



A foreign company constitutes a service PE in India under the India-UAE tax treaty. Services provided in the form of sharing or permitting to use the special knowledge or expertise falls within the term 'royalty' under the tax treaty

Background

Recently, the Bengaluru Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of ABB FZ-LLC¹ (the taxpayer) held that the taxpayer had a Service Permanent Establishment (PE) in India since the taxpayer has been furnishing services to the Indian company even without any physical presence of its employees in India. In the present age of technology where services, information, consultancy, management, etc. can be provided with various virtual modes such as email, internet, video conference, remote monitoring, remote access to the desktop, etc., through various software. It is not the stay of the employees for more than nine months, but it is rendering of services or activities which are required to be rendered for a period of nine months. Service PE is not dependent upon the fixed place of business as it is only dependent upon the continuation of the activity.

The Tribunal also held that the services provided by the taxpayer were in the form of sharing or permitting to use the special knowledge, expertise and experience of the taxpayer and it falls under the term 'royalty', under Article 12(3) India-UAE tax treaty (the tax treaty). The visits of the officials of the taxpayer were only for the purposes of providing access for using the information pertaining to industrial/commercial/scientific experience and to help commercially exploit it. The dominant character of agreement between the taxpayer and Indian company was for sharing the secret, confidential and Intellectual Property Rights (IPRs) information made available. The Tribunal observed that tax treaty clearly uses the word for the 'use of' or 'right to use of', commercial, scientific equipment and has not used the word either 'imparting' or 'alienation' of knowhow. The language used in the tax treaty is plain and

unambiguous, and therefore the reading of words 'alienation' or 'imparting' of know-how in the tax treaty would not be permissible.

Facts of the case

- The taxpayer is UAE-based entity engaged in the business of providing regional service activities for the benefit of ABB legal entities in India, Middle East, and Africa. In pursuance of the regional headquarter service agreement between the taxpayer and ABB Limited, the taxpayer has rendered services to ABB Limited during Financial Year (FY) 2009-10 and 2010-11. In terms of the agreement, the taxpayer has received payment from its associate concern.
- The taxpayer claimed that the above amounts are not taxable in India under the tax treaty, as the tax treaty does not have a clause for Fees for Technical Services (FTS) and since this clause has been specifically excluded from the treaty, the taxability would fall under Article 22 of the tax treaty. As per Article 22 of the tax treaty, the amount would be taxable in India only if the entity has a PE in India and in the instant case since there is no PE in India, the sum is not liable to be taxed in India.
- The Assessing Officer (AO) held that the services rendered by the taxpayer would be treated as FTS both under the Income-tax Act, 1961 (the Act) and under the tax treaty as prescribed under Explanation 2 to Section 9(1)(vii) of the Act. In an alternative argument, the AO held that most of the

¹ ABB FZ-LLC v. DCIT [ITA(TP) No. 1103/Bang/2013] – Taxsutra.com

services rendered by the taxpayer were covered under the definition of 'royalty' as per the Explanation 2(ii), 2(iv) and 2(vi) under Section 9(1)(vi) of the Act, as well as under Article 12(3) of the tax treaty.

- The Dispute Resolution Panel (DRP) confirmed the order of the AO.

Tribunal's decision

Eligibility of tax treaty benefit

- For the purposes of availing the tax treaty benefit, the taxpayer is required to furnish a certificate being a resident of the other country. In the present case, though the taxpayer is incorporated in the UAE, but the Tax Residency Certificate (TRC) has not been furnished before the lower authorities. In the absence of any such findings by the lower authorities and also in the absence of evidence produced by the taxpayer, it is difficult to give the benefit of the tax treaty to the taxpayer.
- It is for the taxpayer to furnish the certificate of residence of UAE and the onus is on the taxpayer to prove that the taxpayer is managed and controlled wholly in UAE. There is an inbuilt purpose for satisfying these twin conditions namely to prevent treaty shopping and to ensure that the benefits under the tax treaty should only be available to legal entities having *bona fide* business activities in the contracting states.
- The taxpayer has filed a certificate of residence issued by the UAE authorities. However, this certificate was issued only for a period of one year, with effect from 1 April 2012 whereas the AYs under consideration are 2009-10 and 2010-11. Therefore this certificate would not help the taxpayer as this is not relevant for the years under consideration.
- Thus, the taxpayer cannot be treated as a resident of UAE at the filing of returns of income within the meaning of Article 4 of the tax treaty. Further, the taxpayer has not provided any evidence showing that the taxpayer was wholly managed and controlled in UAE. Accordingly, the taxpayer is not entitled to any tax treaty benefits.

