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Flash News

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Solar days to be considered and not man days for determining Service PE under the India-Saudi Arabia tax treaty. In the absence of FTS article under a tax treaty, services are taxable under 'Other Income' article

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Electrical Material Center Co. Ltd.[1] (the taxpayer) held that only solar days and not man days are to be considered for determining Service PE under the India-Saudi Arabia tax treaty (tax treaty). Since the stay of the taxpayer's engineers in India was only for 90 days which is less than 182 days as required under a Permanent Establishment (PE) article of the tax treaty, it did not constitute a PE in India.

The Tribunal also observed that Fees for Technical Services (FTS) clause is missing in the tax treaty, therefore, income from services is taxable under the 'other income' article of the tax treaty. Therefore, as per the 'other income' article, the taxpayer's income was held to be taxable in the state of residence i.e. Saudi Arabia.

Facts of the case

- During the Assessment Year (AY) 2010-11, the taxpayer, a company based in Saudi Arabia, received income from provision of services. The services were provided by the taxpayer's four engineers in India.
- The Assessing Officer (AO) held that the taxpayer constituted a Service PE in India under the tax treaty, due to presence of four service engineers in India for 90 days each. The AO considered man-days of services rendered instead of the period for which activities continues in India (i.e. solar days).
- Further, the AO held that where tax treaty did not contain specific article for taxability of a particular payment, the provisions of the Income-tax Act, 1961 (the Act) would be applicable. It was also held that fees received by the taxpayer is taxable as FTS under Section 115A of the Act.
- The Dispute Resolution Panel (DRP) upheld the order of the AO.

Tribunal's decision

Service PE in India

- The Tribunal in the case of Clifford Chance[2] held that only solar days are to be considered and not man days for computing number of days under Article 5 of the tax treaty. Applying the decision of the Mumbai Tribunal to the facts of the present case, the Tribunal observed that there is no PE of the taxpayer in India.

[1] Electrical material Center Co. Ltd v. DDIT [ITA(TP) No. 1104 (Bang) 2013, dated 28 September 2017] – Taxsutra.com

[2] Clifford Chance v. DCIT [2002] 76 TTJ 725 (Mum)

- The Tribunal in the case of Clifford Chance observed that multiple counting of the common days is to be avoided so that the days when two or more partners were present in India, together, are to be counted only once. Multiple counting would lead to absurd results. For example, if 20 Partners were present in India together for 20 days in one fiscal year, multiple counting would result in 400 days. There cannot be more than 365 days in a year.

- The decision in the case ABB FZ[3] relied on by the tax department is distinguishable on the facts of the present case. In that case, the taxpayer had rendered managerial and consultancy services and as per the Tribunal, these services can be rendered without physical presence of the employees. However, in the present case, as per the invoice, the taxpayer has raised a bill of USD57764 for 2063 man days at USD28 per day. This is not a case of the tax department that any other invoice is raised by the taxpayer.

- When admittedly, the only invoice raised is in respect of stay of four engineers in India on the basis of man hours spent by them in India, it cannot be said that any other service was rendered in the present case without physical presence by way of virtual modes like e mail, internet, video conference etc. and therefore, physical presence of employee is not essential. Because of these differences in facts, the Tribunal order cited by the tax department is not applicable to the facts of the present case.

- Accordingly, it has been held that the stay in India of the taxpayer was only 90 days and since it is less than 182 days as required under Article 5(3)(b) of the tax treaty, there is no PE in India.

Taxability of FTS under other income article

- Relying on the Madras High Court in the case of Bangkok Glass Industry Co. Ltd.[4], the Tribunal observed 'Other Income' article is applicable to the taxpayer as FTS clause is missing in the tax treaty. In view of 'Other Income' article of the tax treaty, FTS is not taxable in India but in the state of residence i.e. Saudi Arabia.

Royalty

- With respect to issue of whether the payments are Royalty or FTS, since the exact details of the work done by the four service Engineers were never furnished, the issue remitted back to the AO.

[3] ABB FZ – LLC v. DCIT [2017] 83 taxmann.com 86 (Benaluru)
[4] Bangkok Glass Industry Co. Ltd. v. ACIT [2013] 215 Taxman 116 (Mad)

Our analysis

Solar days v. man days for determination of Service PE

The issue with respect to consideration of solar days v. man days for determination of Service PE has been a matter of debate before the Courts. Some of the Courts[5] have held that for the purpose of determining the Service PE, 'solar days' and not 'man days' are to be considered. For e.g. the day on which more than one person was present in India 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 have held that the multiple counting is to be avoided. However, tax department in many cases determined the PE on the basis of 'man days'.

In relation to determination of Service PE, the OECD commentary of 2014 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 apply in relation to the enterprise and not to the individuals. It is therefore not necessary that the same individual or individuals who perform the services are present throughout these periods. As long as, on a given day, the enterprise is performing its services through at least one individual who is doing so and is present in the state, that day would be included in the period or periods. Clearly, that day will be counted as a single day regardless of how many individuals are performing such services for the enterprise during that day.

