Decoding the Principles for Constitution of Fixed Place PE

The taxation of Permanent Establishments ('PE') is one of the most important concepts in International taxation. The potential exposure to a PE is a major concern amongst the corporate houses having international presence. With the advent of globalisation, India has become a hub for many multinational enterprises to set up their businesses. While a foreign enterprise can establish the presence in India in different forms (viz. branch, subsidiary company, liaison office, etc.), one of the vital parameters for choosing the type of entity in which presence is to be established, is the taxability of income from Indian operations.

Section 9(1)(i) of the Income-tax Act, 1961 ('the Act'), inter alia, includes income arising in India through or from any business connection in India. As per Article 7 of the bilateral tax treaties entered into by India ('tax treaties'), business profits of the foreign enterprise are taxed in India only if it carries on the business in India through a PE. Thus, once presence of the foreign enterprise in the form of a PE is established, the income attributable to operations in India becomes taxable. Para 1 of Article 5 provides that PE means a 'fixed place of business' through which the 'business of an enterprise' is wholly or partly carried on. The determination of PE requires carrying out a functional and factual analysis of activities undertaken by the foreign enterprise.

In the aforesaid backdrop, the endeavour of this Article is to throw light upon some of the recent decisions on fixed place PE highlighting the key principles propounded by the judicial authorities in said cases. While these decisions also deliberate upon the issue of service PE, agency PE, etc. for the sake of brevity, we have limited our discussion on findings related to fixed place PE in this Article.

I. SC Ruling in the case of E-Funds IT Solution Inc.[1]

Recently, Supreme Court ('SC') in the case of *E-Funds IT Solution Inc.* has held that the outsourcing of work to an Indian company would not create a fixed place PE. It observed that in the given case, no part of the main business and revenue earning activity of foreign enterprise is carried through a fixed business place in India and therefore, it didn't have fixed place PE in India.

(Contributed by Committee on International Taxation of the ICAI. Comments can be sent to citax@icai.in.)

[1] *ADIT vs. M/s E-Funds IT Solution Inc.[(2017)(399 ITR 34)(SC)]*

a. Facts of the case

- E-Funds Corp and E-Fund Inc. (referred to as 'the taxpayers'), residents of United States of America ('USA') are engaged in the four businesses, namely, ATM management services, electronic payment management, decision support/risk management and global outsourcing and professional services.
- E-Fund India, an indirect wholly owned subsidiary of E-Funds Corp, performed certain activities outsourced to it by taxpayers i.e. back office and data entry operations in respect of above businesses.
- The Assessing Officer ('AO') alleged that the taxpayers had a fixed place PE in India (i.e. e-Fund India) from where they carried on their own business. The Commissioner of Income Tax Appeals ('CIT(A)') as also the Income Tax Appellate Tribunal ('ITAT') upheld the decision of the AO. The High Court observed that e-Fund India is a separate entity entitled to provide services to the taxpayers. Further, due to interaction/cross transactions between Indian subsidiary and the foreign principal, it will not become PE under Article 5(1) of the India USA tax treaty. The High Court observed that the manner and mode of the payment of royalty/associated transactions is not a test for determining whether fixed place PE exists and held that taxpayers did not have a PE in India.

b. Issue under consideration

Whether mere outsourcing business to Indian subsidiary would create a fixed place PE for taxpayers in India?

While determination of PE is purely a fact driven exercise, with the time evolution, the judiciaries have tried to establish the substance of the arrangement between Indian and foreign enterprise basis agreements, employee engagements etc. The principle criteria being laid down as per respective tax treaty, such decisions provide some guidance value on factors relevant/not relevant for applying such criteria.

c. Supreme Court's Ruling[2]

