

Tax Alert | Delivering clarity

28 April 2020

Whether activities of a liaison office constitute a permanent establishment?

The Hon'ble Supreme Court, in a decision announced on 24 April 2020, held that the activities carried out by a liaison office as per the RBI approval do not constitute a permanent establishment of the taxpayer in India

Facts of the case:

- U.A.E. Exchange Centre (taxpayer)¹ is a United Arab Emirates (UAE) based company engaged in the business of, inter alia, remittance services for transferring money amounts from UAE to India.
- The taxpayer set up liaison offices (LO) in India. The Reserve Bank of India (RBI) permits the Indian LO to carry out certain activities, such as:
 - Act as a communication centre for receiving computer (via modem) advices of mail transfer, T.T. stop payments messages, payments details etc., originating from UAE and transmission to Indian correspondent banks;
 - Printing Indian Rupee drafts with facsimile signature from the Head Office and counter signature by the authorised signatory of the office at Cochin.
- Further, the RBI approval is subject to certain conditions, such as:
 - The LO not carrying on trading, commercial or industrial activity;
 - The LO not charging any commission / fees;
 - The LO meeting all its expenses out of funds received from abroad.
- The LO undertook activities in accordance with the RBI approval.
- The taxpayer enters into a contract and offers remittance services to non-resident Indians in the UAE. For this, the taxpayer charges a one-time fee of Dirham 15. Funds collected in UAE are remitted in the following two ways:
 - By telegraphic transfer through bank channels; or
 - By sending instrument / cheque to the beneficiary (through the India LO) – for this the LO downloads the remittance particulars, prints the cheques / drafts and couriers them to the beneficiary in India. The LO while performing this activity remains connected to the main server in UAE.
- The taxpayer had filed an application with the Authority for Advance Rulings (AAR) for confirmation on whether income accrued or was deemed to accrue in India in respect of the activities carried out by the LO?
- The AAR vide its ruling dated 26 May 2004 held that the income of taxpayer accrued in India and was liable to pay tax, as it had carried on business through a permanent establishment in India.

¹ Union of India & Anr. vs U.A.E. Exchange Centre (Civil Appeal No. 9775 of 2011) (SC)

- The AAR relied on the case of R. D. Aggarwal² and held that the act of the LO in downloading information, printing and preparing of cheques / drafts and sending the same to beneficiaries in India contributes to the earning of commission income and thus, results in a business connection in India; and
- The activities of the LO are significant part of the main activity and cannot be termed to be preparatory and auxiliary. Thus, the activities carried out by LO constitute a permanent establishment of the taxpayer in India under Article 5 of the India-UAE tax treaty.
- The taxpayer filed a writ petition before the Delhi High Court (HC) against the order of the AAR. The HC relying on the case of Azadi Bachao Andolan³ held that in the current case the provisions of the India-UAE tax treaty relating to permanent establishment would be relevant and not the provisions of domestic income-tax law relating to business connection. Further, the HC relied on the case of Morgan Stanley⁴ and held that the activity carried on by the LO did not contribute to the earning of profits or gains by the taxpayer in UAE. Thus, the HC held that the taxpayer did not have a permanent establishment in India.
- Aggrieved by the High Court's order, the Revenue filed an appeal before the Hon'ble Supreme Court (SC).

Decision of the Hon'ble SC:

- The Hon'ble SC relying on various cases⁵ held that the current case required examination under the provisions of the India-UAE tax treaty.
- The Hon'ble SC observed that the taxpayer had a place (i.e. the LO) in India and thus, would be covered under the term "permanent establishment" under Article 5(2) of the India-UAE tax treaty. However, it was to be examined whether the activities were preparatory and auxiliary in nature as per Article 5(3)(e) of the India-UAE tax treaty and thus, providing exclusion from permanent establishment under Article 5 of the India-UAE tax treaty.
- The Hon'ble SC noted that the crucial activities of the LO were of downloading particulars of remittance, printing cheques / drafts and couriering / dispatching them to beneficiaries in India. While doing these activities, the LO remained connected to the main server in UAE.
- Further, the limited activities of the LO were covered by the RBI approval. The RBI had not allowed the LO to enter into contract with anyone in India or render any consultancy or any other services.
- The Hon'ble SC referred to the cases of Morgan Stanley⁴ and E-Funds IT Solution Inc⁶ and held that based on the onerous conditions provided in the RBI approval, the activities carried out by the LO qualified as preparatory and auxiliary as per Article 5(3)(e) of the India-UAE tax treaty. Thus, activities carried out as per the RBI approval at the fixed place (i.e. the LO) did not qualify as a permanent establishment of the taxpayer as per Article 5 of the India-UAE tax treaty.

² CIT vs R. D. Aggarwal & Company & Anr. AIR 1965 SC 1526

³ Union of India & Anr. vs Azadi Bachao Andolan & Anr. 10 SCC 1 (2004) (SC)

⁴ DIT(IT) vs Morgan Stanley & Co. 7 SCC 1 (2007) (SC)

⁵ Union of India & Anr. vs Azadi Bachao Andolan & Anr. 10 SCC 1 (2004) (SC); CIT AP(I) vs Vishakhapatnam Port Trust 144 ITR 146 (1983) (AP); CIT vs Davy Ashmore India Ltd. 190 ITR 626 (1991) (Cal); Leonhardt Andra Und Partner, GmbH vs. CIT 249 ITR 418 (2001) (Cal); CIT vs. R. M. Muthaiah 202 ITR 508 (1993) (Kant); Arabian Express Line Ltd. of United Kingdom & Ors. vs. Union of India 212 ITR 31 (1995) (Guj)

⁶ ADIT-1 vs. E-Funds IT Solutions Inc. 13 SCC 294 (2018) (SC)

Observations:

- There has been litigation on whether activities carried out by a liaison office constitute permanent establishment of the foreign entity in India.
- The Hon'ble SC in the case under consideration has observed that considering stringent RBI conditions provided in a liaison office approval, the approved activities were preparatory and auxiliary in nature.
- This ruling is likely to provide relief to liaison offices involved in similar litigation.



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This material and the information contained herein prepared by Deloitte Touche Tohmatsu India LLP (DTTI LLP) is intended to provide general information on a particular subject or subjects and is not an exhaustive treatment of such subject(s). This material contains information sourced from third party sites (external sites).

DTTI LLP is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such external sites. None of DTTI LLP, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this material, rendering professional advice or services. This information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this material.

©2020 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited