KPMG

#KPMG josh

TAX FLASH NEWS

26 April 2019

Multiple counting and period of leave is to be excluded from the period of stay of an employee to determine Service PE threshold

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Linklaters[1] held that while determining the period of 90 days for ascertaining a Permanent Establishment (PE) of the non-resident under the India–UK tax treaty (tax treaty), the leave period of an employee is to be excluded. Further, the stay of employees in India on a particular day has to be taken cumulatively and not independently. In other words, multiple counting is to be avoided.

Facts of the case

The taxpayer, a partnership firm, is a tax resident of United Kingdom (U.K.) and is engaged in the practice of law. Apart from its head office in the U.K., the taxpayer has offices in various other countries around the world. The taxpayer does not have any branch office in India. The taxpayer was appointed as a legal advisor for some of the projects in India and provided legal consultancy services to them. In connection with rendering such legal consultancy services, the taxpayer received fees from the clients in India.

The taxpayer filed its return of income for the Assessment Year (AY) 2002-03 on 31 October 2002, declaring nil income. The statement accompanying the return of income stated that since the taxpayer had no branch office in India, the fee received is not chargeable to tax in India in the absence of a PE in India.

The Assessing Office (AO) observed that the employees/other personnel of the taxpayer have rendered services in India for more than 90 days during the relevant financial year, hence, the taxpayer had a PE in India in terms of Article 5(2)(k)(i) of the tax treaty. Therefore, income earned from rendering legal consultancy services in India is taxable in India.

Tribunal's ruling

The only issue that is required to be examined is, whether the employees/other personnel of the taxpayer have stayed and rendered services in India during the relevant financial year exceeding the period of 90 days to constitute a PE in India.

In this context, the taxpayer had contended that (a) if the vacation period of one of the employees Shri Narayan Iyar (said employee) is excluded, the period of stay of the employees of the taxpayer in India would be 87 days and (b) multiple counting of employees in a single day is not permitted.

The said employee had not rendered any services in India from 17 April 2001 to 4 May 2001, as he was availing a study leave and therefore, the same period has to be excluded for computing the period of 90 days as no other employee of the taxpayer was rendering services in India.

The next issue which requires consideration is, whether multiple counting of employees on a single day is permissible. A careful reading of Article 5(2)(k)(i) of the tax treaty makes it clear that as per the expression used therein if the employees or other personnel have stayed in India for a period exceeding 90 days in any 12 month period, it will constitute a PE. In the facts of the present case, the AO had reckoned any 12 month period to be the financial year beginning from 1 April 2001 to 31 March 2002.

Therefore, the stay of employees in India on a particular day has to be taken cumulatively and not independently. That being the case, multiple counting of employee in a single day, as was done by the tax authorities, is not impermissible under Article 5(2)(k)(i) of the tax treaty. The Tribunal referred to the decision of the Mumbai Tribunal in the case of Clifford Chance[2], relied upon by the taxpayer.

[1] Linklaters v. DDIT (ITA no.3250/Mum./2006 Assessment Year - 2002–03) - taxsutra.com

[2] Clifford Chance v. DCIT [2002] 82 ITD 106 (Mum)

Thus, if the period during which the said employee was on leave is excluded and the multiple counting of employees in a single day is avoided, the aggregate period of stay of taxpayer's employees' in India during the relevant financial year is 87 days.

Therefore, there was no PE of the taxpayer in India during relevant assessment year. That being the case, the fees received by the taxpayer from legal consultancy services rendered in India is not taxable in India.

Our comments

The issue with respect to calculation of man-days vis-à-vis determination of Service PE has been a matter of debate before the courts. In some of the decisions[3] it has been held that for the purpose of determination of Service PE, 'solar days' are to be considered as against 'man days'. For e.g. in case where more than one person was present in India, the issue that needed consideration was whether that day should be counted as one single day. Multiple counting of days could lead to absurd results, for e.g. if 20 employees are present in India for 20 days then as per multiple counting the presence in India would go upto 400 days. Therefore, Courts/Tribunals have held that the multiple counting is to be avoided. However, the tax department in many cases has attempted to ascertain the existence of a PE on the basis of 'man days'.

