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TAX FLASH NEWS

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Space provided by an organiser to a foreign entity for rendering services relating to an event constitutes a PE in India

Background

Recently, the Authority for Advance Rulings (AAR) in the case of Production Resource Group[1] (the applicant) held that the space provided by an organiser to a foreign service provider for rendering services relating to an event, i.e., lighting, sound, video, etc., constitutes a Permanent Establishment (PE) in India since the space is available at its disposal with exclusive right of access, controlled by it and used for its business. There was a clear link between the place of business and an identifiable geographical point, from where its business was done. The establishment need not be enduring or permanent in the sense that it should be in its control forever. The applicant had met each of the criteria for establishing a PE, namely, place of business, the power of disposition, the permanence of location, business activity and business connection. Accordingly, the AAR held that the payments received by the applicant for rendering lighting and searchlight services, earned through its PE in India, would be taxable as business profits under Article 7 of the India-Belgium tax treaty (tax treaty) and under the provisions of the Income-tax Act, 1961 (the Act).

The AAR held that the services rendered by the applicant were technical services since such services were complex and could not be availed without the assistance of highly trained technical personnel. However, the AAR held that by virtue of Most Favoured Nation (MFN) clause under the tax treaty, a restricted scope of Fees for Technical Services (FTS) [make available condition] provided under the India-Portugal tax treaty will be imported into the tax treaty. It cannot be said that the applicant had 'made available' the technical knowledge, experience, skill, knowhow or processes, which enable the development and transfer of a technical plan or technical design, and which enable the person acquiring the services to apply the technology contained therein. Therefore, the services provided by the applicant are not taxable as FTS.

Further payment for such services is also not in the nature of royalty since there is no assignment of any right to use the know-how, technical experience, skill, processes and methodology, or even the copyright, patent, trade mark, design or model, or any intellectual input comprised therein.

Facts of the case

- The applicant is registered in Belgium, and it is engaged in the business of providing technical equipment and services for events including lighting, sound, video and LED technologies. It entered into a service agreement with the Organising Committee of the Commonwealth Games, Delhi, (OCCG), for a term commencing on 9 July 2010 and expiring on 30 October 2010, to provide services on a turnkey basis.
- In terms of the agreement, the applicant rendered the services for two days, namely 3 October 2010, at the opening ceremony, and on 14 October 2010 at the closing ceremony of the Commonwealth Games Delhi, 2010. Its employees and equipment were in India for a period of only 66 days for the preparatory, installation and dismantling of equipment from 2 August 2010 to 24 October 2010.

[1] Production Resource Group (AAR No. 1330 of 2012, dated 8 November 2017) – Taxsutra.com

- As a consideration, OCCG agreed to pay fees of USD3.5 million, inclusive of the withholding and service tax, in installments. Four invoices were raised of which payments have been made against three after withholding tax at source and issued withholding tax certificates.

Issues before the AAR

- Whether the applicant has PE in India?
- Whether payments received for rendering, lighting and searchlight services to the OCCG would be taxable in India?

AAR ruling

Permanent Establishment

- The AAR observed that in providing services[2], the applicant has to do all related activities, such as abiding by and obtaining all authorisations, permits, and licenses, engaging personnel with the requisite skills, ensuring their availability; supply and/or procure all necessary equipment for its business, subcontracting; and shipping and loading, insurance, etc.
- Further, OCCG has provided the applicant and its subcontractors' lockable space for storing its tools and equipment inside the stadium. Thus, it has, at its disposal, space which is 'lockable', implying that it has access to and control over this space. This space is not merely for storage alone, but looking into the nature of the business. It is for carrying out the business itself.
- Looking into the expensive equipment, the time lines, the precision involved and the highly technical nature of the work involved, it is inconceivable that such facility would not be at its disposal with exclusive right to access and under the control of the applicant.
- On reference to the Klaus Vogel Commentary, it is immaterial that the place of business is located in the business facilities of another enterprise who may be the owner. Thus, as long as there is a space placed at its disposal with the exclusive right of access, controlled by it and used for its business, it would form a PE. The degree of control need not exceed the level of what is required for this specific business.
- The facilities provided to the applicant indicates that there was a clear link between the place of business and an identifiable geographical point, from where its business would be done. In fact, coupled with space, the lighting facilities created and erected by the applicant would also be part of the place of business as it is not necessary that they may be fixed to the soil, as long as they form an intrinsic part of its income-generating apparatus, and remain at a particular site.
- The AAR observed that the establishment need not be enduring or permanent in the sense that it should be in its control forever. The context in which a business is undertaken is relevant. The project consists of providing technical equipment and services for events including lighting, sound, video and LED technologies in connection with the Commonwealth Games, etc. Hence, this can obviously not last forever. This issue is considered in great length by the Supreme Court in the case of Formula One[3].
- Various clauses of the agreement indicate that the tasks performed by the applicant, including providing 3 phase supply, multiple synchronised generators, mains distribution and mains cabling, till its equipment were handed over or shipped. All these services were an integral part of the project and covered a much longer period.
- The insurance was taken by it for the period from the date of signing the agreement till 31 December 2010. The entire project was spread over a sufficiently long period of time comprised in the preliminary, preparatory, actual display, and winding up operations.
- The applicant subcontracted some of its activities, and this is clearly indicative of the fact that the applicant had an address, an office, from which it could call for and award subcontracts. It is difficult to assume that without any premises under its control, it could hire and house key technical and other personnel, who would need regular and ongoing instructions during the entire period.
- The AAR held that all these activities indicate that the applicant has a fixed place of business. It has been observed that no insurance company would insure any equipment, structures, etc. against any risk of fire, damage or theft unless the place was safe and in exclusive custody and at the disposal of the customer, and in a well-defined address or physical care. And even after installation, they are at its sole disposal and control so it could effectively and efficiently discharge its obligations of lighting, etc. at the ceremonies.