In line with the same, the Bangalore Tribunal held that only solar days are to be considered and not man days for computing number of days for determination of service PE under Article 5 of the tax treaty.

[5] 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), Clifford Chance v. DCIT [2002] 76 TTJ 725 (Mum)

When FTS clause is missing in the tax treaty

The Courts/Tribunal have extensively dealt with the issue with respect to taxability of services in the absence of specific FTS article in the tax treaty. Some of the Courts[6] have held that in absence of FTS article in the tax treaty, services should be taxable under 'Business Profit' article if the taxpayer is having PE in India. If the taxpayer does not have PE in India such services would not be taxed in India. However, in various cases, the tax department (in addition to the above point) contended that if the taxpayer does not have PE in India, taxability of such services needs to be examined under the residuary article.

However, the Bangalore Tribunal[7] observed that 'other income' article provides that income which are not dealt with in the any of the articles of the tax treaty, shall be taxable in 'other income' article. An item of income is said to have been dealt with other articles of the tax treaty if such income can be classified as taxable or not under any of the articles of the tax treaty. If the payments are dealt with by Article 7 of the tax treaty, Article 23 has no application. Therefore, such services cannot be taxed under 'other income' article of the tax treaty.

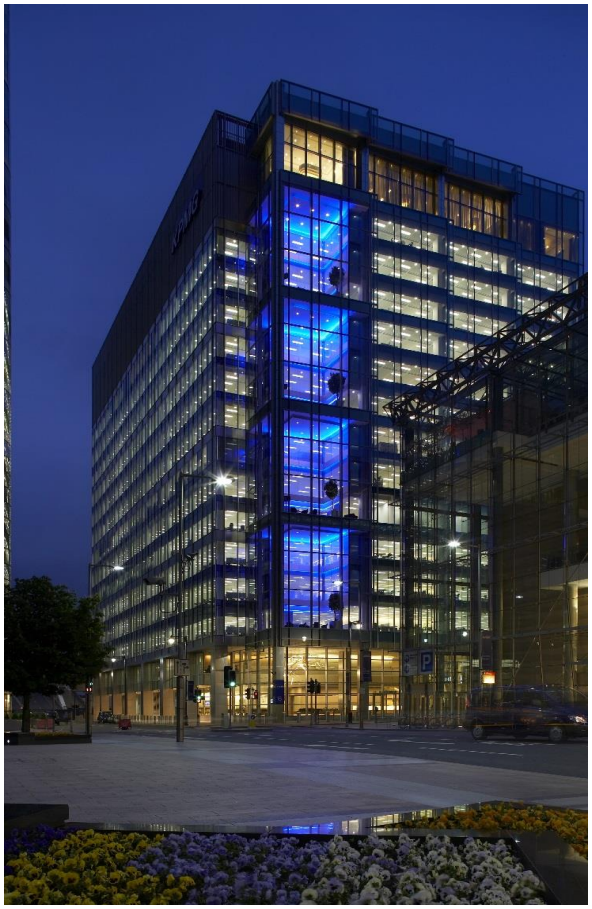
The Authority for Advance Rulings (AAR)[8] observed that since there is no specific article for taxation of FTS in the tax treaty, it would be directly governed by Article 22 of the tax treaty which is residuary article in the tax treaty. The AAR has not examined the 'Business Income' article for such income.

It is pertinent to note that the Bangalore Tribunal in the case of Spice Telecom[9] observed that since services provided by the taxpayer are not covered under India-Mauritius tax treaty, the same are not taxable in India. Accordingly, it is also possible to argue that in absence of FTS article, the services would not be taxed in India.

The tax department has been arguing that when FTS article is missing in the tax treaty, the taxability of services should be under the Act. The Chennai Tribunal[10] held that only for a reason that tax treaty is silent on a particular type of income, it could not be said that such income will automatically become business income of the recipient. When the tax treaty is silent on a particular article, the provisions of the Act have to be considered.

In the instant case, the Bangalore Tribunal held that 'other income' article of the tax treaty is applicable to the taxpayer as FTS clause is missing under India-Saudi Arabia tax treaty and therefore, FTS is not taxable in India but in the state of residence i.e. Saudi Arabia.

There is a considerable litigation on the above issue and the Courts/Tribunal have rendered contrary decisions on the same. Therefore, one needs to take an informed decision based on facts of each case, analysis of the above decisions and the language of particular tax treaty.



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[6] McKinsey Business Consultants v. DDIT [2015] 54 taxmann.com 300 (Mum), Bangkok Glass Industry Co. Ltd. v. ACIT [2013] 34 taxmann.com 77 (Mad)
[7] IBM India Private Limited v. DDIT [I.T. (IT) A. Nos. 489 to 498/Bang/2013]
[8] Lanka Hydraulic Institute Ltd [2011] 11 taxmann.com 97 (AAR)
[9] Spice Telecom v. ITO [2008] 170 Taxman 82 (Bang)
[10] DCIT v. TVS Electronics Ltd (ITA No. 811/Mds/2010)

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