

Services provided by the seconded employees of a foreign company to its subsidiary in India do not result in permanent establishment

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Samsung Electronics Company Ltd.¹ (the taxpayer) held that the services provided by the seconded employees of a foreign company to its subsidiary in India do not result in Permanent Establishment (PE) in India. The Tribunal held that the expatriate employees are only discharging functions of subsidiary towards the holding company for the benefit of the business of the subsidiary. It is to make the Global Business Management (GBM) understand the priorities and preferences of the Indian customers by providing India specific information to GBM which in turn then carry out research and development to develop India-specific products.

Facts of the case

- The taxpayer is a tax resident of South Korea engaged in the business of manufacturing and sales of various categories of television, home appliances, telecommunication terminals, semi-conductors as well as other state of the art IT products for global markets. The taxpayer has two wholly owned subsidiaries in India i.e. Samsung India Electronics Private Limited (SIEL) and Samsung India Software Operations Private Limited (now known as Samsung R&D Institute India Bangalore Private Limited) (Samsung R&D).

- During the relevant year, a survey was conducted, wherein it was found that SIEL was manufacturing the items under the technical assistance of the taxpayer for which the taxpayer used to receive Fees for Technical Services (FTS). The Assessing Officer (AO) observed that the parent company had not paid any royalty for the use of its brand name 'SAMSUNG' by the Indian subsidiary company. Thus, the income of Korean company in the form of royalty had escaped assessment.
- Pursuant to the said survey, the AO issued a reassessment notice to the taxpayer under Section 148 of the Income-tax Act, 1961 (the Act) for initiating reassessment proceedings under Section 147 of the Act for six Assessment Years (AYs) from AY 2004-05 to 2009-10. In response to the above notice, the taxpayer filed its tax returns for all these years declaring income from branch activities for AY's 2004-08 to 2008-09 which was declared in the original return as well and also royalty/FTS which was not declared in the original return for any year.
- The AO observed that the Indian company's office was being used as place of management for South Asia operations by the parent company and therefore, the Indian company would constitute PE of the foreign parent company under Article 5(2)(a) of the India-Korea tax treaty (tax treaty) and a part of income from sales in South Asian countries such as Bangladesh, Nepal, Bhutan, and Maldives should be attributed to Samsung Electronics, Korea.

¹ Samsung Electronics Company Ltd v. DCIT [2018-TII-91-ITAT-DEL-INTL]

- The AO held that the Indian company was acting as a dependent agent of the foreign company in terms of Article 5(5) of the tax treaty, and the transactions between the two were not at arm's length. The AO held that expatriates employees create a PE of the taxpayer in India by rendering services to SIEL through its employees basis, and added an estimated income of 10 per cent on the remuneration paid to such expatriate employees during the years under consideration to determine the profits attributable to tax in India by applying Clause (iii) of Rule 10 of the Income-tax Rules, 1962 (the Rules).
- The Dispute Resolution Panel (DRP) upheld the order of the AO.

Tribunal's decision

Reassessment proceedings under Section 147/148 of the Act

- A perusal of the figures in the statement furnished in respect of the income as reported in the original return of income and the return furnished under Section 148 of the Act leaves no doubt that there is huge difference, and it cannot be said that the notice under Section 148 of the Act is not supported by any valid reason or reasons proposing to re-open the assessment for the AYs between 2004-05 and 2009.
 - It has been held that non-reporting of the receipt of income on account of royalty is a valid ground for the AO to propose the reopening of the assessment, and it cannot be said that there was no escapement of income merely because the tax was deducted at source on such income.
 - When it is open under Explanation 3 to Section 147 of the Act for the AO to reassess the income on any issue which newly comes to his/her notice subsequent to the issuance of notice under Section 148 of the Act, it cannot be said that mere wrong mentioning of the provision of law relating to the other issues in the reasons recorded would vitiate the proceedings. Accordingly, the Tribunal rejected the contention of the taxpayer that the reopening proceedings are bad under the law.
- Fixed place PE**
- The entire dispute on this issue revolves around the status of the expatriate employees working with the SIEL and the nature of functions they are performing. Whether they are actually the employees of the taxpayer and placed with the subsidiary to run the business of the taxpayer, or they are taxpayer's employees who are seconded to SIEL and the SIEL is the economic employer who exercises full control over them.
 - There is seamless information exchange between the employees of the taxpayer and the expatriate employees. However, on a careful consideration of the entire matter including the statements of the expatriate employees, the Tribunal observed that the statements show that such information exchange relates to the models/designs to the liking of the Indian consumers, plans and strategies relating to the sale of the products, detailed stock/logistical status, the market strategies both the mid and long terms, etc.
 - All the activities that are spoken by the expatriate employees related to the specificity of the products, stock verification, they design according to the preferences of the Indian consumers, the market strategies to be adopted, etc. are clearly within the ambit of the business of the Indian subsidiary. Such communication would primarily benefit the Indian subsidiary and would help the taxpayer in its GBM to sustain its supply chain management and to place optimised purchase orders at a right timing or to acquire the most promising manufacturing technologies.
 - At best, the statements and other material relied upon by the tax department indicate that by way of the seamless communication between the Indian subsidiary and the taxpayer, the expatriate employees were only discharging the duties of the subsidiary company towards the holding company.
 - Whatever the benefits that are derived by the Indian subsidiary by such communication are offered to tax in India. The Tribunal held that the activities stated by the expatriate employees in their statements are in the nature of reporting required in the course of discharge of the functions of the subsidiary company towards the holding company, and such activities do not constitute a PE under Article 5(4)(d), (e) and (f) of the tax treaty.
 - Even if the activities of seconded employees amount to the rendering of services to subsidiary by the taxpayer, in view of the fact that there is no provision for a Service PE under the tax treaty, no question of Service PE arises in this matter.
 - On a perusal of Article 5 of the tax treaty, the Tribunal observed that in order to constitute a PE, there must be a fixed place of business available to the taxpayer, through which the business of the taxpayer is wholly or partly carried on.

