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TAX FLASH NEWS

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Japanese company's Indian Joint Venture company does not constitute a fixed place or a supervisory PE in India

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of FCC Co. Ltd.[1] (the taxpayer) dealt with the constitution of Permanent Establishment (PE) in India under Article 5 of the India-Japan tax treaty (tax treaty). The Tribunal held that the premises of the Joint Venture company (JV) do not constitute a fixed place PE in India under the tax treaty. Merely providing access to the premises by JV for the purpose of providing certain services by the taxpayer would not amount to the place being at the disposal of the taxpayer. Though the taxpayer had access to the factory premises of JV, it was for the limited purposes of rendering agreed services to JV without any control over the said premises. The taxpayer's business was not carried out from the alleged fixed place PE.

Further, the Tribunal held that there was no Supervisory PE of the taxpayer in India since none of the activities performed by the employees were in the nature of supervisory functions. The employees were not rendering any services in connection with a building site, construction project, installation project or assembly project.

Facts of the case

The taxpayer, a tax resident of Japan, is engaged in the business of manufacturing of clutch systems for cars, motorcycles, utility vehicles, specialised tools and dies and molding and machining of plastics. The taxpayer entered into a joint venture agreement with Rico Auto and formed a JV company in India (FRL) in the year 1997. The taxpayer also incorporated a WOS (FCC) in India. Both FRL and FCC are engaged in the business of manufacturing and supply of automobile clutch assemblies. As a part of restructuring, Rico Auto exited FRL by transferring its stake to FCC and thereafter FRL was merged with FCC with effect from 1 January 2015. Consequently, as a part of a merger, FRL ceased to exist, and it stands dissolved. The taxpayer received the following types of income from FRL:

- Royalty income under the license agreement
- Fees for technical services (FTS) under the agreement for dispatch of engineers
- Income from the supply of raw material, components and capital goods under the Master Sales Agreement (MSA)

All three agreements were integral to each other. The taxpayer's business was extended to India which was performed through engineers on a visit to the workplace in India.

The Assessing Officer (AO) held that the taxpayer had a business connection in India under Section 9(1)(i) of the Income-tax Act, 1961 (the Act) and a fixed place PE as well as a Supervisory PE in India under Article 5 of the tax treaty. The AO held that FRL's premises in addition to hosting the business activities of FRL, serve as a 'branch' and an 'office' of the taxpayer. Therefore, a fixed place PE was constituted. Further, the taxpayer deputed professionally qualified employees to the factory site of FRL in India and hence such factory site constituted a fixed place PE of the taxpayer in India.

The AO also observed that certain employees of the taxpayer who visited India helped FRL in setting up a new product line in India for which end-to-end supervision was provided. The period of stay of these employees in India exceeded 6 months and hence it constituted a Supervisory PE of the taxpayer in India. Accordingly, the AO proceeded to tax the receipts from the sale of raw materials and capital goods by attributing 50 per cent of the profits to the alleged PE in India. The Dispute Resolution Panel (DRP) upheld the order of the AO. Aggrieved, the taxpayer filed an appeal before the Tribunal.

[1] FCC Co. Ltd. v. ACIT ((ITA No.8960/Del/2019) – Taxsutra.com

Tribunal's decision

Fixed Place PE

FRL was alleged to be the place of business from which the taxpayer's business was being carried out. It is a well-settled position that to constitute a fixed place PE it is a prerequisite that the alleged premise must be at the disposal of the enterprise. The Supreme Court in the case of Formula One World Championship[2] has held that merely giving access to the premise to the enterprise for the purposes of the project would not suffice. The place would be treated as at the disposal of the enterprise when the enterprise has the right to use the said place and has control thereupon.

In light of the facts of the case and various judicial precedents wherein the constitution of fixed place PE has been considered and adjudicated upon, the Tribunal observed that the conditions laid down for the creation of a fixed place PE were not satisfied in the taxpayer's case. Merely providing access to the premises by FRL for the purpose of providing agreed services by the taxpayer would not amount to the place being at the disposal of the taxpayer. No doubt the taxpayer had access to the factory premises of FRL but it was for the limited purposes of rendering agreed services to FRL without any control over the said premises. Moreover, FRL was an independent legal entity carrying on its business with its own clients for which the taxpayer provides time to time technical assistance as required by it. The taxpayer's business was not carried out from the alleged fixed place PE.

The tax department relying on the Licence Agreement contended that the title of goods supplied by the taxpayer to FRL passed in India and hence the taxpayer was carrying on business in India. However, reference to these clauses is irrelevant to conclude that the title of goods passed in India and thus fixed place PE of the taxpayer is created in India in view of the decision of the Supreme Court in Mahabir Commercial Co. Ltd[3].

Since the goods were manufactured outside India, the sale of goods took place outside India and consideration was also received by the taxpayer outside India, the title passed outside India and hence the taxpayer had not carried out any operation in India in relation to the supply of the raw material and capital goods. Therefore, the taxpayer did not have a fixed place PE in India.

Supervisory PE

A perusal of the agreement for dispatch of engineers indicates that the employees of the taxpayer visited India to assist FRL in relation to supplies made by FRL/FCC to its customers, resolving problems relating to production, fixing of machines, maintenance of machines, support in quality control, IT related services, support for the launch of new segment line, etc.

