



Permanent Establishment in India: “checking the rule”

The India’s Delhi High Court (HC) has recently ruled that outsourcing of services by US company to Indian affiliate does not constitute PE. It is aim of this report to provide a guidance to determine whether an Indian affiliate constitutes a PE by “checking the rule”.

Permanent Establishment in India

The India's Delhi High Court¹ (HC) has recently ruled that outsourcing of services by US company to Indian affiliate does not constitute PE. The case presented two companies incorporated and residents of USA (E Funds Corporation and E Funds IT Solutions Inc., henceforth: FCs) and one Indian company, E Fund India (henceforth: IC), which was an indirect wholly owned subsidiary of E Funds Corporation.

Previous to the High Court Decision, Tax Authorities contended that FCs had a taxable presence in India as per the Indian Tax Laws (ITL) by way of business connection as well as a PE as defined under Article 5 of the India-USA Treaty. On appeal, the Tribunal upheld the Tax Authorities' contention that a PE exists. But, why has the HC lead to a different conclusion? In order to answer this question eligibility for being considered as a PE must be regarded.

Is an Indian affiliate eligible as PE?

Tax Law Background

From a domestic law perspective, Permanent Establishment is defined under Indian Income Tax Act as a fixed place of business where the business of the enterprise is wholly or partly carried on that indicates business connection between the FC and the IC. This definition is in close connection with the definition from an international perspective. In this regard, Double Taxation Avoidance Agreements stipulate that a Permanent Establishment that generates income with a business connection in India will be taxable in India. All other income without business connection is out of the scope of taxation in India.

Indian Permanent Establishment rules

For a company to determine the existence of a PE in India, the following type of PE rules, in Double Taxation Avoidance Agreements, must be regarded:

- A. Fixed Place PE: two requisites must be fulfilled for a foreign Enterprise to constitute a PE in India:
- fixed place of business and
 - business of the foreign enterprise is wholly or partly carried on.

According to the HC, the FCs did not have any assets or a licensed office to be regarded as presence in India. The main reason was that here was no evidence that the Taxpayers had the "right to use" or "disposal right" over the premises of the IS.

1. TS-63-HC-2014 (DEL)

Hence, even though the Indian affiliate was carrying on core activities for the FCs, it would not constitute a Fixed place PE of the FCs in India. One of the requisites is missing so no PE can be determined.

B. Agency PE: a PE exists when a foreign enterprise has a dependent agent in India provided that the agent:

- exercises of authority to conclude contracts on behalf of the foreign Enterprise,
- secures orders wholly or almost wholly for the foreign Enterprise,
- maintains the stock of goods or merchandise from which the agent regularly delivers on behalf of the foreign enterprise.

The HC stated that the IC does not constitute an Agency PE of the FCs as it was not allowed to conclude contracts on behalf of the FCs and did not maintain any stock or merchandise or secure orders on behalf of the FCs. Hence, the IC would not constitute an Agency PE of the FCs in India.

C. Service PE: a PE exists if the employees of the foreign enterprise furnish or perform services in India, other than services covered under Royalties or Fees for Technical Services, for a specified period of time.

In the case, two employees of the FCs were transferred to the IC for working for the Indian affiliate but their entire expenditure was born by the IC. Hence they were not rendering any services in India on behalf of the FCs. Such employees provided stewardship function. Hence, no PE exists for the FC seconding such employees.

Checking the rule

The decision of the HC of India provides guidance to determine whether an Indian affiliate constitutes a PE. Any of the following questions must be positively answered:

✓ **Does the FC have a PE under the Fixed Place rule?**

To have a fixed place as PE outsourcing of core activities of the foreign enterprise to an Indian affiliate must be performed along with the right of use of the premises or facility from where the services are delivered. The non-compliance of one of the requisites derives in the absence of PE in India, either by the nature of the activity or by the nature of the use of the premises.

✓ **Does the FC have a PE under the Agency PE rule?**

To constitute a PE under the Agency PE rule, the nature of the affiliate in India must be analysed and it must qualify as a dependant agent by performing any of the activities aforementioned, i.e. conclusion of contracts on behalf of the foreign Enterprise, securing of orders for the foreign Enterprise or maintenance of goods

or merchandise from which the agent regularly delivers on behalf of the foreign enterprise.

✓ **Does the FC have a PE under the Service PE rule?**

To constitute a PE under the service rule, the nature and functions performed by the seconded employees and who exercises control and supervises them needs to be examined. If such employees provided stewardship function, no PE exists for the FC seconding such employees. Moreover, if such employees worked under the control of the Indian affiliate, no PE could exist either.

In short, business connection regarding PE exists when an Indian subsidiary constitutes a fixed place, not only physically but also in matter of rights, for the foreign company; it performs activities as dependant agent; or the nature and control of services performed in India are directly connected with the foreign company.



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