
 - Banker had dedicated team and space to perform

settlement function, under the direction and on behalf of the applicant.

- Applicant was responsible for any error during settlement activity of the banker.
- The Indian subsidiary: Constituted fixed place PE in India -
 - Erstwhile LO was admitted as PE and 100 percent of its income was attributed to this PE.
 - On transfer of all assets and employees by the LO to Indian subsidiary, some functions and risks related to transaction processing (which were earlier carried out by the PE), were subsequently carried out by the Indian subsidiary, though not shown in its FAR profile.

Service PE

- Visits of applicant's employees constituted service PE in India
 - The presence in India exceeded 90 days; and
 - The activities carried in India, namely, meeting customers to understand the future requirement, informing new products to clients, etc. were part of the transaction processing service, and not stewardship activities. Reliance was placed on the

judgement of the Supreme Court in the case of E-funds IT Solutions Inc⁷.

Dependent agent PE

- The Indian subsidiary was legally and economically dependent on the applicant, and thus, dependent agent PE of the applicant –
 - The Indian subsidiary obtained instructions and remuneration from, and catered only to the applicant.
 - The term “habitually” was to be interpreted in the context of the business. Though only 2-3 contracts were entered per year, and finalisation of these contracts was done by the applicant in Singapore. However, all the orders were routed through the Indian subsidiary. Thus, it satisfied the requirement of “habitually securing orders”.

The takeaways

- This ruling has emphasised that functions performed in India, assets employed and risks undertaken for such functions, is relevant for PE determination.

Let's talk

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

⁷ ADIT v. E Funds IT Solution Inc [2017] 86 taxmann.com 240 (SC)

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

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