Tax Insights

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Employees traveling to India does not create a fixed place PE if they do not undertake core business activities in India, and the activities are limited to stewardship or preparatory or auxiliary in nature – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal (Tribunal)[1] rejected the Department's contention that employees of the foreign company visiting India creates a permanent establishment (PE) when they do not undertake core business activities in India. The Tribunal observed that the visiting employees neither carried out any core business activities nor any activity for the sale of license from India. The purpose of their visit was in the nature of either stewardship or preparatory or auxiliary activities. Accordingly, the Tribunal concluded that no part of income from software licensing fees can be attributed to the PE.

While concluding the above, the Tribunal further observed that the Revenue had failed to establish on record through credible evidence that the taxpayer has a fixed place PE in India. The Tribunal also observed that the onus of proof is on the Revenue Department.

In detail

Facts

- The taxpayer, a resident of the USA, is a developer, marketer and seller of robotic process automation (RPA) and related products and services. It develops and sells RPA software and the Digital Workforce Platform. The RPA services enable customers to automate business processes through the use of configurable software bots.

- During the year under consideration, the taxpayer earned receipts from the following two streams from India.

  - **Fees from software licensing** – The taxpayer had treated the receipts from the sale of software license as business income and had therefore not offered the same to taxation in the absence of a PE in view of Article 7 of the India–USA Double Taxation Avoidance Agreement (DTAA).

[1] ITA No. 2147/Del/2022 and ITA No. 2148/Del/2022

- **Fees from rendering of services** – The taxpayer had treated the receipts from the rendering of services as fees for included services (FIS) and accordingly offered the same to taxation while filing return of income in India.

- The taxpayer's case was selected for assessment proceedings. During assessment proceedings, the tax officer (TO) called upon various details from the taxpayer such as details of all associated enterprises (AE) in India, details of international transactions with the AE, transfer pricing audit report in Form 3CEB, agreements entered into with the AE and details of employees visiting India for providing services in the relevant year. On perusal of the data furnished by the taxpayer, the TO noticed that 30 employees of the taxpayer visited India for a period of 459 days and rendered services.

- The TO also sought information from the taxpayer's AE in India by exercising the power conferred under section 133(6) of the Income-tax Act, 1961 (the Act). On perusal of the information furnished by the Indian AE, the TO observed as follows –

  - Various employees of the taxpayer have been working for a long duration at the office premises of its AE in India.

  - The employees visited India for performing the business and economic activities of the taxpayer.

  - The visiting employees have free access to the premises of the Indian AE, and through such premises, the taxpayer's employees were carrying on the business activities of the taxpayer. Accordingly, the test of permanency and fixed place is satisfied.

  - Disposal test and duration test were satisfied as the premises of the Indian AE were put at the disposal of the taxpayer's employees, and they were working at the premises of the Indian AE for a long duration.

  - The visited employees of the taxpayer concluded the sales contract, developed software, transferred the licenses and collected payments in India from the licensees.

- In view of the above observations, the TO concluded that the taxpayer has a fixed place PE in India as per Article 5(1) of the India–USA DTAA as the essential characteristics for constituting a fixed place PE were satisfied.

- Having done so, the TO attributed 25% of the revenue earned from the sale of software license as profit attributable to the PE in the draft order passed by it.

Taxpayer's contentions

Taxability of fees from software licensing

- The taxpayer contended that while concluding that it has a fixed place PE in India, the TO had completely ignored the facts of the case. Moreover, the TO also ignored the purpose for which the visits were made by the taxpayer's employees to India. During the Tribunal hearing, the taxpayer brought on record the purpose of the visits made by employees in India as below.

Number of employees who visited India	Number of days visited in India	Purpose of visit
4	41	Shareholder activities
9	126	Stewardship activities
7	104	Marketing, events and activities (the visited employees did not have access or visited the premises of the Indian AE)
4	108	Training

Number of employees who visited India	Number of days visited in India	Purpose of visit
5	107	Wrongly included in the list of visits by employees (out of which one employee had visited India for marriage)