Taxability under Article 22 of the tax treaty

- For the purposes of falling in 'other income' under Article 22 of the tax treaty, it is necessary that the income should not be expressly dealt in Articles 6 to 21 of the tax treaty. If it is held that

the income is not falling within Articles 6 to 21, then the said income would fall within the category of 'other income'. The Bengaluru Tribunal in the case of IBM India Ltd² has held that if the income is not falling under any of the categories mentioned in the tax treaty, then it will fall in residual Article 22 of the tax treaty.

- In our view, the Article 22 of the tax treaty would become redundant if residual income is to form part of business income. Any income which is also not forming part of business profit under Article 7 as well would also form part of the residual clause under Article 22 of the tax treaty. Therefore residual clause (Article 22) would become part of business profit (Article 7) would make the Article 22 incongruous and otiose.

Permanent Establishment

- Furnishing of services including consultancy services by the taxpayer to ABB Ltd for the project in India or with the connected project was for a period of three months after commencing its activities in January 2010. Thus, it fulfills the prerequisite of Service PE and Service PE do not require fixed place PE as well.
- In the present age of technology where the services, information, consultancy, management, etc., can be provided with various virtual modes like email, internet, video conference, remote monitoring, remote access to desk-top, etc., through various software, therefore, the argument of fixed place of business raised by the taxpayer that three employees were rendered services only for 25 days cannot be sustained, as the services can be rendered without the physical presence of employees of the taxpayer.
- The Article 5(2)³ of the tax treaty is by the way inclusive definition in nature and the definition given in Article 5(1)⁴ of the tax treaty has been enlarged by Article 5(2) of the tax treaty.

² IBM India P. Ltd v. DDIT [IT(IT)A Nos. 489 to 498/Bang/2013, dated 24 January 2014]

³ The term "permanent establishment" includes especially:

- (a) a place of management ;
- (b) a branch ;
- (c) an office.....
- (d)
- (e)
- (f)
- (g)

(i) The furnishing of services including consultancy services by an enterprise of a Contracting State through employees or other personnel in the other Contracting State, provided that such activities continue for the same project or connected project for a period or periods aggregating more than nine months within any twelve-month period.

⁴ The term permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Therefore, Article 5(2) of the tax treaty do not require the fulfillment of Article 5(1) of the tax treaty. The Supreme Court has decided the inclusive clauses in various decisions⁵. Thus, it has been held that the Article 5(2) is independent clause and the condition of having fixed place PE under Article 5(1) is not attracted for PE under Article 5(2) of the tax treaty.

