Tax Insights

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Mere existence of a subsidiary would not lead to creation of a PE; in absence of the subsidiary's involvement, there is no basis to attribute profit on account of offshore sale to Indian customers; and mere reimbursement of testing charges is not covered within the ambit of FTS income – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal[1] (Tribunal) has allowed an appeal in favour of the non-resident taxpayer, concluding that profits earned by the taxpayer by offshore sale of goods and other tangible assets should not be attributable to its Indian subsidiary. The Tribunal, while deciding on the facts of the case, has observed *inter alia* that the non-resident taxpayer had exported goods to Indian customers on a principal-to-principal basis, effected through both delivery and receipt of payments for such sales outside India. The Tribunal was of the view that it is not sustainable to hold that the taxpayer has a permanent establishment (PE) merely based on the existence of an Indian subsidiary, without any supporting evidence to prove the existence of such PE. Hence, based on the facts of the present case, the Tribunal has concluded that the non-resident taxpayer did not have a PE in India; accordingly, profit attribution to the taxpayer on this account is liable to be deleted. The Tribunal has further confirmed, based on the facts involved, that mere reimbursement of expenses, being lab-testing charges, cannot be considered as fees for technical services (FTS) in the hands of the taxpayer receiving such reimbursement from its Indian subsidiary.

In detail

Facts

- The taxpayer is a tax resident of Austria and has an Indian subsidiary (I Co). The taxpayer had earned the following revenue from India during the financial year 2012–13.
  - Income from services rendered to I Co: offered to tax in the tax return
  - Reimbursement of expenses incurred for lab-testing charges outside India: claimed as exempt income in the tax return
  - Offshore sale of goods and other tangible assets to Indian customers: not offered to tax in the tax return

[1] ITA No. 286/Del/2023

- During the re-assessment proceedings, the tax officer (TO) examined the taxpayer's claim of exemption regarding business income from offshore sale and income from reimbursement. The TO *inter alia* was of the view that the taxpayer procured business in India through I Co and concluded that the taxpayer had allegedly deputed its expatriate personnel in order to supervise and provide repair services to I Co. The TO accordingly concluded that the taxpayer had a fixed place PE in India in the form of I Co and attributed profit @ 3.5% to the taxpayer on a presumptive basis by invoking rule 10 of the Income-tax Rules, 1962. The TO further concluded that, in the absence of any documentary evidence, income received on reimbursement pertains to technical services provided by the taxpayer during the year. Before the Dispute Resolution Panel (DRP), the taxpayer filed further additional evidences to support its claim of exemption in the return of income. The DRP, in sum and substance, endorsed the TO's views.

- The taxpayer, *inter alia*, reiterated its facts before the Tribunal, highlighting that the sale was directly made to the Indian customer, and the Indian subsidiary did not perform any services as regards the sale to such Indian customers, as evidenced by invoices raised on customers, bills of lading, etc. The taxpayer also submitted that no business connection exists in India to attract the provisions of section 9 of the Income-tax Act, 1961. The taxpayer further submitted that the reimbursement received was purely at cost with no added value by the taxpayer, while relying on the copy of invoices from concerned test laboratories, management notes, etc.

Tribunal's ruling

PE allegation and profit attribution on account of offshore sales

- The Tribunal has observed that the documentary evidence filed by the taxpayer was not appreciated in the right context. On perusal of the evidence thus filed, the Tribunal has observed the following factual aspects in connection with the offshore sale conducted by the taxpayer:
  - Delivery was made outside India.
  - Payments were received outside India.
  - Export to Indian customers was on a principal-to-principal basis.
- The Tribunal has rejected the contentions of the TO and DRP. It has concluded that the tax authorities had erred in alleging the PE in India on the mere assumption that since the taxpayer had a subsidiary in India, whatever export sale was made by it to Indian entities was with the indulgence of the said subsidiary; without substantiating as to how Indian subsidiary was privy to the purchases by other entities.
- The Tribunal has further observed that the taxpayer was alleged to have neither any fixed place of business in the form of a branch office, project office, liaison office, godown, etc. in India, nor was any employee found working in India. Thus, the Tribunal has struck down the allegation of a PE merely based on the existence of the taxpayer's subsidiary in India. The Tribunal concluded that there is no basis for consequential attribution of the profit to the taxpayer's income.

Reimbursement receipts characterised as FTS income

- The Tribunal has perused the additional evidence submitted by the taxpayer. Accordingly, the Tribunal has observed, *inter alia*, that the TO and DRP had erred in considering the reimbursement income as substantially FTS in nature and taxing the same as FTS.
- The Tribunal, in its considered view, concluded that the taxpayer had not added any value to the laboratory report or played any role except for being a medium to procure a report from a laboratory having higher credibility.
- Accordingly, the Tribunal concluded that mere reimbursement cannot be considered as having the nature of FTS income in the hands of the taxpayer.

The takeaways

The Tribunal, while deciding on the facts of the case, has reiterated the position that to establish the existence of a PE, mere assumption or inference by the tax authorities that existence of an Indian subsidiary constitutes a PE, is not sufficient. The tax authorities should prove with supporting evidence that the Indian subsidiary was in fact involved in the sale of goods by the non-resident taxpayer.

The Tribunal, based on the factual evidence, also upholds the principle that mere reimbursement of testing charges by an Indian company should not be taxable in India. This underscores the existing legal position in respect of the taxability of reimbursements.

The above ruling also highlights the importance of keeping relevant factual documentation on the issue pertaining to PE and reimbursements as well as understanding how the same is critical for the actual outcome.

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