- In view of the above, the taxpayer contended that on an average, each employee visited India for less than 14 days in a year.
- Moreover, the taxpayer submitted that visiting employees were given temporary space for meeting with the employees of the Indian AE, and they did not carry out any core business activities of the taxpayer at the premises of the Indian AE. The visiting employees had no legal rights or effective powers over the office of the Indian AE. They also did not have any right to organise meetings in the premises of the Indian AE.
- The top-level officials of the taxpayer had visited India to meet the officers of the Indian AE for the sake of owners' or shareholders' interests in the subsidiary. The other technical staff visited the Indian AE to foster and strengthen the relation with them. Thus, the visiting employees were only performing stewardship activities or activities which were preparatory or auxiliary in nature.
- The taxpayer further argued that the conclusion drawn by the TO that the taxpayer formed a fixed place PE in India was merely based on conjecture and surmises that the visiting employees had free access to the premises of the Indian AE without any restrictions.
- Additionally, the TO did not bring on record any material or evidence to prove the following findings –
  - The taxpayer has satisfied the permanency test, disposal test, duration test and function test.
  - The visiting employees had free access to the premises of the Indian AE.
  - All the employees who visited India visited the office of the Indian AE.
  - Visiting employees have either developed or sold a licence for the RPA software from the premises of the Indian AE.
- The taxpayer contended that a fixed place of business would mean a place where the entity is free to use the premises, at any time at its own choice, for work relating to more than one customer and for internal administrative and bureaucratic work. In this regard, the taxpayer had placed reliance on the decisions of the Supreme Court in case of Formula 1 World Championship Limited[2].
- It was also argued that the burden to prove that the foreign entity has a PE in India is initially on the Revenue by placing reliance on the Supreme Court decision in the case of E-funds IT Solutions Inc[3]. The taxpayer submitted that its case is fully covered by the Supreme Court decision in the case of Ericsson Radio Systems AB[4] and submitted the detailed parity analysis between both the cases in a tabular format.
- The taxpayer furnished evidence to prove that licenses were sold from outside India. It was also contended that when there is no evidence to demonstrate that the entire licence fee received by the taxpayer was through the PE, 25% out of such licence fee cannot be attributed as profit of the PE.
- The taxpayer, without prejudice to the above, submitted its contention that, even assuming that it had a fixed place PE, if such fixed place was used for auxiliary and preparatory work, it should be excluded from being treated as a PE as per Article 5(3)(e) of the India–USA DTAA.

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2 Formula 1 World Championship Limited *v.* CIT [2017] 394 ITR 80 (SC)

3 Asst DIT *v.* E-funds IT Solutions Inc [2017] 399 ITR 34 (SC)

4 Ericsson Radio Systems AB *v.* DCIT [2005] SCC online ITAT 1

Taxability of fees from rendering of services

- On appeal before the Tribunal, the taxpayer raised the following two additional grounds with respect to the fees received on account of rendering services.

  - The taxpayer erred in law by treating the receipts from rendering services to be taxable in India. In this regard, the taxpayer contended that fees received on account of rendering services should be treated as excluded from the scope of FIS as per Article 12(5)(a) of the India–USA DTAA, and accordingly, it should not be treated as taxable in India.

  - The TO erred in not treating the receipts from rendering services as revenue of the fixed place PE.

Tribunal's ruling and observations

Taxability of fees from software licensing

- On perusal of details of the employees visiting India, it was observed that none of the employees came for the purpose of either development or sale of or any activity related to the development and sale of the RPA software platform. It also does not appear that any of the employees visiting India were carrying on any activity regarding the sale of the license. The purpose of visits of the employees included shareholder activity, stewardship activity, marketing events, for receiving training, etc.

- The information obtained by the TO from the Indian AE also nowhere reveals that the taxpayer was carrying on any activity of sale of license through its employees by using the premise of the Indian AE.

- The allegations of the TO are not backed by any supporting evidence, and the TO has failed to establish evidence that the taxpayer has a fixed place PE in India through which it earned income relating to sale of software licenses.

- As per the facts and material available on record, there was nothing to demonstrate that the taxpayer has carried out any activity, either wholly or partly, in relation to the sale of the software licence through the alleged PE in India.

- With regard to the argument of the taxpayer that the burden to prove that essential tests of fixed place PE get satisfied is on the Revenue, the Tribunal also agreed with this argument made by the taxpayer.

- Considering the above, the Tribunal was of the view that the Revenue has failed to establish on record through credible evidence that the taxpayer has a fixed placed PE in India through which it has earned the income relating to the sale of software licence. Accordingly, the Tribunal was of the view that no part of software licensing fees can be attributed to the PE.

Taxability of fees from rendering of services

- The taxpayer has *suo moto* offered the income received from services rendered as FIS under Article 12(4) of the India–USA DTAA.

- The claim of the taxpayer that the receipts cannot be covered within the ambit of FIS in view of Article 12(5)(a) of the India–USA DTAA was not made either before the TO or the Dispute Resolution Panel. Thus, neither of the authorities have factually examined the nature and character of such receipts.

- Entertaining the taxpayer's claim at this stage would require fresh investigation into the facts, which is not permissible at this stage.

- Therefore, Tribunal concluded that the additional ground raised by the taxpayer is not covered in the category of pure legal issue as it is a mixed question of law and fact. Since the facts related to the issue were not examined at any stage, the Tribunal refused to entertain the additional ground.

The takeaways

While concluding on the issue of the fixed place PE, the Tribunal established the principle that the taxpayer's employees merely travelling to India would not trigger the existence of a PE in India. What needs to be seen to analyse the existence of the PE is the purpose for which the employees would have travelled to India and the activities undertaken by them in India. Visit to India by employees of foreign companies for stewardship or auxiliary or preparatory activities would not create a PE. What has worked in this ruling for the taxpayer is availability of robust documentary evidence to substantiate the purpose of visit of its employees to India.

Moreover, the Tribunal also once again emphasised that the burden of proving the existence of a fixed place PE is on the Revenue Department, and mere occurrence of the characteristics of a fixed place PE is insufficient.

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