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TAX FLASH NEWS

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Indian associate enterprise of a Singapore company does not constitute a PE in India

Executive Summary

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of AB Sciex Pte Ltd.[1] (the taxpayer) dealt with the determination of a Permanent Establishment (PE) in India under the India-Singapore tax treaty (tax treaty). The Tribunal held that the taxpayer does not have fixed place PE under the tax treaty since the sales effected by the Indian entity were on its own independent status. The products purchased by the Indian entity and kept in its inventory cannot be considered to be the products belonging to the taxpayer. The sales transaction was on principal-to-principal basis for resale by the Indian entity to Indian customers. The taxpayer did not have a warehouse or sales outlet in India to constitute a fixed place PE in India under Article 5(1) of the tax treaty.

Further, the Indian entity cannot be treated as dependent agent PE under the tax treaty since it was not habitually exercising authority to conclude contract on behalf of the taxpayer.

Facts of the case

The taxpayer, a Singapore based company, is engaged in the business of manufacturing and sale of scientific research instruments and peripheral. The taxpayer had entered into three separate contracts with its Associated Enterprise (AE) in India, namely, Sales Commission Agreement, Distribution Agreement and Marketing Support Services Agreement. Indian AE, for all practical purposes, acts as an Indian representative of the taxpayer and also maintains inventory of spare parts in their premises. Indian AE is maintaining a warehouse in its premises for the equipments of the taxpayer and the premises is used as a sales outlet for soliciting or receiving orders. During the Assessment Year (AY) 2017-18, taxpayer received revenue from Annual Maintenance Contract (AMC).

The Assessing Officer (AO) observed that the products sold by the taxpayer require maintenance, calibration, which involves servicing, repairing and supply of spares. Therefore, the taxpayer offers maintenance service to its customers worldwide, including India. The AO held that since the premises of the Indian AE was used by the taxpayer as a warehouse to stock goods and being used as a sales outlet, it had to be considered as a fixed place PE. Further, the AO observed that Indian AE habitually exercises a predominant role in India for concluding contracts on behalf of the taxpayer and also habitually maintains in India stock of goods or merchandise from which it is regularly supplying goods merchandise on behalf of the taxpayer. Indian AE acts solely on behalf of the taxpayer while providing services to taxpayer's customers in India. Therefore, Indian AE was to be considered as a dependent agent PE of the taxpayer. Accordingly, the AO held that income attributable to the PE was to be taxed in India. The AO held that 37 per cent of the profit earned by the taxpayer in India was attributable to the PE and taxed it at the rate of 40 per cent with surcharge and education cess. The Dispute Resolution Panel (DRP) upheld the additions made by the AO. Aggrieved, the taxpayer filed an appeal before the Tribunal.

Tribunal decision

Agency PE

On perusal of invoices, it was clear that sales to Indian customers were directly made by the taxpayer from Singapore. Further it was observed that the taxpayer had appointed Indian AE on non-exclusive basis for providing services related to sales, installation, warranty for the products and spare parts sold directly by the taxpayer to customers in India. The agreement provides that the taxpayer may solicit or, upon an order being placed by a customer, take orders requiring delivery of products, whereas the taxpayer designates Indian AE as an authorised warranty-related service provider. The scope of services under the agreement are as follows:

[1] AB Sciex Pte Ltd. v. ACIT (ITA No.514/Del/2021) – Taxsutra.com

- Interaction and liaising in relation to orders from customers on behalf of the taxpayer.
- Other incidental activities like tracking delivery schedules, etc. for the customers based on directions provided by the overseas entities.
- Installation of products supplied by overseas entity to customers in India.
- Services in relation to warranty claims from customers, etc.

The agreement provides that Indian AE in a commercially reasonable manner, provide all customers necessary assistance and services during the warranty period, to the extent required under the terms of the relevant product warranty, irrespective of the fact, whether the product was purchased directly from the taxpayer or Indian AE. The agreement also provides that for performing installation and warranty related services, Indian AE shall be remunerated in the terms provided under the agreement. The commission for sales related activities was at 6 per cent and commission towards installation and first year warranty of instruments was at 3 per cent. In case of providing any spares under warranty/maintenance, Indian AE will provide for the same out of its own stock and Indian AE shall have the right to get a replacement product/part free of cost from the taxpayer or cross charge the cost of the product/part to the taxpayer.