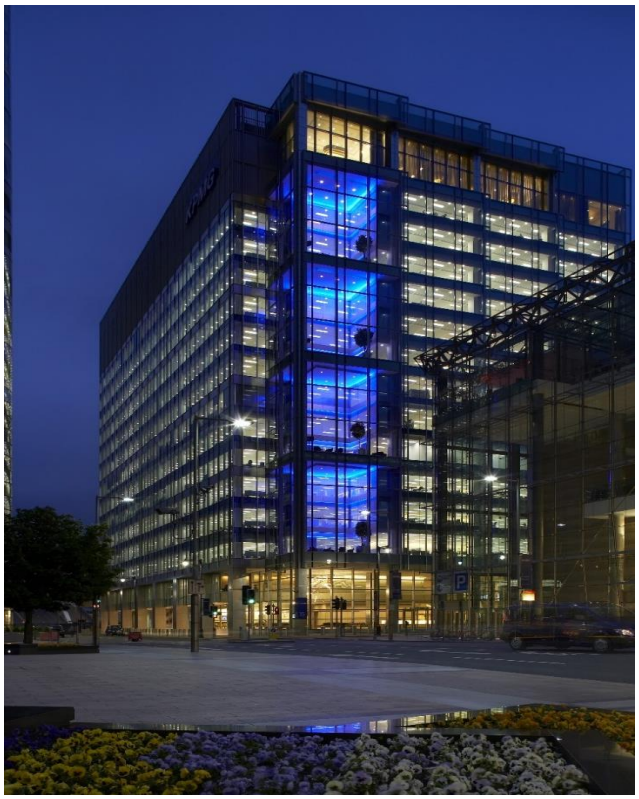
In the instant case, the Mumbai Tribunal has held that multiple counting of employee is to be avoided along with the exclusion of the period when the employee is on leave for ascertaining the determination of a service PE in India.

In relation to determination of Service PE, the 2017 OECD Commentary on Article 5 on PE article addresses the situation of an enterprise that performs services in a contracting state in relation to a particular project (or for connected projects) and which performs these through one or more individuals over a substantial period. The period or periods referred to in the subparagraph apply in relation to the enterprise and not to the individuals. Therefore, it is not necessary that the same individual or individuals should perform the services and also be present throughout these periods. As long as, on a given day, the enterprise is performing its services through at least one individual and is present in the country, that day would be included in the period or periods. That day will be counted as a single day regardless of how many individuals are performing such services for the enterprise during that day.

However, in the era of a virtual world, it is interesting to note that certain countries have introduced the concept of 'Virtual Service PE' for e.g. Saudi Arabia, Israel, etc. The Bangalore Tribunal in the case of ABB FZ-LLC[4], in the context of determination of a Service PE, has observed that in the present age of technology where the services, information, consultancy management, etc. can be provided with virtual modes like email, internet, video conference, remote monitoring, remote access to desktop, etc. through various software. Therefore, the taxpayer's contention about three employees rendering services only for 25 days was not acceptable as the services can be rendered without the physical presence of employees of the taxpayer.

However, the decision of the Bangalore Tribunal in the case of ABB FZ-LLC has been distinguished by the subsequent decision of the Bangalore Tribunal in the case of Electrical Material Center Co. Ltd.[5] The Bangalore Tribunal observed that in the case of ABB FZ-LLC, the taxpayer had rendered managerial and consultancy services without physical presence of the employees. Whereas in the subsequent decision in the case of Electrical Material Center Co. Ltd., the services could not be rendered without physical presence.

Going forward, it would be interesting to see how the judiciary will view such factual difference vis-à-vis rendering of services remotely without physical presence.



[3] Worley Parsons Services (P) Ltd [2009] 312 ITR 317 (AAR), J. Ray Mcdermott Eastern Hemisphere ltd v. JCIT [2010] 39 SOT 240 (Mum), ADIT v. Valentine Maritime (Mauritius) Ltd. [2011] 45 SOT 34 (Mum).

[4] ABB FZ-LLC v. DCIT [2017] 83 taxmann.com 86 (Bang)

[5] Electrical Material Center Co. Ltd. v. DDIT [2017] 86 taxmann.com 222 (Bang)

www.home.kpmg/in

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000