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TAX FLASH NEWS

18 September 2019

German company does not have a PE or business connection in India for sale of cars on a principal to principal basis to its associated enterprise in India

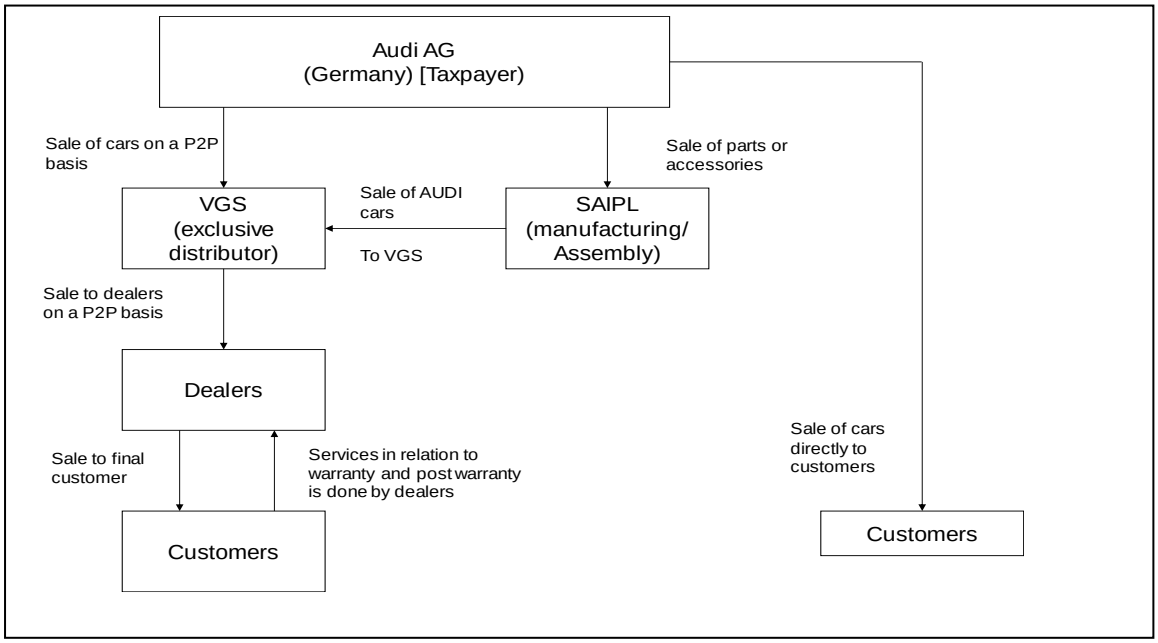
Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Audi AG[1] (the taxpayer) held that the transaction of sale of cars by a foreign company in India on a principal to principal basis to its Associated Enterprise (AE) [a sole distributor of its cars in India) did not result into a business connection under the Income-tax Act, 1961 (the Act) or a Permanent Establishment (PE) under Article 5 of the India-Germany tax treaty (tax treaty).

Facts of the case

The taxpayer, a German company, is one of the world's leading Car manufacturers. The taxpayer is a part of Volkswagen Group Sales India private Limited (VGS) and is engaged in the business activities i.e. export of cars, export of parts and accessories, export of tools and machinery and export of sales promotion material. It also provides service to its India Group Companies for grant of right to use information technology system, provision of training outside India, consultancy/management and other support services.

The taxpayer had appointed VGS as a sole distributor of Audi brand cars in India. The taxpayer also sold part and accessories to Skoda Auto India Private Ltd (SAIPL/Skoda India), pursuant to which Skoda India manufactures/assembled Audi brand cars in India in its manufacturing unit at Aurangabad, India. VGS is engaged in wholesale trading of Audi and Volkswagon brand car. VGS purchases fully built-up cars from the taxpayer, Volkswagon Group (AG) and Skoda India and sales the same to the dealers/distributor.

The diagrammatic representation of the group is as follows:



[1] Audi AG v. ADIT (ITA No. 7335/Mum/2012) – Taxsutra.com

During the Assessment Years 2009-10 and 2010-11, the taxpayer sold fully built-up cars and accessories to its AEs in India.

