Tax Hotline

October 23, 2017

ONLY SOLAR DAYS RELEVANT FOR ESTABLISHMENT OF SERVICE PE IN INDIA: BANGALORE TRIBUNAL

Bangalore ITAT holds that:

- Solar days are relevant for Service PE in India.
- In the absence of specific provisions regarding taxability of FTS under DTAA, FTS is not taxable in India under other 'income clause' of the DTAA and should only be taxed in the state of residence of the Taxpayer.

Recently, the Bangalore Tribunal ("Tribunal") in the case of *Electrical material Center Co. Limited v. Deputy Director of Income Tax*[1] held that for establishing a service Permanent Establishment ("**PE**") in India, only solar days should be considered and not man days, i.e., the days when two or more partners/employees were present in India together, the number of days in India should be counted as only once. The Tribunal also held that the fact that the the India-Saudi Arabia Tax Treaty ("**Tax Treaty**") does not provide for the Fees for Technical Services ("**FTS**") clause, the services provided by the engineerers in India cannot be taxed as FTS.

BACKGROUND

Electrical material Center Co. Limited ("**Taxpayer**"), a company based in Saudi Arabia sent four service engineers in India to provide services to an Indian entity. The total number of days that the engineering stayed in India were 90. However, the Assessing Officer ("**AO**") held that the due to the presence of four service engineers in India for 90 days each, the total number of days should be 360 days.

Under the Tax Treaty a service PE in India is constituted if services, including consultancy services are furnished by a foreign entity, through employees or other personnel engaged by the entity for such purpose. However, such activities should continue in India for a period or periods aggregating more than 182 days within any 12-month period. Since the AO calculated the days as 360 as opposed to 90, the AO concluded that the Taxpayer had a PE in India.

Further, the AO also ruled that payments received by the Taxpayer as royalty under Income Tax Act, 1961 ("**ITA**") and even when the argument of the Taxpayer was that the services should considered to be FTS in nature and since there is no specific provision under the Tax Treaty for taxing FTS, the services should not be subject to tax in India. The Dispute Resolution Panel ("**DRP**") confirmed the order of the AO. Aggrieved by order of the AO / DRP, the Taxpayer filed an appeal before the Tribunal.

ISSUES

1. Whether the services provided by the four engineers in India resulted in the Taxpayer constituting a service PE in India?

2. Whether the services provided by the engineers in India should be considered as FTS / Royalty and how should it be taxed in the hands of the Taxpayer.

RULING

No Service PE

On the question of whether the Taxpayer had a PE in India, the Tribunal ruled that the Taxpayer has no PE in India. The Tribunal reached its conclusion by placing reliance on the decision of the Mumbai tribunal in the case of *Clifford Chance v. DCIT*[2] ruled that only solar days should be considered and not the number of man-days the individuals were present in India. The Court in Clifford Chance held that ***"Multiple counting of the common days is to be avoided so that the days when two or more partners were present in India, together, are to be counted only once. Multiple counting would lead to absurd results. For example, if 20 partners were present in India together for 20 days in one fiscal year, multiple counting would result in 400 days. There cannot be more than 365 days in a year".*** Therefore, Tribunal was of the opinion that multiple counting of more than one employees present in India has to be avoided. Since in the present case, the engineers were present in India for only 90 days, it was less than the number of days prescribed under the Tax Treaty for a service PE to be formed in India; the Taxpayer could not have been construed to have a PE in India.

Notably, the Tribunal rejected the argument of the revenue department which relying on the recent Bangalore ITAT case of ABB FZ-LLC v. DCIT ("**ABB**") argued that service PE could be established even without the physical presence of the employees in India. The tribunal in ABB case also held that service PE is not dependent upon the fixed place of business as it is only dependent on the continuation of the activity, which does not mandate physical presence in India.

In the present case, Tribunal distinguished the ABB case on the difference in facts. The Tribunal observed that in the case of ABB, managerial and consultancy services were provided which could also be provided without a physical

Research Papers

Structuring Platform Investments in India For Foreign Investors
March 31, 2025

India's Oil & Gas Sector– at a Glance?
March 27, 2025

Artificial Intelligence in Healthcare
March 27, 2025

Research Articles

2025 Watchlist: Life Sciences Sector India
April 04, 2025

Re-Evaluating Press Note 3 Of 2020: Should India's Land Borders Still Define Foreign Investment Boundaries?
February 04, 2025

INDIA 2025: The Emerging Powerhouse for Private Equity and M&A Deals
January 15, 2025

Audio

CCI's Deal Value Test
February 22, 2025

Securities Market Regulator's Continued Quest Against "Unfiltered" Financial Advice
December 18, 2024

Digital Lending - Part 1 - What's New with NBFC P2Ps
November 19, 2024

NDA Connect

Connect with us at events, conferences and seminars.

NDA Hotline

Click here to view Hotline archives.

Video

Vyapak Desai speaking on the danger of deepfakes | Legally Speaking with Tarun Nangia | NewsX

presence in India. Whereas, in the present case, engineers provided personalized services in India and there is no evidence of online services being rendered by Taxpayers. Therefore, based on these differences in facts, the Tribunal ruled that ruling of ABB is not applicable in the present case.

FTS not taxable under Tax Treaty

The Tribunal accepted the contention of the Taxpayer, held that since the Tax Treaty does not contain a clause on taxation of FTS, FTS should not be taxable in India. The Taxpayer placed reliance upon the judgment of Madras High Court in *Bangkok Glass Industry Co. Ltd. vs. ACIT*[3], wherein the revenue had argued that payment receipts were not taxable as Business Profits under the India- Thailand tax treaty; however, the receipts would fall under "other income" clause of the tax treaty. The High Court, in that case, held that FTS was not taxable as royalty and rejected AO's finding that FTS was taxable under residual clause under the treaty.

Similarly, in the present case, Tribunal held that there are no provisions under the tax treaty addressing taxability of FTS and this should not be taxed as "other income" in India. Under the Tax Treaty, other income is taxable in Saudi Arabia. However, since adequate facts were not availale with the AO, the matter was remanded back to the AO for examine taxability as royalties.

ANALYSIS

This a welcome judgment from the Tribunal. The Tribunal has followed the decision in *Clifford Chance* and has rightly rejected the applicability of *ABB case*. Considering that Courts have consistently ruled that for service PE to be formed solar days have to be considered, it wasn't correct on part of the AO to calculate the days basis man-days the engineers were present in India. Taking such an aggressive approach shows how the revenue department is working towards maximizing collection by increasing superfluous tax scrutiny, which is only causing inconvenience and harassment for taxpayers.

A trust based taxation regime has been the need of the hour for some time and while India has come a long way to make reforms to its tax regime, however there is still a lot to cover. One of the key elements for any jurisdiction to receive foreign investment is tax certainty. However, acts such as these make foreign investors lose faith in the system and make them reluctant to invest in India.

– Alaukik Singh & Ashish Sodhani
You can direct your queries or comments to the authors

[1] Electrical material Center Co. Ltd. [TS-451-ITAT-2017(Bang)]
[2] [2002] 82 ITD 106 (Mumbai)/[2002] 76 TTJ 725 (Mumbai)
[3] Bangkok Glass Industry Co. Ltd. [TS-5375-HC-2012(MADRAS)-O].

April 01, 2025

Vaibhav Parikh, Partner, Nishith Desai Associate on Tech, M&A, and Ease of Doing Business
March 19, 2025

SIAC 2025 Rules: Key changes & Implications
February 18, 2025