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Tax Flash News

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Anti-fragmentation rule in the definition of permanent establishment not applicable in the absence of any business activity carried on by foreign enterprise in India

Executive summary

In the case of *RGA International*[1], the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) held that the Indian group company, providing preparatory and auxiliary support services, shall not constitute a fixed place permanent establishment (fixed place PE) or a dependent agent PE (DAPE) of the taxpayer in India under the India-Ireland tax treaty (treaty).

The Tribunal also analysed the anti-fragmentation rule introduced through the Multilateral Instruments (MLI), which overrides the PE exemption provided for preparatory or auxiliary activities under the treaty. It concluded that the rule was not applicable in the instant case, as the taxpayer and the Indian group company were not conducting complementary business activities that formed part of a cohesive business operation in the same country i.e., India.

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[1] *RGA International Reinsurance Company Designated Activity Company* v. *DCIT* (ITA No. 1092/ Mum/ 2025)

Facts of the case

The taxpayer, a tax resident of Ireland, was engaged in business of life reinsurance.

It entered into reinsurance agreement with Indian insurers/ cedants (the Indian customers) and received reinsurance premium for underwriting the risks.

The taxpayer operated without any physical presence/office or employees in India.

RGA India, an Indian group company, provided business support services, including underwriting and actuarial support, risk profiling, suggestions for underwriting proposals, marketing support services (market research, customer relationship management) and administrative assistance. For these services, RGA India was remunerated by the taxpayer on an arm's length basis under a cost-plus mark-up arrangement.

Asserting that the services rendered by RGA India were preparatory or auxiliary in nature and the taxpayer had no PE in India under the treaty, the taxpayer took the position that the reinsurance premium received from Indian customers was not taxable in India.

However, the Revenue alleged that RGA India constituted both a fixed place PE[2] and a DAPE[3] of the taxpayer in India under the treaty. The Revenue attributed 50 percent of the gross premium receipts to the alleged PE and applied a 10 per cent profit margin to determine taxable business profits in India.

Relevant provisions of the treaty

A foreign enterprise has a fixed place PE in India if it carries on business through a fixed place of business in India.

However, a PE is not constituted if a fixed place of business is being maintained solely for carrying on preparatory or auxiliary activities (the P&A exemption clause)[4].

The P&A exemption clause is not applicable if the business activities are carried out by the foreign enterprise or its closely related enterprise at the same place or at another place in India and:

- the overall activity resulting from the combination

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[2] Article 5(1)
[3] Article 5(6)
[4] Article 5(5)

of both enterprises' activities is not of a preparatory or auxiliary in character, and

- their business activities constitute complementary functions that are part of a cohesive business operation.

This provision has been introduced into the treaty through the MLI to prevent artificial fragmentation/ segregation of business operations between two entities, aimed at avoiding establishment of a PE (MLI exception)[5].

DAPE clause provides that a foreign enterprise has a DAPE in India if a dependent agent, *inter alia*, has and habitually exercises in India an authority to conclude contracts in the name of the enterprise or secures orders for the enterprise.

Insurance PE clause[6] is not applicable in the case of re-insurance.

Revenue's contentions

RGA India performed vital and core business functions, which had a continuous and intimate connection with the taxpayer's business in India, and thus, established a 'business connection' under the Income-tax Act, 1961(the Act)[7].

RGA India constituted a fixed place PE under the treaty as the decisions related to reinsurance were taken by the taxpayer based on the support services provided by RGA India.

Since the operations of RGA India did not have an independent status, it also formed DAPE of the taxpayer under the treaty.

The services rendered by RGA India were primary business functions and not in the nature of auxiliary or preparatory services.

Even if the activities of RGA India were considered as preparatory in nature, the P&A exemption was not applicable as the services rendered / activities performed by RGA India constituted complementary functions that were part of a cohesive business operation of the taxpayer, thus, triggering the MLI exception and resulting in constitution of PE in India.

[5] Article 13 of the MLI – Artificial avoidance of Permanent Establishment status through the specific activity exemptions

[6] Article 5(7)

[7] Section 9(1)(i)

Tribunal’s Decision

The Tribunal relied on its own decision in the taxpayer’s case in the preceding years and upheld that the taxpayer had no PE in India during the relevant year. Key observations from the Tribunal’s orders passed in the preceding years include:

No business connection in India

Evaluation of ‘business connection’ under the Act was not relevant when beneficial provisions under the treaty are applicable.

Even otherwise, the taxpayer had no ‘business connection’ in India as RGA India operated independently, served multiple Group entities, was not economically dependent on the taxpayer and was compensated at arm’s length.

No fixed place PE in India

The taxpayer had no physical premises or office space in India for undertaking reinsurance business activities. RGA India’ office premises were not at the disposal of the taxpayer.

None of the employees of the taxpayer visited India for business purposes during the relevant year.

The core business activities of the taxpayer were not carried out in or from India:

— The taxpayer’s infrastructure, personnel and capital required to carry out reinsurance activities were located outside India.

— The core reinsurance activity involves the assumption of risk, which was undertaken by the taxpayer in Ireland (not in India).

