

Tax Hotline

December 16, 2005

LIAISON OFFICE HELD NOT TO BE TAXABLE IN INDIA - HOLDS AAR

In a recent case decided by the Authority for Advance Ruling ("**Authority**"), in Gutral Trading Est [2005] 278 ITR 643 (AAR) ("**Applicant**"), it has been held that the liaison office of the Applicant would not be taxable in India. The Authority examined in detail whether the activities carried on by the liaison office of the Applicant amounted to establishing a business connection in India, as contemplated under the Income Tax Act, 1961 ("**ITA**").

A liaison office set up in India, in accordance with Reserve Bank of India regulations, does not prima facie attract any tax liability, unless it constitutes a "business connection" with India as stipulated under the ITA, or a Permanent Establishment ("**PE**") in India under the applicable Double Taxation Avoidance Agreement ("**Tax Treaty**").

In the present case the Applicant was engaged in Dubai as an agent of a company, for which company the Applicant performed marketing activities. The Applicant was merely to disseminate information about the products of the "principal company", to provide direct support to the principal company for obtaining data related to the credit risk and credit rating of the customers/ potential customers, and to provide assistance for collecting the amount of outstanding dues from customers. The terms of the agreement specified that all the business dealings were to be carried out by the customer/potential customers directly with the "principal company". The Applicant had no authority to conclude contracts on behalf of the principal. Based on the above assignment agreement, the Applicant had set up liaison office in India to carry out the following activities:

- holding seminars, conferences, or shows to provide information about the technology being used by the principal in manufacturing reflective glasses of different kinds and to give replies to the queries of the customers; and
- receiving trade enquiries from the customers so as to pass on the same either to their Dubai office or directly to principal company.

The Applicant had a status of an "individual establishment" in Dubai, which was not a taxable entity under the UAE tax regime.

The Authority, did not examine whether the liaison office of the Applicant would constitute a PE as it relied on the reasoning given in the case of **Abdul Razak** and held that the provisions of the Tax Treaty between India and UAE, the respective contracting states, would not apply, as the Applicant was not a resident for taxation purposes in Dubai (UAE). This was because of the fact that the tax regime in UAE did not tax the Applicant.

The Authority scrutinized the above activities of the liaison office to see whether it amounted to having a business connection in India. It examined the term business connection as defined under the ITA and as discussed in the cases of **UAE Exchange Centre, LLC** and **Sutron Corporation**. It held that the scope of activities of the liaison office were not contemplated either under the definitions of business connection or the judicial elucidation on the same. It also held that since the activities were only in the nature of dissemination and collection of information and not for the procurement of any contracts, the liaison office operated only on the lines of a "Communication Channel". It further stated that since this communication channel was between the potential customers, traders, and industry on the one hand and the principal company on the other, there was no intimate connection between the two for the liaison office to be termed as a business connection.

The Authority further held that since the agreement did not authorize the liaison office to either negotiate or conclude contracts, there was no business connection with India. It was contended before and noted by the Authority that the principal company had made separate arrangements through its independent agents in India for the sale of its products, and thus the liaison office did not earn any income in India.

The Authority concluded that the activities of the liaison office cannot be held to be earning any income for the Applicant in India, and since there was no business connection in India no income could be said to be accruing to the Applicant in India.

-Nithya Reddy & Annapoorna Jayaseelan

Source: Gutral Trading Est [2005] 278 ITR 643 (AAR)

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