[2] The applicant is engaged in the business of providing technical equipment and services for events including lighting, sound, video and LED technologies

[3] Formula One World Championship Limited v. CIT [2017] 394 ITR 80 (SC)

- The applicant had indeed met each of the criterion for establishing a PE, as enumerated by itself, namely place of business, the power of disposition, the permanence of location, business activity and business connection which cumulatively and collectively are the sine qua non of a PE. In view of this position, the applicant's income arising from the PE was chargeable to tax in India as business income under Article 7 of India Belgium tax treaty.

Taxability under the Act

- The above income is also covered within the meaning of Section 9(1)(i) of the Act since the same has arisen and accrued from a business connection, which is wider in scope than a PE, and from a source in India.

Royalty

- Referring to OECD Model Conventions, Klaus Vogel Commentary, the AAR observed that in principle, royalties in respect of licences to use patents and similar property and similar payments are income to the recipient from a letting. This implies that the intangible asset, the Intellectual Property Rights (IPR) remains with the service provider, but the right to use the same may be granted or let to someone for a consideration, which would be a receipt in the nature of royalty.

- The AAR has discussed this matter at length in the case of AnapharmInc[4]. Citing Klaus Vogel Commentary, it was clarified that a contract for the provision of know-how was different from that of providing services. In the present case the applicant has assigned the rights to use the final product, the works, i.e., providing equipment and services, including lighting, sound, video and LED, etc., for use of the organiser, and for which the consideration has been received by the applicant.

- There is no assignment of any right to use the know-how, technical experience, skill, processes and methodology, or even the copyright, patent, trade mark, design or model, or any intellectual input comprised therein. These have only been used by the applicant itself in creating the final product, the equipment, and services. OCCG cannot and does not get to know how they were designed or developed, or acquires any knowledge of any intellectual input, nor it is enabled or empowered to do that work by itself in future.

- In events of this nature, it is usual to assign the exclusive rights to the client to use the equipment and services, to keep intact the element of uniqueness and novelty in experiencing the lighting display. But how this experience was created remains a trade secret with the creator of the same. Hence, the payment received as a consideration for the services rendered and equipment, etc. supplied does not constitute Royalty.

FTS

- As against the use of telephony and cell phone services for use of the public at large, as referred to in the case of Skycell Communications[5], on which the applicant has relied, in the present case where the services of lighting, search lights, LED technology etc., were provided by the applicant along with technical personnel to operate the same during the opening and closing ceremonies of the games.

- The same did not involve mere pressing of a button and receiving the service, but were complex and could not be availed without the assistance of highly trained technical personnel, as they were not routine and mechanical, as stated by the applicant.

- Also, ‘rendering' does not necessarily imply going on forever. As long as the applicant was present in India, it was rendering these services, till the events, starting with the preparatory work, since the laying of cables, switching systems, etc. were also highly technical in nature, and were part and parcel of the project. Hence, the services rendered were in the nature of technical services, as contemplated under the Act.

- However, on reference to the provisions of the tax treaty, read with its Protocol (MFN clause) and also read with the India-Portuguese Republic tax treaty, the AAR cannot escape from limiting the scope of Article 12, as applicable in the present case. Since the tax treaty with Portugal has a ‘make available’ clause, under the definition of FTS, the same needs to be imported into the tax treaty, and the definition of FTS needs to be re-examined in this light.

- In view of the above, taking a restricted meaning of the term, it cannot be said that the applicant had ‘made available’ technical knowledge, experience, skill, knowhow or processes, which enable the development and transfer of a technical plan or technical design, and which enable the person acquiring the services to apply the technology contained therein.

