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TAX FLASH NEWS

17 August 2021

Time spent on interconnected services under a unified agreement is to be aggregated to determine a Permanent Establishment in India

Executive summary

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Telenor ASA[1] (the taxpayer) dealt with the issue of constitution of Permanent Establishment (PE) under the India-Norway tax treaty (tax treaty) for interconnected services under the unified agreement. The Tribunal observed that different services under the Service Order Form (SOFs) involve various activities like sourcing, marketing, ITeS, network, project, etc. These activities consist of inter-connected projects and no single activity can give rise to performance and achieving of the purpose of the recipient. Therefore, the duration threshold of the employees who perform such services would fall within the provisions of Article 5(2)(I) of the tax treaty. It is required to be aggregated together, and it exceeds the threshold prescribed under such provisions. Therefore, the taxpayer constitutes a PE in India under the tax treaty.

Facts of the case

The taxpayer, a tax resident of Norway, entered into Business Service Agreement (BSA), dated 10 August 2010 with Unitech Wireless (Tamil Nadu) India P. Ltd. (Indian company) effective from 1 April 2009. As per the BSA, the taxpayer provided services under SOFs to Unitech Wireless (UW). Various SOFs constitute separate projects / activities, and it cannot be treated as a single consolidated activity. There are different services like marketing activities and sourcing activities which are undertaken by different departments and cannot be clubbed together as an integrated project but should be treated as separate and independent activities. The taxpayer claimed that said income was in the nature of 'Fee for Technical Services (FTS) and offered to tax at 10 per cent on gross basis under Article 13 of the tax treaty.

The Assessing Officer (AO) held that the taxpayer had a PE in India under Article 5(2)(I) of the tax treaty. The AO held that the time spent by the employees of the taxpayer in India during the relevant year, while rendering services to the Indian company exceeded the threshold provided in that Article and has attributed 100 per cent of the receipts to the PE of the taxpayer in India. The AO computed the income of the PE of the taxpayer in relation to the service fee received from the Indian company after allowing deduction of expenses at 40 per cent. The Dispute Resolution Panel (DRP) upheld the order of the AO.

Contentions

The taxpayer contended that various functions such as HR and marketing should be treated as separate projects but cannot be aggregated to determine the period of stay for the purpose of 'Duration Test' under Article 5(2)(I) of the treaty.

Since no PE of the taxpayer existed in India, prior to the visit of personnel of the taxpayer to India, the aforesaid FTS cannot be said to be 'effectively connected' to any pre-existing PE. Consequently, subject payments are taxable as FTS on a gross basis in terms of Article 13(2) of the tax treaty.

The tax department contended that the Article 5(2)(I) doesn't distinguish between same or similar types of services. It is an inclusive definition of services and mandates that the services including consultancy services of the same are to be treated as connected projects. SOFs form an integral part of the BSA, and this fact has never been disputed by the taxpayer.

However, the taxpayer contended that the SOFs constitute separate and independent projects, which are merely governed by uniform terms and conditions agreed between the parties. Mere mention of varying services in a common agreement is not a valid ground for the tax department to treat all SOFs as one consolidated project.

[1] Telenor ASA v. DCIT (ITA No. 1307/Del/2015) – Taxsutra.com

Tribunal decision

Permanent Establishment

The business service agreement is a single unified agreement. On perusal of the clauses of the agreement, it was observed that no single clause is giving it a shape of multiple agreements. With regard to the scheme of billing, it was observed that the bills are raised on a quarterly basis and consolidated invoices raised irrespective of the SOFs under which the services were rendered. The common billing by the recipient and the common payments gives rise to a conclusion that this is one single contract.

Various service order forms indicate that the contracts are performed in accordance with the service agreement between the Indian company and the taxpayer.

The Tribunal referred to several SOFs which involve various activities like sourcing, marketing, ITeS, network, project, etc. On perusal of the sequence of activities and OECD Commentary with regard to Article 5(2)(I), it can be concluded that the activities consist of same and interconnected projects.

The Tribunal observed that the activities of the taxpayer with regard to the recipients for services can be said to be interconnected, inter laced, sequential technical services. It cannot be said that they are unrelated to each other as none of the activities could stand in isolation with the other activity and no single activity can give rise to performance and achieving of the purpose of the recipient.

