



Tax Flash News



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Agency permanent establishment denied as the actual facts did not support the fulfilment of prescribed conditions

Executive summary



The determination of whether or not a foreign company has an agency permanent establishment (PE) in India is a fact driven exercise.

In a situation where an Indian subsidiary provides the market support services to the non-resident enterprise, the Revenue has been alleging that the subsidiary is involved in negotiations or conclusion of the contracts on the behalf of the non-resident or securing orders for the non-resident, to argue that the non-resident has an agency PE in India.

The Delhi bench of the Tribunal in the case of *ITOCHU Corporation*¹, based on the factual analysis, held that the Indian subsidiary neither had an authority to conclude the contracts nor secured orders in India for the non-resident taxpayer. Accordingly, the conditions prescribed for constituting an agency PE under the India-Japan tax treaty are not satisfied.

¹ *ITOCHU Corporation v. ACIT* (ITA No 760/Del/2021) (Del) – Source: Taxsutra

Relevant provisions of the treaty

A non-resident enterprise is deemed to have an agency PE² in India if a dependent agent:

- (a) habitually exercises in India an authority to conclude contracts on behalf of the principal (enterprise) or
- (b) habitually maintains in India a stock of goods from which he regularly delivers goods on behalf of the enterprise or
- (c) habitually secures orders in India wholly or almost wholly for the enterprise.

Facts of the case

The taxpayer, a resident of Japan, is involved in domestic and overseas trading of products like textile, machinery, minerals and provides various services.

The taxpayer had a subsidiary in India which was also engaged in trading activities. The taxpayer entered into an agency agreement with the subsidiary to provide services to support its sales activities in India and also purchase activities for exporting the goods outside India.

The taxpayer sold goods to the Indian customers either directly or with the support of its Indian subsidiary.

The Revenue alleged that the taxpayer has an agency PE in India in the form of the subsidiary. The tax officer attributed 50 per cent of sales made to Indian customers (including direct sales) to the alleged PE in India and applied a profit rate of 10 per cent of such sales.

Taxpayer's contentions

The taxpayer did not have an agency PE in India as did not satisfy the conditions of the agency PE clause. The role of the subsidiary was limited to act as a communication channel between the taxpayer and the customers.

The subsidiary was not legally or economically dependent on the taxpayer and has a major source of income in India from its own trading activities.

The negotiation of prices with the customers did not relate to the sales activities but related to the purchase functions for the taxpayer for exporting goods outside India. Such purchase activities of non-resident are exempt from tax under the Income-tax Act, 1961³.

² Article 5(7) of the treaty

³ Clause (b) of Explanation 1 to section 9(1)(i)

Revenue's contentions



The subsidiary secured orders in India for the taxpayer and also negotiated and finalised the prices with the taxpayer's customers. The prices decided by the subsidiary have the binding effect on the taxpayer.

Tribunal's decision



The taxpayer did not have agency PE in India as the prescribed conditions are not fulfilled.

Merely referring to the parties as principal or agent in the agreement was not sufficient to invoke the provisions of agency PE.

In this regard, the tax officer needs to establish that the agent has an authority to take decisions in relation to business operations on its own and without any instructions or directions of the principal. It should also be established that the agent has the requisite skills and resources to perform the services.

No authority to conclude or negotiate the contract on behalf of the taxpayer

The subsidiary did not take active part in the negotiation of the prices and terms with the

customers. The services rendered by the subsidiary were recommendatory in nature. The Indian company only acted as a facilitator in the negotiation process.

The taxpayer was principally responsible for such negotiations with customers and making all final decisions on the pricing and contract terms.

The majority of Indian customers were existing customers of the taxpayer. The taxpayer already possesses a substantial amount of information about such customers. The subsidiary did not generally assist the taxpayer in identifying the customers.

The credit evaluation of the customers is also made by the taxpayer. The final decision of accepting or rejecting the customer (along with the pricing) is taken by the taxpayer.

The taxpayer was solely responsible for developing the pricing of the products and services. The subsidiary did not independently develop the pricing recommendations.