- It is not the stay of the employees for more than 9 months, which is required to be there but it is a fact of rendering of services or activities which were required to be rendered for a period of nine months. On perusal of reply of the taxpayer, it indicates that the taxpayer: (a) Has rendered the services through its three employees and their stay was for 25 days; and (b) As is clear from the second reply, the taxpayer has rendered the services on various occasions from January to March 2010.
- The providing of services for a period of nine months is stipulated in the period of 12 months. Once the activity of the taxpayer commenced only in the month of January 2010, then the argument of completing 9 months service before March 2010, is preposterous, implausible and against common sense. It is not expected to complete the nine months between January to March 2010.
- The completion of 9 months activities by the enterprise was only conceived in a period of 12 months. However, it is not disputed by the taxpayer that it continues to render the services with effect from January 2010 and thereafter also in the subsequent assessment year. If we give a literal interpretation to clause 5(2)(i) of the tax treaty, then it is clear that the services are required to be rendered by the enterprise through its employees or other personnel for a period of nine months within any 12 months period.
- Relying on the decision of the Supreme Court in the case of *Calcutta Knitwears*⁶ it has been observed that the requirement of fixed place of business is not applicable to the clauses (2), (4) and (5).
- Article 5(2)(i) of the tax treaty provides that the Service PE is not dependent upon the fixed place of business as it is only dependent upon the continuation of the activity the same project or connected project for a period/periods aggregating to more than 9 months within 12 months period. Accordingly, it has been held that the taxpayer has a Service PE in India. However, the determination of this issue will only have any bearing on the issues under considerations if on

the examination of the facts the Tribunal come to the conclusion that the activities of the taxpayer do not fall in any of the Article of the tax treaty.

Taxability of Royalty

- The activities rendered by the taxpayer were in the form of sharing or permitting to use the special knowledge, expertise, and experience of the taxpayer, and was shared by it with ABB Ltd. squarely falls within the realm of 'royalty', as defined in Article 12(3) of the tax treaty.
- The visits of the officials of the taxpayer were only for the purposes of providing access for using the information pertaining to industrial/commercial/scientific experience belonging to the taxpayer and to help ABB Ltd to commercially exploit it. The dominant character of agreement between the taxpayer and Indian company was for sharing a secret, confidential and IPRs information made available during the years.
- The information provided by the taxpayer to ABB Ltd was in the nature of a know-how contract, given by the taxpayer so that such know-how can be used by ABB Ltd for its commercial and industrial purposes and further this special knowledge and experience would remain unrevealed to the public.
- This information was not already existing and was supplied by the taxpayer after its development or creation to ABB Ltd, and there also exist specific provisions concerning the confidentiality of these information. Moreover, the taxpayer has done little after giving access to this information to ABB Ltd. Thus, the information provided by the taxpayer to ABB Ltd with the right to use and exploit commercially were concerning industrial, 'commercial or scientific experience activities and would fall under the royalty provision of the tax treaty.
- In the India-UAE tax treaty in Article 12(3), the term 'royalty' has been differently defined than what it was defined in the India-Thailand tax treaty in the case of *Gecf Asia Ltd*⁷ as the expression alienation and imparting is not used in the treaty. In that case the Tribunal was discussing the issue of India-Thailand tax treaty in respect of 'royalty', and as held if there is imparting or alienation of any know-how while rendering the service on account of information concerning industrial, commercial and scientific expertise than it is royalty and if there is no alienation or use of any right to use of know how or, then it cannot be termed as 'royalty'.

⁷ *GECF Asia Ltd v. DDIT* [2014] 65 SOT 257 (Mum)

⁵ *Ramala Sahkari Chini Mills Ltd v. CCE* (2010) (13) SCR 1152

⁶ *CIT v. Calcutta Knitwears* [2014] 362 ITR 673 (SC)

- In our view the tax treaty under consideration clearly uses the word for the 'use of' or 'right to use of', commercial, scientific equipment and has not used the word either 'imparting' or 'alienation' of knowhow. The tax treaty entered into between the two contracting states is a complete code in itself and is required to be strictly interpreted. The language used in the clause under consideration is plain and unambiguous and therefore reading of words 'alienation' or 'imparting' of know how in the treaty would be tantamount to rewriting the treaty by this Tribunal, which is not permissible.
- Following the rules of interpretation of statute as held by the Supreme Court in the case of Calcutta knitwear⁸ and in the case of Raghunath Rai Bajera⁹ restrictive meaning is required to be given to the tax treaty between India and UAE.
- As we had held that the activities under consideration of the taxpayer falls under Article 12 of the tax treaty and not under residual clause, therefore the taxpayer is liable to be taxed in India in accordance with Article 12 of the tax treaty, Section 5 read with Section 9 of the Act.
- The various decisions¹⁰ relied on by the taxpayer are distinguishable on facts of the present case. Moreover, on examination of the agreement and information provided by the taxpayer to ABB Ltd, with a right to use the said information, was held by us to be 'royalty'. Therefore once payment of any kind received as a consideration for the use for the use of or the right to use, industrial, commercial or scientific equipment by the taxpayer it will fall within the realm of royalty as per the tax treaty.

