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Tax alert: Physical presence in India is prerequisite for service PE, no virtual service PE

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The Delhi Bench of the Income-tax Appellate Tribunal has rendered its decision that the taxpayer neither constituted service permanent establishment (PE) nor virtual service PE in India, in terms of Article 5(6) of the India-Singapore tax treaty.

In a nutshell

To constitute a service PE, actual performance of service in India is essential and accordingly, only when the services are rendered by the employees within India, with their physical presence during the financial year, shall be taken into account for computing threshold limit for creation of a service PE of the taxpayer in India.

Since no provision regarding establishment of virtual service PE is mentioned under India-Singapore tax treaty, the present service PE provision under the India-Singapore tax treaty which requires physical rendition of service in India, should only be applied.

Further, the ruling has excluded the vacation period, days involving business development activities (business development days) and common days from the total number of days, for computing the days for which the services were furnished in India.

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Background:

- The taxpayer[1] is a tax resident of Singapore, engaged in providing legal advisory services to several international clients including in India.
- During Financial Years (FYs) 2019-20 and 2020-21, corresponding to Assessment Years (AYs) 2020-21 and 2021-22, the taxpayer entered into legal advisory contracts with the Indian clients:
  - In AY 2020-21, part of the advisory services was rendered remotely outside India and there were situations where employees of the taxpayer had travelled to India for rendering services.
  - In AY 2021-22, the services were rendered remotely from outside India and no employees had visited India for provision of services.
- During the course of audit proceedings for the relevant AYs, the Assessing Officer (AO) observed that the receipts from rendering services to Indian clients were claimed as exempt by the taxpayer in the return of income for the relevant AYs. The AO held that the taxpayer constituted:
  - Service permanent establishment (PE) based on physical presence of employees in India; and
  - Virtual service PE on the grounds that in terms of Article 5(6) of the India-Singapore tax treaty, what was important was the aggregate duration of provision of services by the non-resident within India and Singapore, and duration of physical presence of the employees in India was not material.

  Accordingly, the AO attributed 100% of the gross receipts to such service PE.
- Aggrieved, the taxpayer filed objections / appeal and in the course of proceedings the matter reached before the Delhi Bench of the Income-tax Appellate Tribunal (ITAT).

The key contentions of the taxpayer were as follows:

- During the relevant AYs i.e. AY 2020-21 and 2021-22 the taxpayer did not have any premises at its disposal in India through which it carried on business.
- To constitute a service PE there should be furnishing of service within the source state meaning thereby actual performance of service in the source state i.e. India. Reliance was placed on an earlier ruling[2] of the Supreme Court (SC) in this regard.
- The services provided by the taxpayer did not make available any technical knowledge, experience, skill, know-how which may enable the Indian client to be able to apply the same independently and hence, these were not in the nature of Fees for Technical Services (FTS) under the provisions of India-Singapore tax treaty.

AY 2020-21

- The taxpayer had no office or fixed base in India and the aggregate stay of the employees in India was only 44 days which was less than 90 days as provided in Article 5(6)(a) of the India-Singapore tax treaty. Given that the threshold of 90 days was not met the taxpayer did not constitute a service PE.
- Two employees of the taxpayer had travelled to India for rendering services to Indian clients. Although they were present in India for 120 days in total, their vacation period, days involving business development activities (business development days) and common days had been excluded from the total number of days after which it was determined that the total days for which the services were furnished in India is 44 days.

AY 2021-22

- No associates / employees had visited India to render services to Indian clients.
- As per Article 5(6) of the India-Singapore tax treaty, the taxpayer should actually furnish services in India by

[1] Clifford Chance PTE Ltd. vs ACIT [2024] 160 taxmann.com 424 (Delhi ITAT)

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

way of physical presence of its employees in India for the purpose of computing the threshold of 90 days. As the services were furnished remotely outside India, the taxpayer did not constitute a virtual service PE in India.

Relevant provisions in brief:

Relevant extract of Article 5(6) of the India-Singapore tax treaty

"*An enterprise shall be deemed to have a permanent establishment in a Contracting State if it furnishes services, other than services referred to in paragraphs 4 and 5 of this Article and technical services as defined in Article 12, within a Contracting State through employees or other personnel, but only if :*

(a) activities of that nature continue within that Contracting State for a period or periods aggregating more than 90 days in any fiscal year; or

(b) activities are performed for a related enterprise (within the meaning of Article 9 of this Agreement) for a period or periods aggregating more than 30 days in any fiscal year."