The activities start with preparation, execution and negotiation of the Global System for Mobile Communication (GSM) to devising the strategy development, preparation of IT solutions architect, benchmarking the same, recruiting the manpower for the purpose of implementation and training them for various activities in relation to GSM role out to customers.

It is a clear commercial coherence between the said activity as no single activity mentioned above doesn't serve any purpose individually, when segregated. All these activities are different facet of one seamless function. The project as defined in the Article 5(2)(I) consists of a bundle of interconnected and inter-related services with the underlying theme of completion of projects. In the instant case, the implementation of one SOF leads to the other, and it can be observed that they are well integrated, the outcome of one SOF become the inputs for the other SOF. Thus, based on the unified agreement, consolidated billing pattern, the activities being inter-related, it was held that the taxpayer has PE in India since the aggregated period of stay for the purpose of 'duration test' under Article 5(2)(I) of the treaty was fulfilled.

Attribution

The AO made ad-hoc disallowance of 60 per cent of the revenues received by the taxpayer allowing only the 40 per cent of the receipts as expenditure. The taxpayer argued that only the mark-up of 3.5 per cent of the cost, which translates to 3.38 per cent of the revenues could at best be considered as the income attributable to the revenues pertaining to the PE in India.

The Tribunal is in in agreement with the taxpayer that the revenues raised out of the services rendered from Norway cannot be attributed to the PE of the taxpayer in India. The issue of determination of the profits is remanded back to the AO to pass an order by taking into consideration, the services rendered by the taxpayer from India and also from Norway, the evidence of the expenses incurred as submitted by the taxpayer.

Our comments

The OECD Commentary 2017 on Article 5 (Permanent Establishment), while dealing with the taxation of services, provides that the reference to 'connected projects' is intended to cover cases where the services are provided in the context of separate projects carried on by an enterprise but these projects have a commercial coherence. The determination of whether activities are connected will depend on the facts and circumstances of each case. Accordingly, the OECD Commentary provides various factors that may be relevant for this purpose.

While determining a PE, some of the Courts have treated different projects (which are carrying out different functions) as separate projects, and they have not aggregated the time involved on such separate projects to conclude the existence of a PE.

The Mumbai Tribunal in the case of Valentine Maritime (Mauritius) Ltd[2] held that the duration of independent projects cannot be aggregated for the purpose of ascertaining the time period. Further, it was held that the only situation in which aggregation principle should be applied is when the activities are so inextricably interconnected or interdependent that these are essentially required to be viewed as a coherent whole.

The AAR in the case of Tiong Woon Project & Construction Pte Ltd[3] held that the time period of independent installation and assembly projects cannot be aggregated in order to determine the constitution of a PE under Article 5(3) of the India-Singapore tax treaty. The work undertaken by the taxpayer was towards independent projects and there was no interconnection and interdependence amongst them.

[2] ADIT v. Valentine Maritime (Mauritius) Ltd [2010-TIOL-195-ITAT-MUM]
[3] Tiong Woon Project & Contracting Pte Ltd [2011] 338 ITR 386 (AAR)

Therefore, the duration test for installation and assembly projects provided under Article 5(3) of the India-Singapore tax treaty cannot be read together for all the projects that do not pass the test of cohesiveness, interconnection and interdependence.

The Tribunal in the present case has held that different services under SOFs involve various activities which are inter-connected with the projects, and no single activity can give rise to performance and achieving of the purpose of the recipient. Therefore, duration threshold of the employees who perform such services would fall within the provisions of Article 5(2)(1) of the tax treaty, and it was required to be tested collectively together and hence the taxpayer had a PE in India.

It is important to note that Article 14(1) of MLI provides a mechanism to determine a period (or periods) of time after which specific projects or activities shall constitute a PE. It requires aggregation of different periods of time during which the enterprise has carried on activities at building site, construction or installation project, or other place identified in the relevant provision of the tax treaty where connected activities are carried on.

However, as per Synthesized text of the India-Norway tax treaty such MLI provisions will not apply to consultancy services or to service PE provisions under the India-Norway tax treaty[4].

With respect to the attribution of profits, the Tribunal did not agree with the higher attribution made by the AO and remanded the matter back to the AO. It is important to note that CBDT had released draft profit attribution rules in April 2019. Though the rules are not finalised, it would be important to analyse the same to determine the attribution of profits to a PE in India.

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[4] synthesised-text-of-mli-and-India-Norway-dtaa_indian-version.pdf (incometaxindia.gov.in)

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