

TAX FLASH NEWS

15 June 2021

Foreign employees deputed to the Indian associated enterprise do not constitute agency PE in India

The Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Lubrizol Advanced Materials Inc.¹ (the taxpayer) dealt with the issue of constitution of an Agency Permanent Establishment (PE) and attribution of salary of the employees working under the supervision of an Associated Enterprise (AE) to a supervisory PE under the India-U.S. tax treaty (the tax treaty). The Tribunal held that the foreign employees working with the Indian subsidiary do not constitute an agency PE in India since there was no connection between such employees and the taxpayer. Further, the deputed personnel were employees of the AE and worked under the supervision and guidance of AE in India. Merely displaying information on the website does not lead to the conclusion that these are employees of the foreign taxpayer. Therefore, salary of the employees of the AE cannot be attributed to the supervisory PE in India.

Facts of the case

The taxpayer, a US based entity, is having an AE in India. The AE of the taxpayer was in the process of establishing a new manufacturing plant in India. For this purpose, the AE entered into inter-company services agreement with the taxpayer for providing engineering, technology, design and project supervisory services. As per the agreement, the AE was to pay actual cost-plus mark-up at the rate of 10 per cent to the taxpayer. Accordingly, the taxpayer sent its personnel to India for supervision of the project. During the year under consideration, the taxpayer sold certain goods to its AE in pursuance of purchase agreement which was signed by employees of the AE on behalf of the AE. As per clause 5(2)(k) of the tax treaty, the taxpayer was having a supervisory PE India and thus filed its return of income in India.

The Assessing Officer (AO) held that there were two more employees of the taxpayer who were involved with the supervisory services provided in connection with the establishment of plant of the AE in India. However, their salary which was also partly reimbursed by the AE to the taxpayer was not considered in the income of the supervisory PE. Further, the AO observed that the taxpayer had sold certain goods to its AE in India in pursuance of purchase agreement which was signed by the two employees on behalf of the AE being managing directors. These two employees were working for the taxpayer and accordingly there exists a dependent agent PE with respect to such transaction as per Article 5 of the tax treaty. The AO held that such transaction should be brought to tax in India. Accordingly, the AO computed the amount of profit attributable to India as per the provision of Rule 10 of the Income-tax Rules, 1962 (the Rules). Subsequently, the Dispute Resolution Panel (DRP) confirmed the order of the AO.

Tribunal's decision

Attribution of salary of AE employees to supervisory PE

During the year, the salary of the two employees of the taxpayer was paid by the AE and it has also deducted taxes and issued TDS certificate. These employees had also filed their return of income in India and copy of the same were furnished before the AO.

It was agreed upon by the parties that the deputed personnel will be the employee of the AE and will work under the supervision and guidance of the AE India. The AE will pay the salary to those personnel and bear the cost of all the benefit provided to them. It was also agreed upon that the part of the salary will be paid in foreign currency for the purpose of convenience but the quantum of same would be decided by the AE as per rules and regulation applicable in India.

¹ Lubrizol Advanced Materials Inc. v. DCIT [ITA No. 2455 /Ahd/2018]

Subsequently, the employment agreement was entered into between the AE and the employees. On perusal of the employment agreement it was revealed that the employees were working exclusively for the AE. Thus, no adverse inference can be drawn against the taxpayer merely on the information displayed on the website. Further, the information displayed on the website cannot precede the documents which are available on record for deciding the issue in the present case. Accordingly, salary of two employees working at AE cannot be attributed to a Supervisory PE in India.

Dependent Agent PE

It has already been held that the employees were not the employees of the taxpayer. Rather these are the employees of the AE of the taxpayer. Therefore, the purchase agreement signed by them was entered on behalf of the AE in the capacity of authorised signatory being the directors. Accordingly, it can be concluded that there was no connection between the employees and the taxpayer which can establish any agency PE in India.

Our comments

In the present case, the issue was with respect to agency PE vis-à-vis deputed employees. The deputed employees were working fully under the India AE of the taxpayer and not under the taxpayer. The purchase agreement for which the tax department was invoking agency PE was signed by the deputed employees was entered on behalf of the India AE. Thus, the Tribunal held that there was no agency PE in India.

The Tribunal has reiterated the principle that, foreign employees deputed to an Indian company, were to be considered as employees of the Indian company since they worked under the supervision and guidance of the Indian company, their salaries were paid by the Indian company and the cost of benefits provided to them were also borne by the Indian company.

The determination of agency PE is a factual aspect and taxpayers should carefully evaluate their transaction by applying this decision.

In this decision, the tax department relied on the information given on foreign companies website to contend that the deputed employees were working under the foreign company. However, the Tribunal observed that the information displayed on the website cannot precede the documents which are available on record for deciding the issue. Thus, one cannot merely on the basis of information available on the website can reach to a conclusion on the issue. It is necessary to examine all the relevant documents and conduct of the parties to determine its nature.



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