- The burden of proving that a foreign taxpayer has a PE in India and, therefore, suffers tax from the business generated from such PE, is initially on the tax department. In the absence of any specific finding in the assessment/appellate orders to this effect, it could not be established that the taxpayer has a PE in India.
- The Hon'ble Court for interpretation of fixed place PE, applied the principles in case of Formula One World Championship Ltd[3] (discussed in detail in subsequent paragraph) held that there must exist a fixed place of business in India at the disposal of the taxpayers, through which they carry on their own business.
- The Court observed that the lower authorities adopted a fundamentally erroneous approach in saying that contracting with 100 per cent subsidiary to which a business activity is outsourced, resulted in the creation of PE. The criteria adopted by them i.e. close association between e-Fund India and the taxpayers, functions performed, assets used and risk assumed are not proper/appropriate tests to determine if fixed place of business exists.
- While examining the report on nature of business of tax payers, it observed that no part of the main business/revenue earning activity of the taxpayers is carried on through a fixed business place in India which has been put at their disposal.
- It is clear that the Indian company only renders support services, which in turn enable the taxpayers to render services to their clients abroad. This outsourcing of work by taxpayer to India (i.e. to Indian subsidiary) would not give rise to a fixed place PE. Further, reliance placed by the tax department on the United States Securities and Exchange Commission Form 10K Report was misplaced as it speaks of the e-Funds group of companies worldwide as a whole.

II. Other Key Rulings

1. SC Ruling in case of Formula One World Championship Ltd.

a. Facts of the case

- Formula One World Championship Ltd. ('the taxpayer') a UK resident, is commercial rights

[2] While the decision also deliberates upon the issue of service PE and agency PE, for the sake of brevity, we have limited our discussion only on fixed place PE

[3] *Formula One World Championship Ltd. vs. CIT (IT) [(2017)(394 ITR 80)(SC)]*

For a place to be at the disposal of foreign enterprise, the enterprise should have right to use and control said place. The close association between Indian company and foreign enterprise, risk assumed by an Indian company etc. are not appropriate tests for determining PE status. The factual determination that the foreign enterprise is able to carry its business through the fixed place in India is essential.

holder in respect of the Formula One World Championship. It acquired the said rights by entering into an agreement with Federation Internationale de I' Automobile ('FIA') and Formula One Asset Management Limited.

- To participate in every F-1 event, participant teams, known as 'Constructors', enter into a contract with the taxpayer and the FIA.
- Jaypee Sports International Limited (herein referred to as 'Jaypee') entered into 'Race Promotion Contract' with the taxpayer for a consideration of USD 40 million and acquired the right for hosting, staging and promoting the F-1 Grand Prix of India event. They also entered into another agreement for use of certain marks and intellectual property belonging to the taxpayer.
- Being approached to Authority for Advance Rulings ('AAR') to determine the taxability of above-mentioned payments, AAR held that the taxpayer did not have PE in India and treated the consideration as royalty under the tax treaty/the Act. The issue was further appealed before Delhi High Court which reversed the ruling of Authority on both the counts. It observed that taxpayer had full/ exclusive access (through its personnel, racing/ spectator team) to the Buddh International Circuit. Taking note of the arrangement and the agreements, it concluded that the taxpayer carried on business in India within the meaning of Article 5(1) of the tax treaty, and thereby created PE in India. A further appeal was filed before Supreme Court.

