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TAX FLASH NEWS

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Indian subsidiary represented by its managing director constitutes a fixed place PE in India

Background

Recently, the Chennai Bench of the Income Tax Appellate Tribunal (the Tribunal) in the case of Carpi Tech SA[1] (the taxpayer) held that the amount received by the taxpayer pursuant to NHPC project was taxable in India since the taxpayer's subsidiary in India represented by its managing director constitutes a fixed place Permanent Establishment (PE) in India.

The Tribunal observed that the project executed by the taxpayer was in the nature of repair and supply of material and cannot be strictly categorised as one relating to building site, construction, installation or assembly project as is specified in Article 5.2 (j) of the India-Switzerland tax treaty (tax treaty). Therefore, the time limit prescribed in Article 5.2(j) would not be applicable to the taxpayer's case.

Facts of the case

- The taxpayer is a foreign company, resident in Switzerland, specialised in geo composite membrane water proofing and drainage systems for dams, canals, tunnels and other hydraulic structures.

- The taxpayer has a subsidiary, namely, Carpi India Waterproofing Specialists Pvt. Ltd. (CIWSPL) in India represented by Sri. V. Subramanian (Managing Director, MD).

- The taxpayer had rendered services for Tamil Nadu Electricity Board (TNEB) at Kadamparal, and the project was executed between 6 November 2004 and 21 May 2005.

- During the Assessment Year (AY) 2008-09, the taxpayer received a sum of INR 11,95,56,285 from National Hydro Power Corporation Ltd (NHPC) for providing PVC geo membrane water proofing in Tanakpur Power channel (Tanakpur project) and claimed it as exempt from tax on the ground that it did not have continuous presence or business connection or a PE in India.

- The Assessing Officer (AO) determined the total income as INR 1,09,84,831 after giving deduction of sales and service tax. Aggrieved by the order of the AO, the taxpayer preferred directions from the Dispute Resolution Panel (DRP).

- The DRP upheld the AO's order. Against the direction of the DRP and the final assessment order, the taxpayer went on appeal before the Tribunal.

Tax department's contentions

- CIWSPL was the authorised representative for the project undertaken by the taxpayer and all expenses in India to execute the project were incurred by CIWSPL which were subsequently reimbursed by the taxpayer. CIWSPL was the Indian face of the taxpayer representing it in all practical matters, and to that extent, CIWSPL was the dependent agent of the taxpayer.

- The MD of CIWSPL was also representing foreign enterprises such as Liitostroj Power and Koncar apart from an Indian company VA Tech Hydro.The companies represented by the MD were at different point in time and not during the period when he was involved in

[1] Carpi Tech SA v. ADIT (ITA No 1742/Mds/2011) -Taxsutra.com

undertaking Tanakpur project work of the taxpayer. The claim of the taxpayer contending that CIWSPL represented by MD was an independent agent in terms of Article 5.5 and 5.6 of the tax treaty cannot be accepted.

- The examination of contract documents revealed that CIWSPL represented by the MD was also the designated power of attorney (POA) holder for these projects on behalf of the taxpayer and is responsible for all aspects of the contract right from the stage of signing till the execution of the contract. MD has been mentioned as the project representative at the site and alternatively project coordinator in the contract documents.

Taxpayer's contentions

- The POA in favour of the MD is a specific POA which was issued subsequent to the award of Tanakpur Project contract, and he did not have any general or continuous authority to act on behalf of the taxpayer.

- The 'Invitation Of Bid' clearly describes the scope of work as 'Design, manufacture, supply and installation of exposed impervious PVC Geo composite Membrane' which falls within the purview of Article 5.2(j). The duration of the project was 40 days which is not beyond the threshold of six months as prescribed under Article 5.2(j) of the tax treaty and therefore, would not constitute a PE.

- In view of the time lag of three years between execution of the two projects, PE could not be established as 'business' per se contemplates continuous, organized and systematic activities which were conspicuously absent in the taxpayer's case.

- The address of the MD was only a mailing address, and the mere existence of books of account cannot either conclusively or inferentially lead to the fixed place of business through which the business of the taxpayer is wholly or partly carried on as defined in Article 5.1 of the tax treaty.

Tribunal's ruling

- The claim of the taxpayer that no PE existed in view of Article 5.2(j) of the tax treaty was only a subterfuge on the face of such facts as the nature of service rendered by the taxpayer were not in relation to a building site, construction, installation or assembly project. The work was in the nature of repair and supply of material and therefore, the time limit of six months as prescribed in Article 5.2(j) would not be applicable.

- The Tribunal relying on the decision of the Delhi Tribunal in the case of Fugro Engineers BV[2] held that number of days was not significant in a peculiar type of work undertaken and if the contract is not one of assembly, construction or installation, no time limit has been prescribed for incidence of source country taxation of such projects

- All correspondences relating to prospecting of client, participation in bids, correspondence with customers, signing of contract document, execution of the project and closure of the project, etc. were initiated or routed through the business address of CIWSPL.

- The activities of the taxpayer and CIWSPL are intertwined and CIWSPL participates in the economic activities of the taxpayer. Since the taxpayer and CIWSPL are carrying out identical nature of jobs in India and therefore, the activities of CIWSPL necessarily are to be analysed to determine whether there is a fixed place PE.

- The Tribunal observed that the 'fixed place test' is a positive one for the taxpayer and there was no requirement to go for special inclusion for the purpose of determination of PE.

- What constitutes a place of business for Article 5 of the tax treaty is often a question of fact and law. Place of business usually means premises of the enterprises used for carrying on the business, whether or not exclusively used for the business. To constitute a PE, the business must be located at a single place for a reasonable length of time and the activity need not be permanent, endless or without interruptions. The Tribunal relied on the decision of Sutron Corporation[3] and Motorola Inc[4] wherein the residence of the country manager was held to be a fixed place of business as the same was used as an office address.

- The role played by the MD as an agent of the taxpayer as also CIWSPL who render similar services cannot be easily discerned or separated. There being a unison of interest to a great extent, while as an independent agent there would be required an objectivity in execution of the tasks of the non-resident

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[2] Fugro Engineers B.V. v. ACIT [2008] 26 SOT 78 (Del)
[3] Sutron Corporation v. DIT [2004] 268 ITR 156 (AAR)
[4] Motorla Inc. v. DCIT [2005] 95 ITD 269 (Del) (SB)

taxpayer. In the instant case, the MD was acting exclusively or almost exclusively for and on behalf of the taxpayer during the currency of the project and to that extent, the MD was not acting in furtherance of his ordinary course of business.

Our comments

The Tribunal has held that fixed place test is a positive one and there was no requirement to go for special inclusion for the purpose of determination of PE. The issue with respect to the constitution of a PE under Article 5(2) of the tax treaty independent of Article 5(1) has been a matter of debate before the courts. The Delhi High Court in the case of National Petroleum Construction Company[5] observed that Article 5(1) and 5(2) of the tax treaty complement each other. Thus, all classes of PEs as specified in Article 5(2) of the tax treaty can be construed as a PE subject to the essential conditions of Article 5(1) of the tax treaty being fulfilled.

The type and the nature of activities of the taxpayer is a matter of fact and plays an important role in determining whether such services constitute a PE or not. The Tribunal, in the instant case, based on the nature of activities, held that the activities carried on by the taxpayer were in the nature of repairs and thus, would not qualify for the six months threshold as is applicable to construction, installation and assembly projects under the tax treaty.

[5] National Petroleum Construction Company v. DIT [2016] 383 ITR 648 (Del)

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