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TAX FLASH NEWS

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Indian subsidiary of a foreign company constitutes a PE in India. Income from supply of telecom equipment, its installation and commissioning is taxable in India

The Delhi Bench of Income-tax Appellate Tribunal (the Tribunal) in the case of Huawei Technologies Co. Ltd[1] (the taxpayer/China based entity) dealt with the taxability of income from supply of telecommunication network equipment, its installation and commissioning. The Tribunal held that the income from the supply of equipment is taxable in India. The dominant purpose of the taxpayer was not to sell telecommunication equipment but to commission it after due customisation of hardware and software in accordance with the requirement of telecommunication service provider. Further the taxpayer continued to undertake the risk of rejection of the supply in India and therefore, there was an extension of business of the taxpayer in India in respect of the supply of equipment to India.

The activity of supervision in connection with installation does constitute an installation Permanent Establishment (PE) under Article 5(2)(j) of India-China tax treaty (tax treaty). The Tribunal held that the Indian entity not only constitutes dependent agent PE of the taxpayer but also service PE and fixed place PE within Article 5 of the tax treaty. The Tribunal observed that the foreign employees have visited India to closely monitor the progress at various stages of the project starting from bidding to final implementation phase. Further, joint bidding by both the entities shows that the business activity including signing of bid documents were done from the office premises of the Indian entity. The Indian entity participated in the negotiation of deal with Indian clients on behalf of the taxpayer and the installation/commissioning have been done by the Indian entity.

Facts of the case

The taxpayer is a China based entity engaged in the business of supplying (offshore basis) non-terminal products, i.e. advanced telecommunication network equipment, namely, core and access network equipment, mobile network equipment and data communications equipment, etc. for use in fixed and mobile phone networks and terminal products, that is, mobile phone handsets to various customers (including customers in India). The supplies were made on principal to principal basis and property in equipment was transferred to Indian customers outside India. The taxpayer had a subsidiary in India.

During the year[2] under consideration, the taxpayer provided services to the Indian subsidiary under the terms of Technical Service Agreement. The taxpayer was involved in the provision of integration, installation and commissioning services in relation to telecom network equipment supplied from outside India. The taxpayer had offered revenues accrued on account of technical service provided to the Indian entity on gross basis and paid taxes in accordance with the provisions of Article 12 of the tax treaty. The taxpayer also earned revenue on account of sale of telecom network equipment and terminal equipment/mobile handsets but had not offered that revenue in India.

The Assessing Officer (AO) held that the taxpayer had business connection in India under Section 9(1)(i) of the Income-tax Act, 1961. The statements of senior employees, analysis of survey documents, analysis of agreements and analysis of submissions of the taxpayer established that the taxpayer had carried out business in India with the help of their employees who regularly work from the premises in India and thereby creating a fixed place PE under Article 5(1) of the tax treaty. The AO observed that the employees of the taxpayer had visited India to perform activities relating to the installation projects, which had lasted for more than 183 days and hence it also constituted 'installation

[1] Huawei Technologies Co. Ltd v. ADIT (ITA No. 1500/DEL/2014) – Taxsutra.com

[2] AY 2009-10, 2010-11, 2011-12, 2012-13, 2013-14, 2014-15, 2015-16, 2016-17

PE' under Article 5(2)(j) of the tax treaty. Further, the AO observed that the employees of the taxpayer had rendered services in India other than in the nature of technical services and such services have continued in India for more than 183 days thereby creating 'service PE' in India under Article 5(2)(K) of the tax treaty. The AO also observed that the process of joint bidding done by the taxpayer and the Indian entity resulted into 'dependent agency PE' under Article 5(4) of the tax treaty.

Tribunal's decision

Taxability of offshore supply of equipment and software

The Tribunal observed that the real and intimate relationship exists between the taxpayer and the Indian subsidiary, in as much as, the sale of telecommunication network equipment would serve no purpose of a buyer unless the telecommunication network equipment were installed and commissioned and this was done by the Indian subsidiary in India. Hence, the activities of the taxpayer continue till the telecommunication network equipment were installed and commissioned in India. This entire sequence contributes directly to the earning of income of the taxpayer in its business even if the sale transaction was concluded outside India.

The entire transaction of the sale of equipment offshore has to be considered from another angle. The dominant purpose of the taxpayer was not to sell telecommunication equipment but to commission it after due customisation of hardware and software in accordance with the requirement of telecommunication service provider. Thus, the dominant purpose was to set up the equipment as per the requirement of the telecom service providers. Reference was made to the decision of BSNL[3] wherein the dominant nature test of an equipment was explained.

In the present case, Indian resource was involved in dealing negotiations on behalf of the taxpayer. Purchase order from the purchaser refers to the email offer from an employee of the Indian subsidiary. Hence it was evident that this employee was representing the taxpayer for finalisation of contract/purchase order. Further, the joint bidding team included resources from the Indian entity as well as the taxpayer, which highlights that the Indian resources were participating in the bidding process including deal negotiations along with Chinese resources. The letter from the telecom company confirms that the responsibility of installation and commissioning along with supply of equipment was with the taxpayer.

The Tribunal observed that if the buyer had right to reject the equipment on failure of acceptance test, then the transactions cannot be considered as completed outside India. The Tribunal relied on the decision of Ericsson A.B.[4] where it was observed that the position would be different if the buyer had the right to reject the equipment on failure of acceptance test carried out in India. The Tribunal also relied on the decisions of the Andhra Pradesh High Court in the case of L&T Ltd[5] and the Supreme Court in the case of Usha Beltron Ltd[6] and observed that the taxpayer continued to undertake the risk of rejection of the supply in India and therefore, there was extension of business of the taxpayer in India in respect of the supply of equipment to India.