b. Supreme Court's Ruling

- A combined reading of sub-articles (1), (2) and (3) of Article 5 would clearly show that only certain forms of establishment are excluded as mentioned in Article 5(3), which would not be PEs. Otherwise, sub-article (2) uses the word 'include' which means that not only the places specified therein are to be treated as PEs, the list of such PEs is not exhaustive. In order to bring any other establishment which is not specifically mentioned, the requirements laid down in sub-article (1) are to be satisfied. Twin conditions which need to be satisfied are: (i) existence of a fixed place of business; and (ii) through that place of business an enterprise wholly or partly carried out its business.
- Also, such physically located premises have to be 'at the disposal' of the enterprise. The place would be treated as 'at the disposal' of the enterprise when the enterprise has right to use the said place and has control thereupon.
- In the given case, Buddh International Circuit is a fixed place. From this circuit, different races, including the Grand Prix is conducted, which is undoubtedly an economic/business activity.
- On the basis of the arrangement in the given case, the Hon'ble Supreme Court found that the entire event is taken over and controlled by the taxpayer and its affiliates. There cannot be any race without participating/competing teams, a circuit and a paddock. All these are controlled by the taxpayer and its affiliates. Event has taken place by conduct of race physically in India. Entire income is generated from the conduct of this event in India. Thus, commercial rights are with the taxpayer which are exploited with actual conduct of race in India.
- Even the physical control of the circuit was with taxpayer/its affiliates from the inception. Omnipresence of the taxpayer and its stamp over the event is loud, clear and firm. Mere construction of the track by Jaypee at its expense will be of no consequence.
- With respect to limited duration of event which was for 3 days, the High Court has rightly concluded that for the entire duration taxpayer had full access through its personnel, number of days for which the access was there would not make any difference.
- One could clearly discern that conducting F-1 Championship at Buddh International Circuit, which is a fixed place, was a virtual projection of the foreign enterprise, namely taxpayer, on the soil of India and, therefore, it led to the creation of fixed place PE in India.

2. Delhi Tribunal Ruling in case of GE Energy Parts Inc[4].

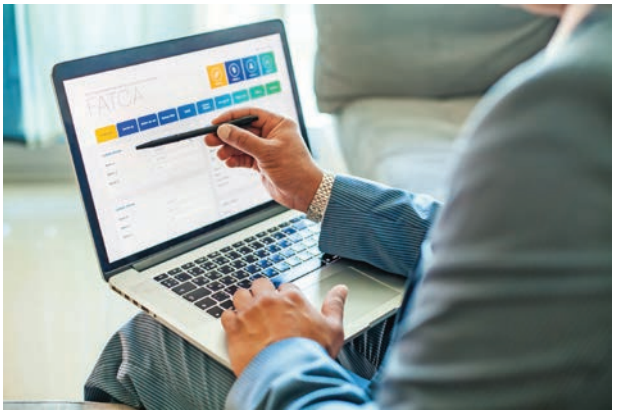
a. Facts of the case and issue under consideration

- The overseas group entities of GE (collectively referred to as 'GE Overseas or the taxpayer') which includes the assessee - GE Energy Parts Inc., supplies equipment to Indian customers. It is engaged in various sales activities in India. For these operations, expatriates were appointed, who were on the payroll of GE International Inc. ('GEII') but working for various businesses of GE group.
- One of the group entity of taxpayer - General Electric International Operations Company Inc. ('GEIOC') had a liaison office ('LO') in India. It had entered into a global service agreement with an Indian company, namely GE India Industrial Pvt. Ltd. ('GEIIPL') to provide certain support services.
- The expatriate employees of GEII located in India and employees of GEIIPL engaged in providing marketing support services for offshore sales into India (collectively referred as 'GE India') was using the LO premises of GEIOC.
- The issue under consideration is whether the taxpayer was conducting the business in India from LO premises which would constitute fixed place PE?

b. Tribunal's Ruling

- On a conjoint reading of the relevant parts of paras 1, 2 and 3 of Article 5, following three ingredients must be cumulatively satisfied for bringing a case within the ambit of a fixed place PE:
  - There should be fixed place of business;
  - Business of foreign enterprise should be wholly or partly carried on from such fixed place; and
  - The activities carried out from such fixed place should not be in the nature of a preparatory or auxiliary character.

