KPMG

#KPMG josh

TAX FLASH NEWS

26 April 2020

Liaison office of UAE based company does not constitute a Permanent Establishment in India – Supreme Court

Recently, the Supreme Court in the case of U.A.E. Exchange Centre[1] (the taxpayer) dealt with an issue whether activities of Liaison Offices (LOs) of a UAE based company constitute a Permanent Establishment (PE) in India. The Supreme Court observed that activities carried on by LOs in India were in the nature of 'preparatory or auxiliary character'. Since such activities are specifically exempt under Article 5(3)(e) of the India-UAE tax treaty (tax treaty), LO of the taxpayer does not constitute a PE in India.

Facts of the case

The taxpayer is a UAE based company engaged in the business of remittance services and it transfers funds from UAE to various places in India. The taxpayer set-up LOs in India with the approval of the Reserve Bank of India (RBI). The activities carried on by the taxpayer from LOs were in conformity with the terms and conditions prescribed by the RBI. The contract was entered between the taxpayer and the non-resident Indian (NRI) remitters in UAE. The funds were collected from the NRI remitters in UAE by charging one-time fee. After collecting such funds, the taxpayer made an electronic remittance on behalf of its NRI customers in the following two ways:

- By telegraphic transfer through bank channels; or
- On the request of the NRI remitters, sent instruments/cheques through its LOs to the beneficiaries in India.

The taxpayer had filed its nil return of income for the Assessment Year (AY) 1998-99 to 2003-04. The taxpayer claimed that no income had accrued or deemed to have accrued to it in India, both under the Income-tax Act, 1961 (the Act) as well as under the tax treaty. These returns were accepted by the tax department without any question. However, to remove certain doubts, the taxpayer filed an application before the Authority for Advance Ruling (AAR). The issue before the AAR was whether any income is accrued or deemed to be accrued in India from the activities carried out by the taxpayer in India. The AAR held that the taxpayer had a PE in India and therefore certain profits need to be attributed to the PE in India. It would be taxable in India under the Act as well as under the tax treaty.

The Delhi High Court quashed the AAR ruling and observed that the taxpayer was not liable to tax in India because no income had accrued or deemed to have been accrued from the activities of LOs in India. Nature of activities carried on by the taxpayer in these LOs were only of preparatory and auxiliary character. Such activities were clearly excluded under Article 5(3)(e) of the tax treaty (PE provisions). The activities carried on by LOs did not in any manner contribute directly or indirectly to the earning of profits or gains by the taxpayer in UAE. Every aspect of the transaction was concluded in UAE, whereas, the activities performed by LOs in India were only supportive of the transactions carried out in UAE. Therefore, LO cannot be treated as taxpayer's PE in India under the tax treaty.

Aggrieved, the tax department filed a Special Leave Petition (SLP) before the Supreme Court.

[1] UOI v. U.A.E. Exchange Centre (Civil Appeal No. 9775 OF 2011) – Taxsutra.com

The Supreme Court's decision

It is not in dispute that the place from where the activities were carried on by the taxpayer in India was an LO and would, therefore, be covered within the term PE under Article 5(2) of the tax treaty. However, Article 5(3) of the tax treaty starts with a *non-obstante* clause and also contains a deeming provision. It establishes that notwithstanding the provisions in clauses 1 and 2 of Article 5 of the tax treaty, it would still not be a PE, if any of the clauses in Article 5(3) of the tax treaty are applicable.

Even if assuming that the stated activities of the taxpayer were business activities, since such activities of the LOs in India were of preparatory or auxiliary character, the same would fall under an exception of Article 5(3)(e) of the tax treaty. Resultantly, it would not constitute a PE in India.

The expression 'preparatory' is not defined in the Act or the tax treaty. The dictionary meaning[2] of that expression can be drawn to the term 'preparatory work'. Further, the expression 'auxiliary' is also not defined in the Act or the tax treaty. In Black's Law Dictionary, the term 'auxiliary' is defined as 'aiding or supporting' or 'subsidiary' or 'supplementary'.

The activities in the present case were of downloading particulars of remittances through electronic media and then printing cheques/drafts drawn on the banks in India, which, in turn, were couriered or dispatched to the beneficiaries in India, in accordance with the instructions of the NRI remitter. While doing so, the LO of the taxpayer in India remains connected with its main server in UAE and the information residing there was accessed by the LO in India for the purpose of remittance of funds to the beneficiaries in India. These were combination of virtual and physical activities unlike the virtual activity of funds being remitted by telegraphic transfer through banking channels.

The RBI has permitted the taxpayer to carry out the limited activities which the taxpayer has been permitted to carry on within India. This permission does not allow the taxpayer to enter into a contract with anyone in India, but only to provide service of delivery of cheques/drafts drawn on the banks in India. The LO in India will not undertake any other activity of trading, commercial or industrial, nor shall it enter into any business contracts in its own name without prior permission of the RBI. The High Court after considering these aspects held that the nature of activities conducted by the taxpayer were in the nature of preparatory or auxiliary character.

The Supreme Court upheld the order of the High Court and held that the services of LOs were in the nature of 'preparatory or auxiliary character' and, therefore, covered by Article 5(3)(e) of the tax treaty. Therefore, LO would not qualify the definition of PE in terms of Articles 5(1) and 5(2) of the tax treaty on account of *non-obstante* and deeming clause in Article 5(3) of the tax treaty.

The transactions were completed with the remitters in UAE, and no charges towards fee/commission could be collected by the LO in India in this regard.