- The expat employees are discharging the functions of a subsidiary towards the holding company, which is for the benefit of the business of the subsidiary to make the GBM understand the priorities and preferences of the Indian customers by providing India specific information. GBM's which in turn then carry out research and development to develop India specific products. It cannot be said that it is in furtherance of the business of the taxpayer *de hors* the business of the subsidiary.
- In the absence of proof as to any management activity of the taxpayer being conducted in India or it is established that the decisions relating to the products to be manufactured, pricing in the domestic markets, or the decisions relating to the launch of such products in India is taken by the taxpayer, the Tribunal observed that it is difficult to agree with the lower authorities that through the expatriate employees the taxpayer has been conducting the business of taxpayer in India. Further, except stating that 10 per cent of the remuneration of these employees has to be assumed as the income of the taxpayer, absolutely there is no evidence that is placed on record by the AO to show that by way of business through these expatriate and seconded employees, the taxpayer derived any business income in India.
- Accordingly, the Tribunal held that there is neither any business conducted by the taxpayer in India through the expatriated employees nor any income is derived by them though the activities of the employees. Consequently, the Tribunal held that there is no fixed place PE of the taxpayer constituted through the expatriated employees.

Profit attribution

- The AO attributed income in respect of PE under Article 7 of the tax treaty. While making recourse to Rule 10(iii) of the Rules, the AO took the remuneration cost of the expatriate employees seconded to Indian subsidiary as the basis for attributing income and added an estimated income of 10 per cent on the understanding that had such services been rendered by an unrelated entity to Samsung India, 10 per cent would be a reasonable markup that would have been earned by it. The DRP confirmed this finding of the AO. However, the Tribunal held that as there is no business activity that is conducted by the taxpayer through the expatriate employees, the question of estimated income does not arise.

Our comments

With the growing trend of globalisation, the concept of PE has gained significant importance, both in India and worldwide, due to its direct influence on the tax revenues earned by a country. The issues regarding the constitution of PE and the attribution of the profits of PE have been matters of debate before the Courts/Tribunal including Supreme Court of India.

The Supreme Court in the case of the Formula One World Championship Ltd.² has dealt with the conditions for the constitution of PE at length. The Supreme Court held that the entire event in India is taken over and controlled by the taxpayer and its affiliates in India and hence the international circuit was at the disposal of the taxpayer through which it conducted business. Therefore, international circuit shall constitute a fixed place PE under the India-U.K. tax treaty even though the duration of the event was only for three days.

Similarly, the Supreme Court in the case of E-funds IT Solutions Inc.³ held that a Fixed Place PE can be created only if it is at the 'disposal of the foreign enterprise', with some 'degree of permanence', from which the 'business is carried on'. The Supreme Court held that no profits of the foreign company would be attributable even if there exists a PE in India since the Indian affiliate was remunerated at arm's length.

However, the Delhi Tribunal in the case of GE Energy Parts Inc.⁴ held that activities carried on by the expatriates of overseas entities under supervision and control of various entities, from the premises of liaison office were substantial and core and thus constituted foreign company's fixed place PE. Further, GE India comprising of expatriates deputed to India and employees of Indian entity, constituted dependent agency PE even though they were negotiating and concluding contracts for several group entities.

The Delhi Tribunal in the present case held that the services provided by the seconded employees of a foreign company to its subsidiary in India do not result in a PE in India.

It is important to note that where the foreign company, as well as its subsidiary, are operating simultaneously in India, operations of both the entities need to be analysed in detail to ascertain the possible PE exposure of the foreign company in India.

² Formula One World Championship Ltd v. CIT [2017] 394 ITR 80 (SC)

³ ADIT v. E-funds IT Solutions Inc. [2017] 399 ITR 34 (SC)

⁴ GE Energy Parts Inc. v. ADIT [2017] 184 TTJ 570 (Del)

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Pralhad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh – 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

KRM Tower, Ground Floor,
No 1, Harrington Road
Chetpet, Chennai – 600 031
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Gurugram

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurugram, Haryana – 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

Salarpuria Knowledge City,
ORWELL, 6th Floor, Unit 3, Phase
III, Sy No. 83/1, Plot No 2,
Serilingampally Mandal, Raidurg
Ranga Reddy District,
Hyderabad, Telangana – 500081
Tel: +91 40 6111 6000
Fax: +91 40 6111 6799

Jaipur

Regus Radiant Centres Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road
Jaipur, Rajasthan, 302018.
Tel: +91 141 - 7103224

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091
Tel: +91 33 4403 4000
Fax: +91 33 4403 4199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai – 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

Unit No. 501, 5th Floor,
Advant Navis Business Park
Tower-B, Plot# 7, Sector 142,
Expressway Noida, Gautam Budh Nagar,
Noida – 201305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex, Mundhwa Road,
Ghorpadi, Pune – 411001
Tel: +91 20 6747 7000
Fax: +91 20 6747 7100

Vadodara

iPlex India Private Limited,
1st floor office space, No. 1004,
Vadodara Hyper, Dr. V S Marg
Alkapuri, Vadodara – 390 007
Tel: +91 0265 235 1085/232 2607/232 2672

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