  What is relevant is the availability of the place at the disposal of the enterprise irrespective of any ownership, lease or other occupancy rights.
- GE India was permanently using the LO premises of GEIOC. While the expatriate employees of GEII were working in India for the GE Overseas entities (though on the pay roll of GEII), the employees of GEIIPL were working under the direct control and supervision of them. Thus, the condition of carrying on fixed place of business is fulfilled.
- Referring to job descriptions, appraisal reports etc., the Tribunal found that the expatriates were India Country heads or working at the top positions, managing the business, securing orders and doing everything possible that could be done *qua* the Indian operations of GE overseas entities. It was in full command of the sales activities in India, not allowing GE overseas even to interfere with what they had agreed with the customer in India. It was found that GE India was conducting business of GE Overseas in India and was directly/wholly involved in negotiating and finalising the contracts.
- With respect to preparatory or auxiliary activities, if the activity carried on from a fixed place in India is simply in aid/support of the core income generating activity, remote from the actual realisation of profits, then same assumes the character of a preparatory or auxiliary nature. Since GE India carried on substantial/ core activities from the LO premises, it may not fall under the exclusion of preparatory or auxiliary activities.
- Thus, since all the three conditions for constituting a fixed place PE under Article 5 of



Mere rendering of support services by Indian affiliate (which would enable the foreign enterprise to carry on its business activity) may not constitute PE. The business of foreign enterprise should actually be conducted by Indian affiliate.

[4] GE Energy Parts Inc. vs. ADIT [(2017)(56 ITR (T) 51)(Delhi Trib)]

the tax treaty are fully satisfied, the LO premises constitute a fixed place PE of the taxpayer.

3. Delhi Tribunal Ruling in Case of Net App BV[5]

a. Facts of the case and issue under consideration

- Net App B.V. ('the taxpayer') a Netherlands based non-resident company (an indirect subsidiary of another group company - NetApp USA), is engaged in the business of selling storage system equipment and products including embedded software and rendering certain other services in India.
- NetApp India Private Limited ('Indian company'), a subsidiary of NetApp USA, provides marketing and sales support services to the taxpayer.
- The issue under consideration is whether the Indian company constitutes a fixed place PE of the taxpayer in India?

b. Tribunal's Ruling

- According to the Article 5 (1) of the tax treaty, PE means a fixed place of business through which the business of the enterprise is wholly or partly carried on.
- The Tribunal observed that there needs to be a clear-cut distinction between the business of the taxpayer and business of the Indian company for its own purposes. In the instant case, the Indian company is merely a service provider to the taxpayer. It would not be appropriate to say that where a person opts for service in relation to his business from another person, then the service provider carries on the business of the service recipient.
- There is no evidence to establish that the taxpayer takes significant/strategic decisions relating to its global business in India. In fact, board meetings of the appellant company/ taxpayer are held outside India and, therefore, there cannot be fixed place of PE in India.
- Transfer pricing dispute in the assessment proceedings of the Indian entity does not have any bearing on the determination of PE of the taxpayer.

III. Parting Thoughts

While determination of PE is purely a fact driven exercise, with the time evolution, the judiciaries have tried to establish the substance of the arrangement between Indian and foreign enterprise basis agreements, employee engagements etc. The principle criteria being laid down as per respective tax treaty, such decisions provide some guidance value on factors relevant/not relevant for applying such criteria. The key takeaways propounded from decisions referred in this article are listed as under:

Mere construction of the place of business by Indian company will be of no consequence. The number of days for which the access is given would not make any difference, as long as full access to a particular thing/ place is given.

- For a place to be at the disposal of foreign enterprise, the enterprise should have right to use and control the said place.
- The close association between Indian company and foreign enterprise, risk assumed by an Indian company etc. are not appropriate tests for determining PE status. The factual determination that the foreign enterprise is able to carry its business through the fixed place in India is essential.
- Mere rendering of support services by Indian affiliate (which would enable the foreign enterprise to carry on its business activity) may not constitute PE. The business of foreign enterprise should actually be conducted by Indian affiliate.
- Mere construction of the place of business by Indian company will be of no consequence.
- The number of days for which the access is given would not make any difference, as long as full access to a particular thing/place is given. ■

[5] Net App B.V. vs. DDIT [(2017)(78 taxmann.com 97)(Delhi Trib)]

However difficult life may seem, there is always something you can do and succeed at. - Stephen Hawking