The Supreme Court referred the decision of E-Funds IT Solution Inc[3] wherein the Court observed that no part of the main business and revenue earning activity of the two American companies was carried on through a fixed business place in India which has been put at their disposal. The Indian company only renders support services which enable the taxpayers in turn to render services to their clients abroad. This outsourcing of work to India would not give rise to a fixed place PE in India.

There was an amendment[4] in Section 9(1)(i) of the Act by the Finance Act, 2003 whereby the meaning of expressions 'business connection' and 'business activity' have been articulated. However, even if the stated activities of the LO were to be regarded as business activity, the same were held as preparatory or auxiliary in nature. Therefore, the activities of LO did not result into PE and the taxpayer was not liable to tax in India.

Our comments

The issue, whether an LO constitutes a PE in India, has been a subject matter of debate before the Courts/Tribunal. It is difficult to presume that LO will not constitute a PE merely because the RBI has given permission for its set-up in India. To determine the taxability of LO in India, it is relevant to examine whether LO is carrying out an important part of the business activity of the foreign company or it is merely carrying out preparatory and auxiliary activities.

In some of the cases[5], the Courts/Tribunal have held that LO does not constitute a fixed place PE in India because the LO was carrying on operations within the restricted activities (i.e. preparatory or auxiliary) permitted by the RBI. However, in few cases[6], the Courts/Tribunal have held that LO constitutes a fixed place PE in India because it was carrying on certain commercial activities which were core activities of the taxpayer.

The Supreme Court in the instant case observed that services of LOs were in the nature of 'preparatory or auxiliary character' and, therefore, covered by an exception to the provisions of PE. Thus, the taxpayer had no PE in India.

---

[2] Black's Law Dictionary

[3] ACIT v. E-Funds IT Solution Inc. [2018] 13 SCC 294

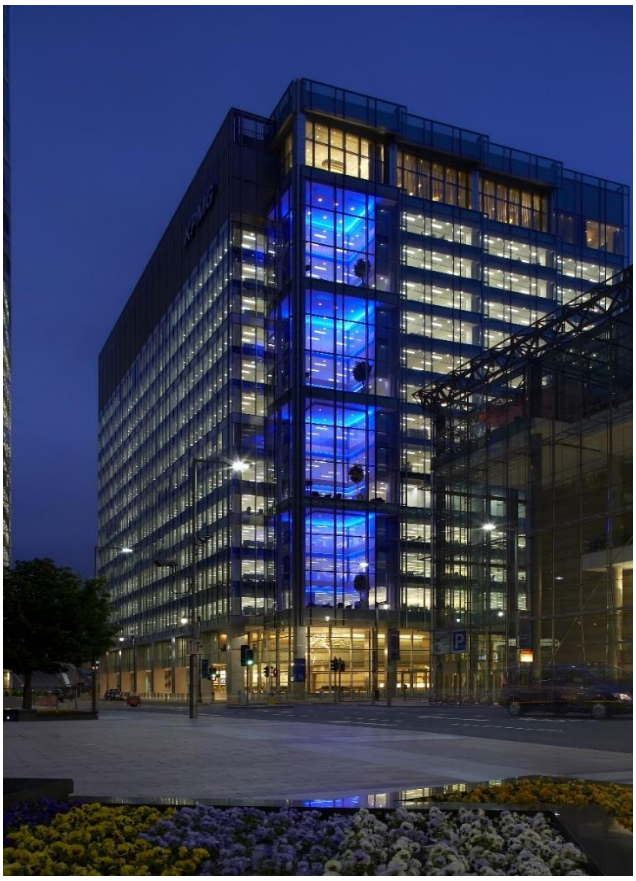
[4] with effect from 1 April 2004

[5] Mitsui & Co. Ltd [1991] 39 ITD 59 (Del), Sumitomo Corpn [2008] 110 TTJ 302 (Del), Motorola Inc [2005] 95 ITD 269 (Del) (SB), Western Union Financial Services Inv [2007] 101 TTJ 56 (Del), Metal One Corpn. [2012] 52 SOT 304 (Del)

[6] Brown and Sharpe Inc. (ITA No.219 of 2014) (Del), Jebon Corporation India [2012] 206 Taxman 7 (Kar), Columbia Sportswear Company [2011] 337 ITR 407 (AAR), UAE Exchange Centre, In re [2004] 139 Taxman 82 (AAR), GE Energy Parts Inc. v. ADIT [2017] 184 TTJ 570 (Del)

It is important to note that Article 13 of the Multilateral Instrument (MLI) deals with the artificial avoidance of PE through specific activity exemptions i.e. activities which are preparatory or auxiliary in nature. It provides two options i.e. 'Option A' which does not change the list of activities already negotiated between the countries.

It ensures that all such activities (or combinations of activities) must be of a preparatory or auxiliary nature in order to qualify as exempt activities[7] and 'Option B' which provides that any activity already existing in the tax treaty which is not specifically required to be of a preparatory or auxiliary nature may continue to fall within the specific activity exemptions. All activities (or combinations of activities) not already mentioned in the existing tax treaty must be of a preparatory or auxiliary nature to qualify under the specific activity exemption. Further Article 13(4) of the MLI tackles the issue of multinational enterprises splitting up their business activities or altering their structures in order to take the benefit of the specific activity exemptions.



[7] India has opted 'Option A'

home.kpmg/in/socialmedia

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

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

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

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

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

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

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

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

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

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 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

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

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