



## Liaison and project offices do not constitute a PE in India

### Background

Recently, the Delhi High Court (High Court) in the case of Mitsui & Co. Ltd.<sup>1</sup> (the taxpayer) held that offices of the taxpayer and its activities cannot be regarded as its Permanent Establishment (PE) in India and the income directly or indirectly attributable to the said offices was not taxable in India. In order to constitute PE within the meaning of Article 5(2) of India-Japan tax treaty (tax treaty), it was not enough to have office, factory or a workshop, etc., but it is required that such place was a fixed place of business through which the business of an enterprise is wholly or partly carried out under Article 5(1) of the tax treaty. The Liaison Office (LO) of the taxpayer was not in fact used for the purpose of business. The LO is solely for the purpose of search or display or solely for the purchases of goods or collecting information or for any other activity. Therefore, it does not constitute a PE in India.

### Facts of the case

- The taxpayer is a non-resident company having its headquarters in Japan. The taxpayer had two projects in India. During the years<sup>2</sup> under consideration, the taxpayer filed income-tax return declaring income which was subsequently revised.
- The Assessing Officer (AO) made an addition holding that the taxpayer had a Permanent Establishment (PE) in India under the tax treaty. The AO observed that the taxpayer had a Liaison Office (LO) in India which helped the taxpayer in finding new purchasers and sellers of goods and merchandise. However, the taxpayer contended that the conditions imposed upon it by the Reserve Bank of India (RBI) permitting it to have an LO in India i.e. to not carry on any trading, commercial or industrial activity from such LO, was fully complied by it. The LOs merely provided information to the overseas offices and, therefore, the taxpayer had declared nil income in respect of its liaison activity in India.

- The AO observed that the details of the telephone expenses of the Project Office (PO) indicate that some part thereof pertained to the LO. The AO, therefore, concluded that it is very difficult to say that the LO is totally separated from the project operations, the imports, and exports done by the taxpayer. The AO held that income from the power project was also held to be taxable under Section 44BBB of the Income-tax Act, 1961 (the Act) by taking the profit at 10 per cent of the total turnover. Accordingly, certain income was added to the taxpayer's income, and the loss of the power project claimed by the taxpayer was disallowed.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that LO cannot be treated as having PE in India. However, the AO was justified in taxing income from power project under Section 44BBB of the Act. Subsequently, the Income-tax Appellate Tribunal (the Tribunal) held that the taxpayer is not having PE in India and therefore exempt under the tax treaty. The taxpayer is not liable to tax under Section 9(1)(vi)(1) of the Act because it was not having any business connection in India.

### High Court's decision

- In the present case, the onus was on the tax department to demonstrate that LO of the taxpayer was a PE within the meaning of Articles 5(1) and 5(2) of the tax treaty. It was not enough for the tax department to show that the taxpayer had an office, factory or a workshop, etc. within the meaning of Article 5(2) of the tax treaty. For the purpose of Article 5(1), the tax department was required to show that such place was 'a fixed place of business through which the business of an enterprise is wholly or partly carried out'.

<sup>1</sup> DIT v. Mitsui & Co. Ltd [2017] 84 taxmann.com 3 (Del)

<sup>2</sup> AY 1994-95 and AY 1995-96

- For the AYs in question, the LO of the taxpayer was not in fact used for the purpose of business. Article 5(6)<sup>3</sup> of the tax treaty assumes significance. The use of LO is solely for the purpose of search or display or solely for the purchases of goods or collecting information or for any other activity. Such an activity would be of 'preparatory or auxiliary in character' and would be outside the ambit of a PE.
- The mere fact that the manager of the taxpayer stated that the books of accounts might be kept in a warehouse or that some portion of the telephone expenses were attributable to the LO or that chief representative of the taxpayer was managing both the LO as well as the PO was hardly sufficient to conclude that the LO was being used to carry on the business of the enterprises.
- The CIT(A) found that the POs were treated as separate taxable units. In fact, the profit was taxed by invoking Section 44BBB of the Act. After having treated the POs as separate taxable units and having offered the profits therefrom to tax under Section 44BBB, the said POs cannot also be treated as PEs for the purpose of the tax treaty.
- The High Court finds merit in the contention of the taxpayer that the factual findings of the CIT(A) which has been conferred by the Tribunal have not shown to be perverse by the tax department. There is a categorical finding of the CIT(A) that two POs were treated as separately taxable units. The CIT(A) correctly held that the AO was unable to prove that the taxpayer had maintained a PE answering the description on a collective reading of Articles 5(1) and 5(2) of the tax treaty.
- On the issue of activity of 'preparatory or auxiliary character', the Delhi High Court in the case of National Petroleum Company Construction<sup>4</sup> observed that a LO can act as a channel of communication between the principal place of business and the entities in India and cannot undertake any commercial trading or industrial activity. However, a project office can play a much wider role. A project office can undertake all activities that relate to the execution of the project, and its function is not limited only to act as a channel of communication.
- The taxpayer was adhering to the conditions imposed by the Reserve Bank of India (RBI) for running an LO, and the RBI had accepted the functioning of the taxpayer's LO for over three decades. The taxpayer has complied the conditions, one of which was that it could not carry on any business or trading activity in the LO.

<sup>3</sup> Exclusions from PE

<sup>4</sup> National Petroleum Company Construction v. DIT [2016] 383 ITR 648 (Del)

- Accordingly, it has been held that the Tribunal was right in holding that the taxpayer does not have any PE in India and its income from business turnover/imports in India was exempt under the tax treaty. It was held that the income directly or indirectly attributable to the said offices was not taxable in India.

## Our comments

The issue with respect to LO constituting PE in India has been a matter of debate before Courts/Tribunal.

In some of the cases<sup>5</sup>, it has been held that LO does not constitute fixed place PE in India because the LO was carrying on operations within the restricted activities (i.e. preparatory or auxiliary) permitted by the RBI. On the other hand, in some of the decisions<sup>6</sup>, it has been held that LO constitutes fixed place PE because it was carrying on certain commercial activities which were core activities of the taxpayer.

Recently, the Delhi Tribunal in the case of GE Energy Parts Inc<sup>7</sup> held that the LO of overseas group entity constitutes fixed place PE under the India-USA tax treaty since activities carried on by Indian entity from LO's premises were substantial and core in nature, and not merely of preparatory or auxiliary character.

This is a welcome decision of the Delhi High Court dealing with PE exposure of multinational entities. However, it is suggested that the foreign entities conducting business in India may regularly assess their possible PE exposure/risk.

<sup>5</sup> Mitsui & Co. Ltd [1991] 39 ITD 59 (Del), Sumitomo Corpn [2008] 110 TTJ 302 (Del), Motorola Inc [2005] 95 ITD 269 (Del) (SB), Western Union Financial Services Inv [2007] 101 TTJ 56 (Del), Metal One Corpn. [2012] 52 SOT 304 (Del)

<sup>6</sup> Brown and Sharpe Inc. (ITA No.219 of 2014) (Del), Jebon Corporation India [2012] 206 Taxman 7 (Kar), Columbia Sportswear Company [2011] 337 ITR 407 (AAR), UAE Exchange Centre, In re [2004] 139 Taxman 82 (AAR)

<sup>7</sup> GE Energy Parts Inc. v. ADIT [2017] 184 TTJ 570 (Del)

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