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Tax alert: No PE in absence of control over premises, income taxable as FTS

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The Delhi Bench of the Income-tax Appellate Tribunal, based on facts, has rendered its decision that the taxpayer did not have permanent establishment (PE) in India and hence, the provisions of section 44DA of the Income-tax Act, 1961 (ITA) were not applicable. Further, the income of the taxpayer from engineering and project management consultancy services were taxable as fees for technical services under section 115A of the ITA.

In a nutshell

Section 44DA of the ITA is applicable when (i) income is in the nature of royalty/FTS (ii) royalty/FTS is received by non-resident/a foreign company from an Indian entity in pursuance to an agreement executed after 31 March 2003 (iii) non-resident/foreign company carries on business through a PE (iv) the right, property or contract in respect of which royalty/FTS is paid is effectively connected with such PE.

The term PE under section 44DA refers to the definition of PE under section 92F(iiia) of the ITA. As per section 92F(iiia) of the ITA, PE includes fixed place of business through which the business of the enterprise is wholly or partly carried on.

The principal test to ascertain whether an establishment has a fixed place of business or not, is to see whether physically located premise is at the disposal of the enterprise i.e., the enterprise has right to use the place and has control thereupon. The burden is entirely on the Revenue to establish that the enterprise has effective control over the premise.

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Background:

- The taxpayer[1], a non-resident corporate having its headquarter in Hong Kong, is a tax resident of Hong Kong. It is engaged in the business of providing engineering and project management consultancy services.
- The taxpayer participated in a global tender for providing engineering and project management consultancy services for the airport line of metro in a city in India. The taxpayer succeeded in the tender and accordingly, work was entrusted to the taxpayer by executing a contract on 19 May 2008.
- During the Financial Year (FY) 2010-11, corresponding to Assessment Year (AY) 2011-12, the taxpayer received payment for the aforesaid services from the contractee (A Co). The taxpayer treated the same as fees for technical services (FTS) within the meaning of section 9(1)(vii) of the Income-tax Act, 1961 (ITA).

  Accordingly, in the return of income filed for the relevant AY, the taxpayer offered the receipts to tax as FTS, at the rate of 10% on gross basis, under section 115A [relating to tax on, *inter alia*, FTS in case of foreign companies] of the ITA.
- During the course of audit proceedings, the Assessing Officer (AO) noticed that in total 24 employees had visited India during the relevant year. Out of which 21 employees stayed in India for more than 183 days. Thus, the AO formed a view that the taxpayer had a Permanent Establishment (PE)/business connection in India. Accordingly, the AO called upon the taxpayer to explain why the receipts from A Co should not be treated as business income in the hands of the taxpayer.
- In response, the taxpayer submitted the following as to why there was no business connection in India:
  - There was no business connection in India in terms of section 9(1)(i) of the ITA. The entire burden lay on the Revenue to establish how and in what manner the business connection existed.
  - The tenure of the contract was neither extendable nor extended. Apart from the contract with A Co, the taxpayer had no other contract in India with anyone.
  - As per the contract with A Co, after the expiry of period of contract and completion of the work, in terms of the conditions of the contract, the taxpayer had to withdraw from India.
- The AO held the following:
  - India did not have any tax treaty with Hong Kong. Thus, taxability of income received by the taxpayer had to be governed under the provisions of the ITA.
  - The expression 'business connection' used in section 9(1)(i) of the ITA was similar to the concept of PE under international tax laws and tax treaties and had a wider connotation as compared to the concept of PE.
  - The time spent by the employees of a non-resident entity in execution of any project/contract played a significant role in determination of PE/business connection. In case of the taxpayer, the employees had stayed in India for more than 183 days. The taxpayer had been provided space with various other facilities by A Co.
  - Further, the taxpayer had entered into a separate agreement for secondment of its employees to the office of A Co in order to complete the consultancy project undertaken by it. However, the salaries of the seconded employees were paid by the taxpayer. As per the terms of the secondment agreement, the taxpayer had employed two teams of employees, viz., offshore and onshore, who were responsible for the

[1]MTR Corporation Ltd. vs DCIT [ITA No.2009/Del/2015] (Delhi ITAT)

consultancy project undertaken by the taxpayer and role of both the teams was specified in the agreement.

— It was not a case of simple consultancy but a case of consultancy service effectively connected to the business presence of the taxpayer in India. From the nature of work executed by the taxpayer and the number of days spent by the employees in India, it could not be said that the services were independent in nature. Hence, the receipts were to be categorized as FTS.

Thus, the AO concluded that since the taxpayer had a PE/business connection in India, the receipts had to be assessed as income from business and profession under section 44DA of the ITA [relating to special provision for computing income by way of royalties, etc., in case of non-residents]. Accordingly, attributing the entire receipts to the PE and deducting therefrom salary cost of the seconded employees, AO brought the balance amount to tax under section 44DA of the ITA by applying the rate of 40%.

- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings the matter reached before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

Relevant provisions in brief:

Relevant extract of section 115A of the ITA

"(1) Where the total income of…

…(b) a non-resident (not being a company) or a foreign company, includes any income by way of royalty or fees for technical services other than income referred to in sub-section (1) of section 44DA received from Government or an Indian concern in pursuance of an agreement made by the foreign company with Government or the Indian concern after the 31st day of March, 1976, and where such agreement is with an Indian concern, the agreement is approved by the Central Government or where it relates to a matter included in the industrial policy, for the time being in force, of the Government of India, the agreement is in accordance with that policy, then, subject to the provisions of sub-sections (1A) and (2), the income-tax payable shall be the aggregate of…

… (B) the amount of income-tax calculated on the income by way of fees for technical services, if any, included in the total income, at the rate of ten[2] per cent; and

Relevant extract of section 44DA of the ITA

"(1) The income by way of royalty or fees for technical services received from Government or an Indian concern in pursuance of an agreement made by a non-resident (not being a company) or a foreign company with Government or the Indian concern after the 31st day of March, 2003, where such non-resident (not being a company) or a foreign company carries on business in India through a permanent establishment situated therein, or performs professional services from a fixed place of profession situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed place of profession, as the case may be, shall be computed under the head "Profits and gains of business or profession" in accordance with the provisions of this Act"

Decision of the ITAT:

The ITAT noted /observed the following:

- The provisions of section 44DA of the ITA are attracted on fulfillment of the following conditions:

  (i) The income must be in the nature of royalty or FTS.

[2]Rate has been enhanced to twenty percent by Finance Act 2023 with effect from 1 April 2024

(ii) It must have been received by a non-resident or a foreign company from an Indian entity in pursuance to an agreement executed after 31 March 2003.

(iii) Non-resident or foreign company carries on business in India through a PE or performs professional services from a fixed place of profession situated therein.

(iv) The right, property or contract in respect of which the royalty or FTS is paid, is effectively connected with such PE or fixed place of profession.

Thus, on fulfillment of the aforesaid conditions, the receipts of the taxpayer would be computed under the head 'Profits and gains from business or profession' in terms with the provisions contained therein.

- The expression 'fixed place of profession' under section 44DA of the ITA is used in the context of a non-resident, which is not a foreign company.

  Though, the expression 'fixed place of profession' has not been defined specifically under the provisions of the ITA, however, the term PE used in section 44DA, in turn, refers to the definition of PE under section 92F(iiia) of the ITA. The definition of PE under section 92F(iiia) of the ITA, includes fixed place of business, through which, the business of the enterprise is wholly or partly carried on. Thus, the fixed place of profession is akin to fixed place of business.

- On perusal of the agreement between the parties, A Co was to provide office space with some other facilities to the employees of the taxpayer in India to carry out their activities. Such premises and facilities were given free of charge. However, the question which arose was whether access given to the taxpayer of the office premise of A Co would constitute service PE or for that matter any other PE.

- The definition of PE under section 92F(iiia) of the ITA includes fixed place of business from where the taxpayer carries on its business wholly or partly. In the case under consideration, the space and facilities provided to the taxpayer by A Co could not be construed to be a fixed place of business from where the taxpayer carried on its business wholly or partly.

- The Supreme Court in an earlier ruling[3] had observed the following:
  - The principal test to ascertain whether an establishment has a fixed place of business or not, was to see whether such physically located premise was at the disposal of the enterprise.
  - Merely giving access to a place to the enterprise for the purpose of project would not amount to putting the premise at the disposal of the enterprise.
  - Putting the premise at the disposal of an enterprise would mean that the enterprise had right to use the said place and had control thereupon. The burden was entirely on the Revenue to establish that the enterprise has effective control over the premises.

- In the case under consideration, the Revenue had failed to establish through corroborative evidence that the taxpayer was having control over the premises. It was A Co which was having control over the premises and the taxpayer was given access to the premises and provided certain space and facilities.

  No corroborative evidence was brought on record to demonstrate that the taxpayer carried on business in India wholly or partly through a fixed place of business.

In view of the above, the ITAT held that the taxpayer did not have PE in India and hence, the provisions of section 44DA were not applicable. Accordingly, the income offered by the taxpayer under section 115A read with section 9(1)(vii) of the ITA was to be accepted.

[3]ADIT vs. E-Funds IT Solution Inc. [2017] 86 taxmann.com 240 (SC)

Comments:

Existence of a PE in a country is a fact based exercise. This ruling while holding that the taxpayer did not have a PE in India has upheld the following principles:

- The provisions of section 44DA of the ITA are applicable when – (i) income is in the nature of royalty or FTS (ii) royalty or FTS is received by non-resident or a foreign company from an Indian entity in pursuance to an agreement executed after 31 March 2003 (iii) non-resident or foreign company carries on business through a PE (iv) the right, property or contract in respect of which royalty or FTS is paid is effectively connected with such PE.
- The term PE under section 44DA refers to the definition of PE under section 92F(iiia) of the ITA. As per section 92F(iiia) of the ITA, PE includes fixed place of business through which the business of the enterprise is wholly or partly carried on.
- The principal test to ascertain whether an establishment has a fixed place of business or not, is to see whether physically located premise is at the disposal of the enterprise i.e., the enterprise has right to use the place and has control thereupon.
- The burden is entirely on the Revenue to establish that the enterprise has effective control over the premises.

It may be pertinent to note that the tax treaty between India and Hong Kong was signed on 19 March 2018 and entered into force on 30 November 2018. The tax treaty is applicable for years beginning on or after 1 April 2019.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

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