

Indian court rules on US companies' permanent establishment due to sales and marketing activities in India

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Executive summary

An Indian court recently held¹ that a group of United States (US) companies (the Taxpayers) created a permanent establishment (PE) in India due to onshore sales and marketing activities carried out by employees of the Taxpayers as well as by employees of an Indian affiliate company. The visiting employees had dedicated rooms available at the offices of an Indian liaison office (LO) setup by one of the companies in India, from which they performed various sales and marketing activities that included collecting market information, performing business development, approaching potential customers, explaining products, negotiating prices, and performing supervision and administration, for and on behalf of the Taxpayers. Based on the facts, the Indian court held that the Taxpayers created a fixed place PE as well as a dependent agency PE in India under the India-US income Tax Treaty (the Treaty).

Detailed discussion

Overview of facts

The Taxpayers were a group of US companies engaged in the manufacture and sale of highly sophisticated equipment to customers across the world, including India. One of the group companies had established an LO in India to perform

certain specific liaison activities to act as a communication channel between the head office and the Indian customers. The group had also set up an Indian subsidiary which provided marketing support services to the Taxpayers and was compensated on a cost-plus basis. A number of the Taxpayers' employees worked in India along with the employees of the Indian group company to support various businesses of the group.

Tax examination

The Indian tax authorities examined various documents of the LO, including email correspondences and performance appraisal reports, and recorded statements of two persons during the examination and the following facts were identified and established:

- ▶ Taxpayers' employees were working in the LO's offices.
- ▶ Some key employees performed leadership roles while visiting India.
- ▶ The foreign and Indian support team employees looked after the business and sales of the group as a whole in India.
- ▶ The foreign and Indian support team employees carried out core sales activities in India instead of acting as mere communication channels.
- ▶ Specific rooms in the LO offices were assigned to the foreign employees' work space.

Based on the above, the Indian tax authorities held that the Taxpayers created a fixed place PE at premises of the LO and a dependent agency PE in India due to the sales related activities of taxpayers and Indian support employees. In the absence of specific information regarding the annual profits of the Taxpayers, the Indian tax authorities adopted a formulary apportionment approach to determine profits attributable to the Indian PE. Under this approach, 10% of the value of sales made by the Taxpayers to Indian customers was deemed attributable to the Indian PE and 35% of such sales were deemed to be taxable profits in India.

The Taxpayers contended that a PE should not be created in India as the activities performed in India were merely preparatory or auxiliary in nature, the activities were a small part of the overall business of the Taxpayers and the participation in negotiations by the foreign and the Indian support team employees was only a small part of the overall sales functions.

Ruling of the Indian court

On appeal, the Indian court upheld the Indian tax authorities' position based on the following basis:

- ▶ **Fixed place PE:** The court ruled that the LO's office premises should be regarded as a fixed place PE of the Taxpayers, as the foreign employees had disposal over such premises and performed activities, including but not limited to: exploring commercial opportunities, performing business development, approaching customers to communicate available options, and performing intensive negotiations in relation to technical and commercial parameters of the contract. Consequently, these activities fall outside of preparatory or auxiliary in nature with respect to the overall business of the Taxpayers.
- ▶ **Dependent agency PE:** The court held that the foreign and Indian support team employees were involved with the negotiation of core or key elements of the contract, including the technical specifications and price negotiations, and therefore these activities should establish a dependent agency PE.
- ▶ **Income attribution:** The court held that the approach for profit attribution applied by the tax authorities was acceptable since it took into consideration existing judicial precedent in India on the subject and that in the absence of statutory or other formal framework for attribution of profits, a method should reflect a reasonable approximation of the amount of profits attributable to the PE.

Implications

There has been extensive jurisprudence in India over the past few years on interpretation of the PE principle. The current ruling seeks to reinforce some existing principles around the concept of a fixed place PE, the nature of preparatory or auxiliary activities for exclusion from PE and the agency PE rule. Given the factual nature of the definition of PE under a given treaty, the court has relied on the extensive factual analyses presented by the Indian tax authorities.

The ruling highlights the potential PE risks that could arise from the activities of foreign employees visiting India. The thresholds for creating a PE in India continue to be lowered based on judicial precedents, expansion of the domestic PE rule and execution of the Multilateral Instrument as part of the OECD's² BEPS³ project. As a result, multinational groups should review these developments, including this ruling, on their existing and proposed arrangements.

Endnotes

1. TS-765-HC-2018 (DEL).
2. Organisation for Economic Co-operation and Development.
3. Base Erosion and Profit Shifting.

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