— Reinsurance agreements with the Indian customers were signed outside India.

— RGA India did not have the regulatory approval from IRDAI[8] to conduct reinsurance business in India.

No DAPE in India

For an agency relationship to exist, a person must hold the position to substitute the principal in executing any contract, with similar role and rights therein. In the absence of IRDAI approval, RGA India was not permitted to enter into any reinsurance agreement in India, and thus, was not an agent of the taxpayer in India. The terms and conditions for such agreements were agreed and concluded between the taxpayer and the Indian customers.

[8] Insurance Regulatory and Development Authority of India

RGA India had no authority to negotiate or conclude contracts in the name of the taxpayer, nor did it secure orders for the taxpayer in India.

RGA India operated on a principal-to-principal basis and provided services to other Group entities (in addition to the taxpayer), indicating economic independence.

The taxpayer did not exercise control over RGA India's operations or provide detailed instructions in relation thereto.

Preparatory/ auxiliary nature of services

RGA India acted as a communication channel between the Indian customers and the taxpayer.

It provided administrative support services to the taxpayer, which included, *inter-alia*, document collection and synopsis preparation for insurance claims, monitoring premium payments, evaluation of proposals from medical and financial perspective, etc.

These services rendered by RGA India were preparatory and auxiliary in nature, falling within the P&A exemption clause under the treaty.

MLI exception not applicable

For the MLI exception to apply, both the taxpayer and RGA India must conduct business activities in the same country and such activities should result in a cohesive business operation.

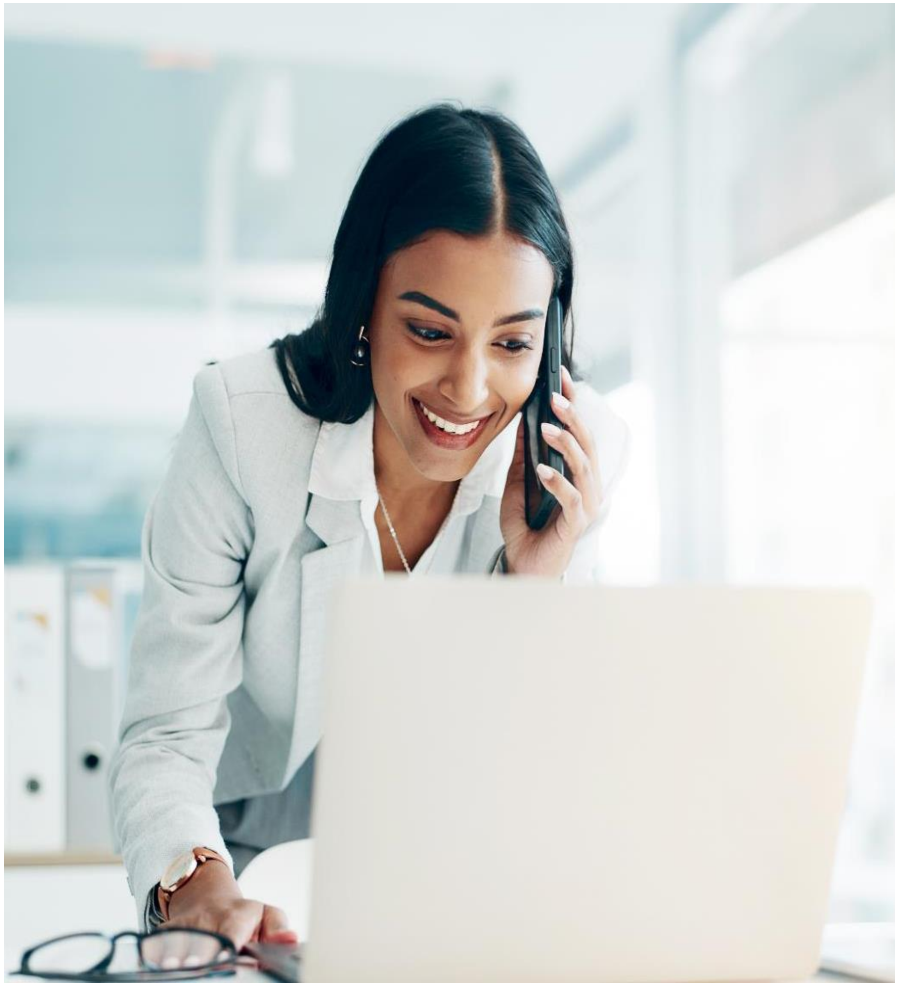
The acceptance of risk which was the key function of reinsurance business was assumed by the taxpayer outside India. The taxpayer did not have any office premises in India.

Thus, the taxpayer and RGA India were not carrying on business activities which constituted complementary functions that were part of a cohesive business operation in the same country, i.e., India. Accordingly, the anti-fragmentation rule brought through the MLI was not applicable.

Our comments

Determination of a PE requires a detailed factual analysis and careful application of the conditions specified in the relevant treaty.

Though the ruling reaffirms the limited scope of the MLI exception, especially where core business functions are performed outside India, it is imperative to evaluate the impact of anti-fragmentation rule in treaties with countries such as Ireland, UK, France, Netherlands.



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