Decision of the ITAT:

The ITAT noted /observed the following:

Service PE

- In terms of Article 5(6) of the India-Singapore tax treaty, the following conditions need to be cumulatively satisfied for constitution of a service PE in India:
  (i) employees or the other personnel of the foreign entity (taxpayer) should be present in India;
  (ii) there should be furnishing of services (other than services referred to in Article 5(4) and 5(5) and technical services as defined in Article 12) within a contracting state (India) through employees or other personnel of such foreign entity (taxpayer); and
  (iii) activities of that nature i.e., such furnishing of services should continue for a period exceeding 90 days in a fiscal year (relevant AY) or 30 days when such services are rendered to related enterprises.

  The term "fiscal year" means the previous year as defined under section 3 of the Income-tax Act, 1961 (ITA) which was the relevant AYs in the case under consideration and the threshold of 90 days was to be applied since the services were rendered to independent Indian client by the taxpayer and not to its related enterprise.
- As per Article 7 of the India-Singapore tax treaty, the profits of a foreign enterprise (not falling within the purview of any other Article dealing with specific items of income i.e., FTS) could be taxed in India only if business was carried on through a PE situated in India.
- Thus, applying the provisions of Article 5(6)(a) of India-Singapore tax treaty, to constitute a service PE, actual performance of service in India was essential. Accordingly, only when the services were rendered by the employees within India, with their physical presence during the FY relevant to AYs, this should be taken into account for computing threshold limit for creation of a service PE of the taxpayer in India. The Supreme Court (SC) in an earlier ruling[3] had observed that requirement of service PE was that services must be furnished within India.
- In the case under consideration, the employees of the taxpayer were present in India for total number of 120 days in AY 2020-21 and none of the employees were present in India in AY 2021-22. Out of the total 120 days, the vacation period amounted to 36 days which was substantiated by the taxpayer by furnishing the relevant evidence thereof. The period of holidays had to be excluded while computing the threshold limit for

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

constitution of service PE. Reliance was placed on an earlier ruling[4] in this regard.

Therefore, if the vacation days (36 days) were excluded from the total days for which the employees of the taxpayer were present in India (i.e., 120 days), the same would total up to 84 days which was less than the threshold of 90 days provided under Article 5(6)(a) of the India-Singapore tax treaty for constitution of service PE of the taxpayer in India.

- Further, business development days comprising of 35 days as well as common days comprising of 5 days, should also be excluded while computing the threshold of service PE as no services were provided to customers in India on the days spent on business development activities and the computation of threshold should not be based on man days by aggregating common days spent by more than one individual.
- In effect, the services were furnished by the taxpayer only for 44 days in India, after excluding vacation period, business development days and common days. Accordingly, the taxpayer did not constitute service PE in India as per India-Singapore tax treaty during AY 2020-21.
- So far as AY 2021-22 was concerned, as physical rendition of services in India beyond the threshold period was a prerequisite for creation of service PE and as none of the employees of the taxpayer were physically present in India during AY 2021-22, the taxpayer did not constitute service PE even in AY 2021-22.

Virtual Service PE

- The taxpayer did not constitute virtual service PE in India as no provision regarding establishment of virtual service PE was mentioned under the India-Singapore tax treaty. Hence, the present service PE provision under the India-Singapore tax treaty which required physical rendition of service in India, should only be applied. The view was supported by the OECD Interim Report 2018 wherein it is clearly mentioned that in the absence of any amendments to the tax treaty provisions themselves, these measures can be challenged by the taxpayers before the courts.

In view of the above, the ITAT held that the taxpayer did not constitute service PE or virtual service PE during the relevant AY 2020-21 and 2021-22 under consideration.

Comments:

Constitution of a PE or otherwise is a combination of factual or legal analysis. A question may arise as to whether the physical presence of employees while rendering services in India is relevant, for the purpose of determining service PE of a non-resident in India.

This ruling while holding that the taxpayer does not constitute a service PE or virtual service PE, has held / upheld the following:

- Applying the provisions of Article 5(6)(a) of the India-Singapore tax treaty, to constitute a service PE, actual performance of service in India is essential. Accordingly, only when the services are rendered by the employees within India with their physical presence during the FY relevant to AYs shall be taken into account for computing threshold limit for creation of a service PE of the taxpayer in India.
- Since no provision regarding establishment of virtual service PE is mentioned under India-Singapore tax treaty, the present service PE provision under the India-Singapore tax treaty which requires physical rendition of service in India, only should be applied.

Further, the ruling has excluded the vacation period, days involving business development activities (business development days) and common days from the total number of days for computing the days for which the services were furnished in India.

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

[4] Linklaters LLP vs. DDIT [2019] 106 taxmann.com 195 (Mumbai ITAT)

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