Chennai Tribunal rules on permanent establishment

By: Ravi S. Raghavan, Partner, Tax and Private Client Group, Majmudar & Partners, India

In the recent *Redington Distribution Pte. Ltd* case, the Chennai Bench of the Income-tax Appellate Tribunal (the "**Chennai Tribunal**) held that a subsidiary company based in Singapore (the "**Singapore Subsidiary**") of an Indian holding company ("**Indian HoldCo**") had a fixed place permanent establishment ("**PE**") as well as an agency PE in India, basis which, the attributable profits of the Singapore Subsidiary would be taxable in India.

This ruling can impact many multinational software companies, who sell their products in India from Singapore but rely extensively on their Indian sales and marketing arms to provide on the ground support in India.

Background

The Redington group is engaged in the business of providing end-to-end supply chain software solutions for personal computers, computer building blocks, networks, enterprises, consumer and lifestyle products. A tax withholding survey was conducted by the Indian tax authorities at the Indian HoldCo's premises. During this survey, information about the Indian Holdco's "Dollar Team" was obtained by the authorities after sifting through employee lists, e-mail correspondences, and service-related documents.

The Dollar Team identified Indian customers for the Singapore Subsidiary, negotiated with them, assisted them in availing customs duty benefits and followed-up with them for outstanding receivables. Except for the shipment of goods from the Singapore Subsidiary's office, all other activities were carried out by the Dollar Team from the Indian HoldCo's office.

The tax authorities noted that the entire sales function of the Singapore Subsidiary was habitually performed in India by the Dollar Team, who appeared to work wholly and exclusively for the Singapore Subsidiary.

Chennai Tribunal Ruling

The Chennai Tribunal held, based on the facts, that the Dollar Team of the Indian HoldCo assisted the Singapore Subsidiary in seeking orders, giving quotes to customers, vendor negotiations, and concluding the terms of sales. Only documents like the packing list, the airway bill, etc., were prepared by the Singapore Subsidiary. The premises of the Indian HoldCo were at the disposal of the Singapore Subsidiary, and the Dollar Team carried out their functions from the premises of the Indian HoldCo. Given that the services rendered by the Dollar Team were neither preparatory nor auxiliary services but main functions of a group business, the Singapore Subsidiary had a fixed place PE in India.

As the Dollar Team of the Indian HoldCo concluded contracts on behalf of the Singapore Subsidiary, the activities undertaken by the Dollar Team also constituted an agency PE of the Singapore Subsidiary in India.

Raheja Chambers, 2nd floor, Free Press Journal Road, Nariman Point, Mumbai 400 021, India
Tel: +91 22 6123-7272; Fax: 6123-7252; E-mail: mailbox@majmudarindia.com
Other Office – Bangalore | Integrated Network Offices – Chennai, Hyderabad and New Delhi
www.majmudarindia.com

In relation to tax on the profits attributable to the PE, the matter has been referred to the tax officer for re-examination, based on available audited financial statements of the Singapore Subsidiary.

Our Comments

Although the Dollar Team members were employees of the Indian HoldCo, who paid them their salary after withholding the appropriate taxes, the Dollar Team clearly did not seem to be engaged in back-office support services but core income generating functions for the Singapore Subsidiary. In activities of a business group, it is pertinent to check whether the activities performed by the Indian entity are the main functions of the business or merely preparatory activities. In ruling on the matter, the Chennai Tribunal also discussed the Indian Supreme Court's decision in the *E-funds IT Solution Inc* case and the *UAE Exchange Centre Ltd* case, as well as the Mumbai Tribunal decision in the *Airlines Rotables Ltd* case, to hold that so long as the premises are under the control and supervision of the non-resident, and business activities are carried out from those premises, it can constitute a fixed place PE.

The Chennai Tribunal also reiterated an important principle that to establish the existence of a fixed place PE, the disposal test is important. The non-resident should have a place at its disposal in India, and from such place, business activities of the non-resident should be carried out. With respect to the agency PE issue, the Chennai Tribunal analysed whether the Indian entity had the authority to conclude contracts and whether it had habitually exercised such authority.

If we consider other tax cases such as the *GE Group* case (you can see our detailed analysis of the *GE Group* case here, where the Delhi High Court ruled that a liaison office constituted a fixed place PE and an agency PE) or the *NetApp* case, alongside the Chennai Tribunal ruling, it appears that the Indian tax authorities are looking for details in commercial arrangements, and their detection techniques have become much more sophisticated. A harmless tax deducted at source audit brought to light (after review of email correspondences and service-related documents) the fact that the Singapore Subsidiary was performing its entire sales function through the Indian Holdco. Therefore, companies need to be careful with their documentation, internal correspondence, posts, social media communication, etc., as the authorities are increasingly taking cognizance of these. Notwithstanding, PE determination is always a fact-based exercise, and non-resident taxpayers should always consider a tax risk analysis of their proposed business activities in India.

Raheja Chambers, 2nd floor, Free Press Journal Road, Nariman Point, Mumbai 400 021, India
Tel: +91 22 6123-7272; Fax: 6123-7252; E-mail: mailbox@majmudarindia.com
Other Office – Bangalore | Integrated Network Offices – Chennai, Hyderabad and New Delhi
www.majmudarindia.com