Thus, the Sales Commission Agreement not only defines the scope of services of Indian AE but also makes it clear that Indian AE will have to provide the services stipulated under the agreement, regardless, whether the product was purchased from the taxpayer or from Indian AE. The scope of services under the agreement indicates that the Indian AE is required to do liaisoning in relation to orders from customers on behalf of the taxpayer. It also had to do other incidental activities like, tracking of delivery schedule for the customers, installation of products and provide warranty services. Thus, the scope of services did not envisage or grant any authority to Indian AE to conclude any contract of sale on behalf of the taxpayer.

On a perusal of the Distribution Agreement, it was observed that under the agreement, the taxpayer had appointed Indian AE as its non-exclusive distributor for distribution of related products and its spare parts to customers within the territory. The agreement include all such products and its spare parts which the taxpayer may decide to distribute under the agreement, and which is to be purchased by Indian AE either from the taxpayer or from third party for resale. Thus, a reading of the Distribution Agreement as a whole, indicated that the purchase of products by the Indian AE from the taxpayer for the purpose of resale in India was on principal-to-principal basis and no agency relationship was there between the parties.

Further it was provided that Indian AE shall at all times act only as an independent contractor, and never as a legal representative of the taxpayer. Nothing in the agreement shall be construed to give either party the power to direct or control the daily activities of the other party, or to allow Indian AE to negotiate or conclude contracts on behalf of the taxpayer, or to constitute the parties as principal and agent, employer and employee, franchisor and franchisee, partners, joint venture partners, co-owners, or otherwise as participants in a joint undertaking. Indian AE had no right or authority to assume or create any obligation of any kind, express or implied, on behalf of the taxpayer to any customer or to any other person and/or to waive any right, interest, or claim that the taxpayer may have against any customer, or other person.

As per the Marketing Support Services Agreement, Indian AE was required to provide the taxpayer and other group companies the marketing support services. For providing such services, the taxpayer was to be remunerated at cost plus markup at arm's length basis. Indian AE had no authority to negotiate or conclude or procure any contract or order on behalf of the taxpayer or any of its group companies or otherwise bind the taxpayer or any other group companies in any way in this regard.

Indian AE may take up/provide such services to any other parties if such arrangement does not prejudice the taxpayer or its group associates in any manner. Thus, even the Marketing Support Agreement makes it clear that Indian AE did not have any authority or power to conclude contracts or enter into any negotiations with the customers on behalf of the taxpayer.

Thus, the three sets of agreements read together or even on standalone basis did not in any manner give impression that Indian AE was habitually concluding contract on behalf of the taxpayer so as to make it a PE under Article 5(8) of the tax treaty. Indian AE was not acting as an agent wholly and exclusively for the taxpayer to make it a PE under Article 5(9) of the tax treaty. Accordingly, Indian entity did constitute dependent agent PE of the taxpayer.

Fixed Place PE

The taxpayer's employees had never visited India. Direct sales to Indian customers were made from Singapore through shipment. The sales effected by Indian AE were on its own independent status. Therefore, the products purchased by Indian AE under the Distribution Agreement and kept in its inventory cannot be considered to be the products belonging to the taxpayer, as, they were sales transaction on principal-to-principal basis for resale by Indian AE to Indian customers. Further, Sales Commission Agreement makes it clear that any replacement of products/spares under warranty/maintenance had to be provided by Indian AE out of its own inventory and Indian AE will have the right to either get a replacement from taxpayer or cross charge the cost to the taxpayer. Therefore, the terms of the agreements make it clear that taxpayer did not have a warehouse or sales outlet in India to constitute a fixed place PE in India under Article 5(1) of the tax treaty.

Reference was made to the decision of the Supreme Court in the case of E Funds IT Solution Inc.[2] In the facts of the present case, it was not disputed that there was no direct presence of the taxpayer in India. It was an admitted factual position that none of the employees of the taxpayer ever visited India in connection with taxpayer's business. Whatever sales of products were effected to Indian customers was directly from Singapore. Thus, applying the ratio laid down by the Supreme Court, it was held that there cannot be any fixed place PE of the taxpayer in India. This was because the revenue authorities have failed to discharge their initial burden of proving such fact.

Accordingly, it was held that the taxpayer did not have any PE in India. Therefore, in absence of PE, the business profits of the taxpayer cannot be taxed in India. Accordingly, the additions made by way of attribution of profit to the PE in India deserve to be deleted.

