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News Alert
14 June 2013



No income accrues or arises in India to a non-resident assessee on carrying out sourcing activities for its affiliates or buyers through a liaison office established in India

Activities limited to quality check to make goods suitable for international market and other allied activities through liaison office in India does not form a business connection in India

Background

In a recent ruling in the case of Nike Inc¹ (assessee), the Karnataka High Court (HC) held that the activities carried out by a liaison office (LO) in assisting foreign buyers in the purchase of goods from Indian manufacturers do not give rise to any income of LO which accrues or arises in India. Also, no business connection of the

non-resident assessee is formed through the liaison office in India, since the subject services are limited to the purchase of goods for the purpose of export.

Facts

- The assessee is a global brand in the field of sports apparel, etc. (goods) and is based out of the US.

¹ ITA No. 976, 978, 979 & 982 of 2008 and ITA No. 341, 342, 343& 344 of 2009

- The assessee has associated enterprises and distributors (buyers) across the globe who sell goods under the assessee's brand.
- Through its office in the US, the assessee assists buyers in activities such as designing, marketing and distribution of goods. The assessee does not manufacture goods on its account but arranges for buyers the sources for procurement of goods and also assists them in identifying the manufacturers of products who can manufacture goods in accordance with the requirement of the assessee and its buyers.
- With a view to spread its operations, the assessee set up an LO in India in accordance with the guidelines issued by the Reserve Bank of India (RBI) and subject to restrictions as imposed by the RBI.
- The assessee established the LO in India mainly to ensure timely and quality delivery of goods along with assistance in identification of manufacturers.
- The LO gives its opinion on the reasonability of price charged and quality of the goods, whereas the decision to finalise a manufacturer is always with the US office. The decision of the US office is directly communicated to the manufacturer and the LO has no role to play in it.
- The goods are directly shipped by the manufacturer to the buyers and the sale consideration is directly paid to the manufacturer for the purchase of goods. No payment is made to the LO as the contract is between the manufacturer and the assessee as an agent of buyers. Further, all the expenditure incurred by the LO is met by the US office.
- The tax authorities alleged that the activities of the LO were beyond the approval of the RBI and the LO was engaged in business-generating activities in India. The Income-tax Appellate Tribunal ruled in favour of the assessee and the tax department approached the HC.

Issues before the High Court

- Whether the activities carried on by the assessee in relation to identification of the manufacturer of its product, identification of supplier, quality control check, supervision, dispatch of goods to buyers and time schedule through an LO in India give rise to any income which accrue or arise or are deemed to accrue or arise in India?

Assessee's contentions

- Activities carried on by the LO in India are ancillary and auxiliary to the activities of its head office (i.e. US office) and its buyers.
- The LO acts as a communication channel between the head office and the manufacturers in India and all decisions are undertaken by the US office.
- Entire expenditure of the LO is met by the assessee from the US office and no consideration is received by the LO from the buyers elsewhere. Accordingly, no business activity is carried on by the assessee in India.
- No income can be deemed to accrue or arise in India to the company in view of Explanation 1(b) to clause (i) to sub-section (1) of section 9 of the Income-tax Act, 1961 (the Act), since the operations of the assessee are confined to the purchase of goods in India for export to its buyers.
- The assessee is covered by circular no. 20 dated 7 July 1964 wherein it was clarified by the Central Board of Direct Taxes that a non-resident will not be liable to tax in India on any income attributable to operations confined to the purchase of goods in India for the purpose of export, even though the non-resident may have an office or an agency in India or the goods may be subject to any manufacturing process before being exported from India.

Revenue's contentions

- In the present case, activities carried on by the non-resident through its LO in India are beyond the activities an LO is allowed to perform. For instance, provision of various data like identification of manufacturer, placing orders with the manufacturer, providing training to the employees of manufacturer, availability of raw materials, list of suppliers of raw material, cost of raw material and quality checks, etc.
- The assessee carries on business through its LO in India and therefore, income accrues or arises in India in terms of clause (b) of sub-section 2 of section 5 of the Act.
- The assessee has a business connection in India and accordingly, income is deemed to accrue or arise to it in India under clause (i) of sub-section (1) of section 9 of the Act.

High Court Ruling

- The HC endorsed the Tribunal's view that the activities of the assessee through its LO are limited to assisting buyers in the purchase of goods and it has no right over the income earned by buyers. Hence, no income can be deemed to accrue or arise in India by rendering such activities.
- It observed that even if it is held that goods supplied to buyers are deemed to be supplied to the assessee, the object of this transaction is to purchase goods for the purpose of export, well within the exclusion clause of section 9 of the Act read along with Explanation 1(b) to the clause (i) of sub-section 1 of section 9 of the Act. Also, the HC clarified that the term 'business connection' shall not include any business activity in its ambit in relation to or limited to the purchase of goods or merchandise for a non-resident.

- The HC, keeping in mind the object of the legislature to encourage exports to earn foreign exchange by deleting the proviso to Explanation 1(b) to clause (i) of sub-section (1) of the section 9 of the Act by the Finance Act, 1964 held that no income can be deemed to accrue or arise in India to the assessee by maintaining office in India for sourcing activitiesSection 145A.

Conclusion

The HC has laid down an important principle that the activities of facilitating the procurement of goods for buyers through an LO in India cannot be said to be taxable in India as the LO does not have any business connection in India and its activities can at best be regarded as purchase for the export of goods. This falls under a category exempt under the Act.

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