The taxpayer relied on the decision of the Delhi High Court in the case of LG Cables[7] to support its cause. However, the decision of the Delhi High Court in the case of Ericsson AB is later than the decision of LG cables and therefore, it could not be relied upon.

Installation PE

On perusal of the key statements recorded at the time of survey operations[8] indicate that the Indian entity's resources were involved in negotiations with customers in India. Further, representatives of the taxpayer were allowed to use the premises of the Indian entity. The foreign expats who are experts in the technology behind the equipment were present in India on site in order to supervise the installation and commissioning process.

In taxpayer's own contention, the Indian entity was not technically equipped to do installation and commissioning on its own and thus requisitioned the expats to supervise the installation process at site in India. Therefore, considering the facts on record, it is a wrong claim that the Indian entity was independent to carry out the installation and commissioning of the equipment.

BSNL's letter confirms the fact that the taxpayer was responsible for installation/commissioning as the letter from BSNL does specify the name of Huawei to not only supply the ports but also the installation/commissioning of the same. This was another reason why claim of the taxpayer that installation/commissioning is independently handled by the Indian entity cannot be accepted. The act of installation was performed only with the supervision of the taxpayer's resources which means that supply and its installation are integral. Therefore, the activity of supervision in connection with installation does constitute 'installation PE' as per Article 5(2)(j) of the tax treaty.

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[3] BSNL v. Union of India [2006] 3 STT 245 (SC)

[4] DIT v. Ericsson A.B. [2012] 343 ITR 470 (Del)
[5] Larsen And Toubro Ltd v. State of Andhra Pradesh (Writ Petition Nos. 22960 of 2007, 14 September 2015) (AP)
[6] Usha Beltron Ltd v. State of Punjab [2005] 7 SCC 58 (SC)
[7] DIT v. LG Cable Ltd 703/2009, dated 24 December 2010
[8] Survey under Section 133A

Fixed place PE, Service PE and Dependent agent PE

Indian resources and Chinese resources were working jointly on a bid submission for Indian customers. The documents impounded during the survey proceedings also establish this fact. The foreign employees were visited to India to closely monitor the progress in project at various stages starting from bidding stage to the final implementation phase. Facts on record reveal that Chinese resources have been seconded to the Indian entity for advancement of business of foreign entity in India.

The Tribunal relied on Supreme Court's decision in the case of Formula One World Championship Ltd[9] and observed that the control vests with the entity which is capable of delivering the critical business functions. There was no dispute that technology ownership was with the taxpayer. The Indian entity had no wherewithal to undertake technical work like installation/ commissioning of telecom network equipment without the aid of the taxpayer. As held by the Supreme Court, the control and disposal go hand in hand. Thus, the disposal of fixed place is determined by the degree of control exercised by the foreign entity.

The Indian resources were involved in deal negotiations on behalf of the taxpayer. Further, joint bidding shows that the business activity including signing of bid documents were done from the office premises of the Indian entity and there was no denial that the Indian entity participated in the negotiation of deal with the Indian clients on behalf of the taxpayer. Facts on record establish that the Indian entity was economically dependent on the taxpayer as it has handled the work of installation of telecom equipment supplied by the taxpayer on technical support provided by the taxpayer. In fact, the Indian entity came into existence with an intent to aid the business of the taxpayer in India. The Indian entity is not capable of supplying the equipment what it was bidding for. The business of the taxpayer in India is also totally dependent on the Indian entity. Even where supplies have been made through third party vendor, the installations/commission have been done by the Indian entity.

In the present case, it was not a supply of standard product, but product based on specific requirements of the customer. Considering the facts in totality, the Tribunal held that the Indian entity not only constitutes dependent agent PE of the taxpayer but also Service PE and fixed place PE within Article 5 of the tax treaty. The decision of the Madras High Court in the case of S. Kader Khan[10] is distinguishable on facts.

[9] Formula One World Championship Ltd [2017] 394 ITR 80 (SC)
[10] CIT v. Kader Khan [2008] 300 ITR 157 (Mad)

Our comments

The taxability of income from supply of telecommunications network equipment has been a subject matter of debate before the Courts.

The Delhi High Court in the case of Ericsson A. B.[11] held that income from supply of telecommunication equipment was not taxable in India because the property in goods had passed outside India. The Delhi High Court in the case of LG Cable Ltd.[12] held that income from offshore supply of equipment cannot be taxed in India merely because it is interlinked with the satisfactory performance of the onshore contract. Further, the Delhi High Court also held that since taxpayer's PE was not at all involved in the transaction of the offshore supply of equipment, the existence of the PE would be irrelevant for taxing offshore supplies.

The Delhi Tribunal in the present case held that the income from the supply of equipment is taxable in India. The dominant purpose of the taxpayer was not to sell telecommunication equipment but to commission it after due customisation of hardware and software in accordance with the requirement of telecommunication service provider. Further the taxpayer continued to undertake the risk of rejection of the supply in India and therefore, there was an extension of business of the taxpayer in India in respect of the supply of equipment to India. The Delhi Tribunal also held that the taxpayer had installation, service, agency and fixed place PE in India.

[11] DIT v. Ericsson A.B. [2012] 343 ITR 470 (Del)
[12] DIT v. LG Cable Ltd. [2011] 197 Taxman 100 (Del)

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