As per the tax treaty, an enterprise shall be deemed to have a PE if it carries on supervisory activities in the contracting state for more than six months in connection with a building site or construction, installation or assembly project which is being undertaken in that contracting state. The Tribunal observed that none of the activities performed by the employees were in the nature of supervisory functions. Supervision being the act of overseeing or watching over someone or something is not reflected in the work done by the engineers in India for FRL. Moreover, no installation or assembly project was going at FRL's premises. FRL has been in the existing business for many years and no new line of business was launched by FRL. The employees were not rendering any services in connection with the building site or a construction project or an installation project or an assembly project. From the nature of the services rendered by the employees, it is amply clear that these activities were not in connection with a building site or construction installation or assembly project.

Hence, the issue of computation of the period of six months also becomes academic. The employees are visiting India on a year-to-year basis under the contract. The employees visited India to render certain technical services under the licence agreement read with the dispatch of engineers agreement which has been duly offered to tax by the taxpayer as FTS as per the provisions of the tax treaty. Therefore, there was no supervisory PE of the taxpayer in India.

Since the taxpayer did not have a PE in India, the issue of attribution of profits to such PE did not arise.

Our comments

With globalisation and changing technology, determination of a PE as well as taxability of royalty/FTS have been subject matters of debate before the Courts/Tribunal.

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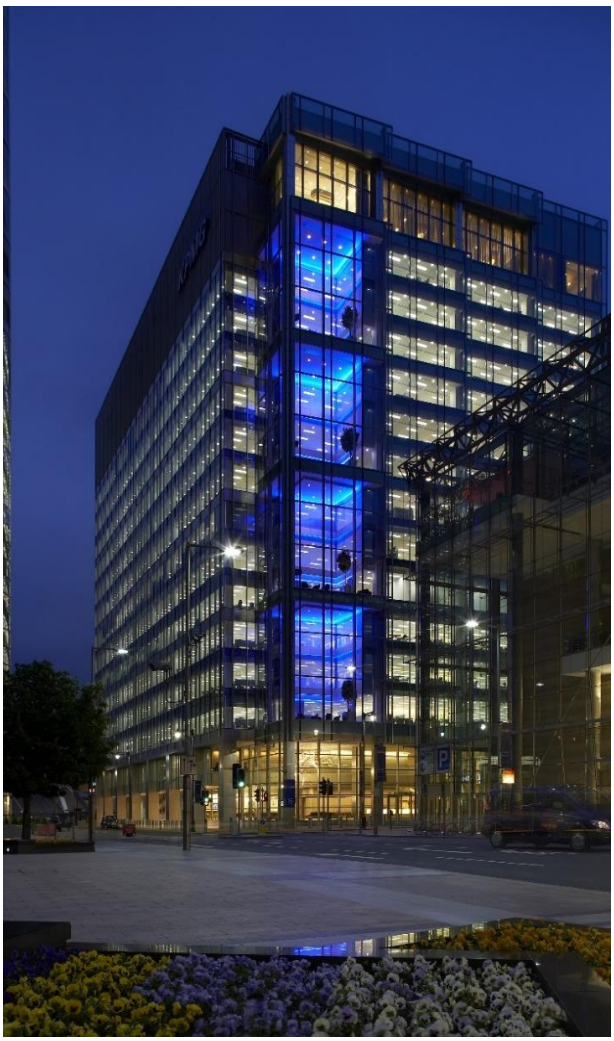
[2] Formula One world Championship v. CIT [2017] 394 ITR 80 (SC)
[3] Mahabir Commercial Co. Ltd. v. CIT 1973 AIR 430

Several commentaries[4] emphasise that the fixed place should be available at the disposal of the enterprise. The Supreme Court in the case of Formula One World Championship Ltd.[5] held that the international circuit constitutes a fixed place of business under the India-U.K. tax treaty since the international circuit was under control and at the disposal of the taxpayer. Similarly, the AAR in the case of MasterCard Asia Pacific Pte. Ltd[6] held that MIP and Mastercard network facilitated its services and the same constituted a fixed place PE in India since the applicant was carrying out its business of facilitation of authorisation of the transaction through such MIPs and network which were at the disposal of the taxpayer.

The Tribunal, in the present case, has held that the premises of the JV company do not constitute a fixed place PE in India under the tax treaty because merely providing access to the premises by FRL for the purpose of providing agreed services by the taxpayer would not amount to the place being at the disposal of the taxpayer. Though the taxpayer had access to the factory premises of JV, it was for the limited purposes of rendering agreed services to JV without any control over the said premises. The taxpayer's business was not carried out from the alleged fixed place PE.

With respect to the Supervisory PE, the Tribunal held that there is no supervisory PE of the taxpayer since none of the activities performed by the employees were in the nature of supervisory functions. The employees were not rendering any services in connection with the building site or a construction project or an installation project or an assembly project.



[4] Philip Baker, Klaus Vogel and OECD commentary (2017)
[5] Formula One World Championship v. CIT [2017] 394 ITR 80 (SC)
[6] MasterCard Asia Pacific Pte. Ltd [2018] 406 ITR 43 (AAR)

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