The financing, invoicing, and collection are carried out directly by the taxpayer for its customers. The subsidiary did not assist in the collection of dues from customers.

The taxpayer develops the overall logistic policies and bear the costs and associated liabilities of logistics. The subsidiary was only responsible for keeping track of the movement of goods sold by the taxpayer and informs the same to the customers upon request.

The supervision and quality control were ensured by the taxpayer and the subsidiary did not play any role in the same.

The subsidiary was merely responsible for staying abreast of market, regulatory, and political conditions in India and updating the taxpayer on a regular basis to enable it to consider these factors in formulating its strategy for India.

In relation to trading transactions, the Indian subsidiary entered into contract with the customers and bears the consequential contractual liability. However, such liability is passed on to the customer as all orders are confirmed order and are entered into on back-to-back basis.

No maintenance of stock for the taxpayer

The subsidiary did not maintain any stock of goods or merchandise for the taxpayer. The goods were supplied offshore and were imported by the Indian customer directly.

In relation to the trading activities, the Indian subsidiary takes flash title to the goods and holds inventory in some cases. However, the inventory held by the Indian subsidiary is backed by the confirmed orders.

No securing of order

Securing an order means the complete involvement from the starting to the end including active involvement in negotiating the terms of the contract and convincing the customer to place orders which was not done by the subsidiary in the instant case.

The role of the subsidiary was limited to act as a communication channel.

Dependency test

Income from the independent trading activities constitutes a major source of income for the Indian subsidiary. The commission income from the taxpayer forms a small portion of the total revenue of the subsidiary.

Profit attribution

The subsidiary was paid a service fee/commission by the taxpayer for its services at an arm's length price. Once it is established that the alleged PE has been compensated at an arm's length, no further profits can be attributed to such PE.

Our comments



For determining whether or not the non-resident taxpayer has an agency PE in India, it is imperative to undertake a thorough factual analysis. Mere mentioning of words like principal and agent in the agreement itself does not create an agency PE. The conditions under the tax treaty need to be evaluated in the light of the actual facts of each case.



KPMG in India addresses:

Ahmedabad

Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road, Prahlad Nagar, Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Hyderabad

Salarpuria Knowledge City, 6th Floor, Unit 3, Phase III, Sy No. 83/1, Plot No 2, Serilingampally Mandal, Ranga Reddy District, Hyderabad – 500 081.
Tel: +91 40 6111 6000

Noida

Unit No. 501, 5th Floor, Advant Navis Business Park, Tower-A, Plot# 7, Sector 142, Expressway Noida, Gautam Budh Nagar, Noida – 201 305.
Tel: +91 0120 386 8000

Bengaluru

Embassy Golf Links Business Park,
Pebble Beach, 'B' Block, 1st & 2nd Floor, Off Intermediate Ring Road, Bengaluru – 560071 Tel: +91 80 6833 5000

Jaipur

Regus Radiant Centre Pvt Ltd., Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road, Jaipur – 302 018.
Tel: +91 141 - 7103224

Pune

9th floor, Business Plaza, Westin Hotel Campus, 36/3-B, Koregaon Park Annex, Mundhwa Road, Ghorpadi, Pune – 411 001.
Tel: +91 20 6747 7000

Chandigarh

SCO 22-23 (1st Floor), Sector 8C, Madhya Marg, Chandigarh – 160 009.
Tel: +91 172 664 4000

Kochi

Syama Business Centre,
3rd Floor, NH By Pass Road, Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Chennai

KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road, Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Kolkata

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

Mumbai

2nd Floor, Block T2 (B Wing), Lodha Excelus, Apollo Mills Compound, N M Joshi Marg, Mahalaxmi, Mumbai- 400011 Tel: +91 22 3989 6000

Vadodara

Ocean Building, 303, 3rd Floor, Beside Center Square Mall, Opp. Vadodara Central Mall, Dr. Vikram Sarabhai Marg, Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada

Door No. 54-15-18E, Sai Odyssey, Gurunanak Nagar Road, NH 5, Opp. Executive Club, Vijayawada, Krishna District, Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

Gurugram

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

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011 Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

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