[4] Anapharm Inc., In re [2008] 305 ITR 394 (AAR)

[5] Skycell Communication Ltd. v DCIT [2001] 251 ITR 53 (Mad)

- The services were not made available to the organiser, in a manner that it acquired the know-how or the ability to use it, or that the service rendered enabled or empowered it to carry out the task in future all by itself. In this case, organiser only utilised the services for its events during the Common Wealth Games, and the consideration was paid for the same.

- Accordingly, the consideration received by the applicant for the technical services rendered could not be considered to be in the nature of FTS under the tax treaty read with Protocol along with the India-Portuguese Republic tax treaty.

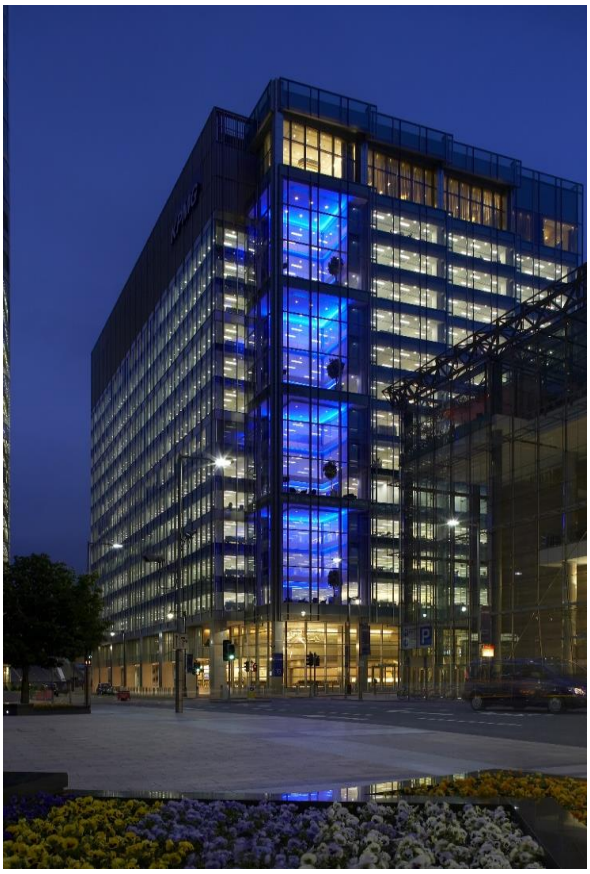
Since it has been held that the applicant has a PE in India, within the meaning of Article 5(1) of the tax treaty, and further that the same was not in the nature of royalty or FTS, the consideration received by the applicant for rendering lighting and searchlight services to organiser, can only be held to be taxable in India as business profits under Article 7 and Section 9(1)(i) of the Act, having accrued and arisen from its business connection and source in India.

Our comments

Determination of PE is a complex issue, and usually, the constitution of PE in India depends upon the facts of each case. Recently, the Supreme Court of India in the case of Formula One World Championship Ltd[6] dealt with the issue that whether the international circuit for a formula one race constitutes a fixed place of business under the India-U.K. tax treaty. Further, whether such international circuit was under the control and at the disposal of the taxpayer. The Supreme Court laid down an important principles and held that the international circuit constitutes a fixed place of business under the India-U.K. tax treaty since the international circuit was under the control and at the disposal of the taxpayer. The Supreme Court rejected taxpayer's contention that since the duration of the event was only three days, the total duration for which limited access was granted to it was not sufficient to constitute the degree of permanence necessary to establish a fixed place PE. The Supreme Court observed that the question of the PE has to be examined keeping in mind that the formula one race was to be conducted only for three days in a year and for the entire period of the race the control was with the taxpayer.

It is important to note that various Indian and foreign courts in various decisions while determining PE given importance to disposal test, control, etc., though the places in such cases were not ordinary place of business. Some of the Indian courts[7] have held that a stall or pitch in the market constitutes a place of business. Similarly, courts[8] have also held that a sales booth (erected using collapsible/mobile equipment) at an exhibition constitute a place of business. The Court of First Instance of Rhineland-Palatinate[9] has held that a hotel room also constitutes a place of business.

The instant decision is important from the perspective of determination of PE in India especially when the foreign enterprise operates in India for a short duration whereby it operates on the space provided by organiser for rendering services.



[6] Formula One World Championship Ltd v. CIT (Civil Appeal No. 3849 of 2017) – Taxsutra.com

[7] Rolls Royce Plc v. DDIT [2008] 113 TTJ 446 (Del) [affirmed in Rolls Royce Plc v. DIT [2011] 339 ITR 147 (Del), Galileo international Inc v. DCIT [2007-TII-40-ITAT-Del-Intl], Golf in Dubai LLC, In re [2008] 306 ITR 374 (AAR)

[8] Fowler v. Her Majesty the Queen (1990) 2 C.T.C. 2351 (Tax Court of Canada

[9] IBFD Case No. 4 K 2608/95 (Court of First Instance of Rhineland-Palatinate)

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