Our comments

The issues with respect to a foreign company having a PE in India as well as the taxability of royalty/FTS has been a subject matter of debate before the Courts/Tribunal.

An issue arises whether the threshold of 9 months should be applied with reference to either a 'calendar year' or a 'fiscal year' or a '12-month period' or, alternatively, the 'entire period' for which services are furnished in State S. It appears that the '183-day' threshold has to be calculated on the basis of the 'entire period' for which services have been furnished

in State S although such period may span across various years¹¹. As per the Indian courts¹², the '183-day' threshold has to be determined based on the relevant fiscal year of State S (i.e. 1 April to 31 March in the case of India).

Both the types of decisions presuppose the existence of physical presence of employees, etc. in the source state. However, the Tribunal in the instant case has held that without any physical presence of employees the taxpayer had a service PE in India. It is not the stay of the employees for more than 9 months, but it is rendering of services or activities which are required to be rendered for a period of nine months, and the taxpayer was providing such services remotely using modern technology.

On the issue of royalty, the Mumbai Tribunal in the case of Preroy A.G.¹³ while dealing with India-Switzerland tax treaty observed that the consideration for information concerning industrial, commercial and scientific experience is to be regarded as royalty, only if it is received from imparting know-how. However, providing strategic consulting services, which may entail the use of technical skills and commercial experience by a strategic consultant, does not amount to know-how being imparted to the buyer of the strategic consulting services. Since the taxpayer was only rendering consultancy services, it did not impart any know-how to the Indian company. Therefore, the receipts cannot be termed as royalty under Article 12(3) of India-Switzerland tax treaty. Various Courts/Tribunal have held on the same line¹⁴.

However, the Tribunal in the present case while distinguishing the case of Geef Asia Ltd observed that under the India-UAE tax treaty, the term 'royalty' has been differently defined than what it was defined in the India-Thailand tax treaty as an expression alienation and imparting is not used in the treaty. The India-UAE tax treaty clearly uses the word for the 'use of' or 'right to use of', commercial, scientific equipment and has not used 'imparting' or 'alienation' of knowhow. The language used in India-UAE tax treaty is plain and unambiguous and therefore reading of words 'alienation' or 'imparting' of knowhow in the treaty would be tantamount to rewriting the treaty by this Tribunal, which is not permissible.

¹¹ IBFD Case No. 95/13/0137 (Supreme Administrative Court of Austria)

¹² See the discussion in Bangkok Glass Industry Co. Ltd. v. ACIT [2013] 34 taxmann.com 77 (Mad)

¹³ DDIT v. Preroy A.G. [2010] 39 SOT 187 (Mum)

¹⁴ Diamond Services International (P.) Ltd. v. UOI [2008] 304 ITR 201 (Bom), Spice Telecom v. ITO [2008] 113 TTJ 502 (Bang), Mckinsey & Co. (Thailand) Co. Ltd. v. DDIT [2013] 36 taxmann.com 375 (Mum), GEFC Asia Ltd. v. DDIT [2014] 65 SOT 257 (Mum)

⁸ CIT v. Calcutta Knitweaves [2014] 362 ITR 673 (SC)

⁹ Raghunath Rai Bajera v. Punjab National Bank (2007) (2) SCC 230

¹⁰ CIT v. HEG Ltd [2003] 130 Taxman 72 (MP), Diamond Services International P. Ltd., v. UOI [2008] 169 Taxman 201(Bom), OECF Asia Limited v. DDIT [2014] 65 SOT 257 (Mum)

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