Profit attribution

Since, it was already held that the taxpayer did not have a PE in India, the aspect relating to attribution of profit to PE was academic and did not require adjudication.

Our comments

The issue with respect to the determination of PE of a foreign company in India has been a subject matter of litigation before the Courts/Tribunal.

The Supreme Court in the case of E-Funds IT Solution Inc. dealt with an issue whether the subsidiary of a U.S. company for back-office support services constitutes a PE in India. The Supreme Court relied on its own decision in case of Formula One World Championship Ltd.[3] and observed that there must exist a fixed place of business in India, which is at the disposal of foreign companies, through which the business has been carried on. The Supreme Court had held that no part of the main business and revenue earning activity of the taxpayer was carried on through a fixed business place in India which was at its disposal. The Indian company only renders support services which enable the taxpayer in turn to render services to its clients. The Supreme Court agreed with the High Court's observations that it had never been the case of the tax department that E-Funds India was authorised to or exercised any authority to conclude contracts on behalf of the U.S. company, nor was any factual foundation laid to attract any of the clauses contained in Article 5(4) of the tax treaty.

[2] ADIT v. E-funds IT Solutions Inc [2017] 399 ITR 34 (SC)
[3] Formula One World Championship Ltd. v. CIT [2017] 394 ITR 80 (SC)

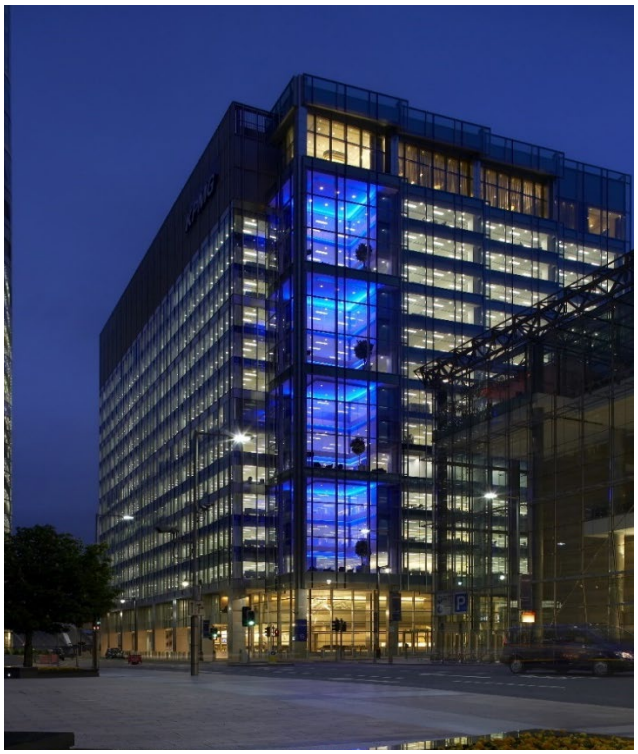
However, the Delhi High court in the case of GE Energy Parts Inc.[4] observed that GE India was located in the space leased by a group company. This space was at the constant disposal of such group company as evidenced by specific chamber/rooms and secretarial staff allotted to GE staff and was used by GE staff for their work. The taxpayer's activities in India were wholly or partly carried on through such a fixed place of business. Accordingly, the High Court had held that the taxpayer had a fixed place PE in India. The High Court while relying on the Italian Supreme Court's decision in Philip Morris observed that if agents are involved even in a phase of a conclusion of a contract it equals to 'authority to conclude contract'. Therefore, GE India's activities constituted agency PE in India.

The Tribunal, in the present case, has held that the taxpayer did not have fixed place PE since the sales effected by Indian entity were on its own independent status. The products purchased by the Indian entity and kept in its inventory cannot be considered as the products belonging to the taxpayer. The sales transaction was on principal-to-principal basis for resale by Indian entity to Indian customers. The taxpayer did not have a warehouse or sales outlet in India to constitute a fixed place PE in India under Article 5(1) of the tax treaty.

With respect to agency PE, the Tribunal held that the Indian entity cannot be treated as dependent agent PE under the tax treaty since it was not habitually exercising authority to conclude contract.

Determination of a PE in India is a fact specific exercise. It is important to analyse the facts of each case and the existing arrangements to mitigate a PE exposure in India.

[4] GE Energy Parts Inc v. CIT [2019] 411 ITR 243 (Del)



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