The Assessing Officer (AO) observed that VGS is the exclusive distributor whose only source of income was from Audi business. The business activities of VGS were devoted wholly on behalf of the taxpayer. Further, the activities of the taxpayer and VGS completed each other and VGS was functioning as an extended arm and replacement of the taxpayer in India. The AO held that the taxpayer had business connection in India and had a PE in India in the form of VGS as per Article 5(1) and 5(5) of the tax treaty. Accordingly, it was held that income attributable to the PE was taxable in India. Consequently, the AO attributed 35 per cent of total income of the taxpayer in India. The Dispute Resolution Panel (DRP) upheld the order of the AO.

Tribunal's decision

There was no dispute that the activities of manufacturing of car was completed by the taxpayer outside India and constitute a separate and independent activity. The assessing officer did not bring any material to counter the stand of the taxpayer that Cars are not sold to VGS on principle to principle basis and thereafter, VGS sold it on a principle to principle basis to the dealers.

The Tribunal relied on the decision of Daimler Chrysler AG[2]. In the said case also, the taxpayer was in the business of manufacturing and selling premium vehicles worldwide and it was tax resident of Germany. In the case of Daimler AG, despite the fact that the AE was performing more activities[3] than the VGS, it was held that the AE was not created either fixed place PE nor dependent agency PE.

The income arising on the sales of car by VGS to dealers in India was income accruing or arising in India and was taxed separately in the hands of VGS. The Tribunal observed that merely acting for non-resident principal would not itself render an agent to be considered PE for the purpose of allocating profit. The taxpayer was not undertaking any definite activity to which profit can be attributed.

Accordingly, it was held that the VGS was an independent and separate entity, which was engaged in selling of fully built up cars imported from the taxpayer, Volkswagen AG and Skoda India to dealers and distributors. Thus, it cannot be regarded as a PE of taxpayer in India.

The decision in the case Aramex Logistic Private Limited[4] relied on by the tax department was distinguishable on facts of the present case. In the said case, Aramex (F Co.) entered into a contract with the customer outside India for delivery of parcel, where the delivery of the parcel located in India. Further, Aramex (F Co.) had an agreement with Aramex India for the delivery of the parcel to the location in India. The privity of contract was between Aramex and customer outside India. The completion of the contract for the delivery of the parcel will only be complete once the parcel is delivered to the location in India. Accordingly, the activity performed in India by Aramex India, viz; delivery of the parcel to the location in India is part of one transaction which cannot be independently performed.

However, in the present case the car was manufactured by the taxpayer outside India and constitutes a separate and independent activity. The car was sold to Volkswagen Group for further sale in India and VGS was not acting on behalf of the taxpayer nor was the taxpayer selling cars through VGS. Moreover, the cars were sold on principle to principal basis. Hence, the taxpayer did not have business connection under the Act and PE under the Article 5 of the tax treaty.

Our comments

Determination of PE is a very fact specific and complex exercise and thus creates challenges for both the taxpayer and tax authorities to examine the transaction to consider it as PE. In view of complex structures of different business models, litigation in this area has been increased substantially. In the present case, the taxpayer's business was to export cars, parts and accessories, tools and machinery relating to such cars, etc. The taxpayer appointed its AE as a sole distributor of its cars in India. The issue was whether under this model of business, the taxpayer constitutes a PE in India for the activities carried on by the Indian AE.

With respect to similar type of facts, the Mumbai Tribunal in the case of Daimler AG[5] held that on a perusal of the General Agency Agreement between the taxpayer and its AE it was clear that delivery of goods took place outside India and the payment was also being made for purchase of goods outside India. Thus, the taxpayer does not have a business connection in India under Section 9 of the Act, and therefore, income in respect of sale of cars are not taxable in India. Further the Indian company does not constitute a PE of the taxpayer in India under the tax treaty.

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[2] ACIT v. Daimler AG [2012] 52 SOT 93 (Mum)
[3] Sales of raw material and parts and completely knocked down kit to Indian entity, direct sales of CBU cars to Indian customers, for which Indian entity rendered certain services i.e. Fee for technical services, interest on delayed payments, etc.
[4] Aramex Logistic Private Limited [2012] 22 taxmann.com 74 (AAR)
[5] ACIT v. Daimler AG [2012] 52 SOT 93 (Mum)

The Tribunal in the instant case, relying on its above decision held that the taxpayer did not have a business connection or PE in India.

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