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Newsflash

Delhi ITAT confirms the non- existence of Virtual PE concept in India-Singapore DTAA in the case Clifford Chance PTE Ltd

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1. Background

1.1 The permanent establishment ('PE') is a universally accepted concept which subscribes to the source-based taxation principle and determines the right of source country to tax the profits of a company that is the resident of another country. This concept is enshrined under the Double Taxation Avoidance Agreements ('DTAA' or "Tax Treaty') aiming to avoid double taxation on 'Business Profits' derived by an enterprise of one country, while doing business in another country. PE serves as the basis of economic nexus between a taxpayer and a taxing state.

1.2 The concept of PE has been recognized and acknowledged by India in its international tax treaties under 'Article 5- Permanent Establishment', and also in the domestic tax laws as a part of statutory transfer pricing provisions under section 92F of the Income-tax Act, 1961 ('Act'). While Article 5 defines PE in an exhaustive manner, section 92F(iiia), in the context of transfer pricing provisions, defines PE in an inclusive manner.

1.3 India's tax treaties provide that Service PEs of the foreign companies can be constituted in India if these companies provide services in the country through their employees or other personnel working under their control and supervision for a period exceeding the threshold provided in specific tax treaties. This concept of service PE is solely based on the length of time during which services are performed in the other country.

1.4 Recognizing the challenges posed by digitalization, the OECD in its interim report on the "Tax Challenges arising from digitalization" during 2018 highlighted the concept of virtual service PE where the physical presence of a foreign entity is not required.

1.5 According to a recent ruling by the Delhi Bench of the Honourable Income-tax Appellate Tribunal (ITAT), it has been determined that the inclusion of the virtual service PE concept in the OECD Interim Report 2018 on BEPS Project 'Tax challenges arising from Digitalization' lacks official endorsement from India. Consequently, it should not be considered when determining the service PE. A key finding of the case is provided below.

2. Fact of the case

2.1 Clifford Chance PTE Ltd ('assessee'), a tax resident of Singapore, is a legal firm that offers legal advising services to various foreign clients, including those from India. The assessee opted to be governed by the provisions of India-Singapore Double Taxation Avoidance Agreement ("DTAA") and filed its return of income for the Assessment Year ("AY") 2020-21 and 2021-22, declaring Nil income and claiming credit of tax deducted at source ('TDS').

2.2 The return of income for both AYs was selected for scrutiny assessment under section 143(3) of the Act.

2.3 During the relevant AYs, the assessee entered into legal advisory contracts with Indian clients. In AY 2020-21, some advisory services were provided remotely outside of India, while others were provided by assessee employees who travelled to India. In AY 2021-22, services were rendered remotely from outside India, with no staff visiting India to provide services.

2.4 During the assessment proceedings, the assessing officer ('Ld. AO') claimed that providing services to Indian clients resulted in the establishment of a service PE in India for AY 2020-21 based on physical presence of assessee's employees in India for more than 90 days, and a virtual service PE for AY 2021-22, subjecting the receipts to taxation in India. Furthermore, the Ld. AO claimed that the physical presence of the employees in India is not material.

3. Contentions raised by the Assessee

3.1 The assessee's fundamental argument was that in order to qualify as a service PE in India under Article 5(6)(a) of the India-Singapore DTAA, not only must the assessee through its employees or other personnel be physically present in India, but that presence must also exceed the 90 days threshold specified in that article. In this context, reliance was placed on the decision of the Hon'ble Supreme Court of India in ***ADIT vs. E-Funds IT Solution[1] Inc***.

3.2 The assessee further submitted that while calculating the 90 days threshold, only the days when the assessee actively offered services should be considered. Any days such as business development days or common days when no services were provided should be excluded as those are non-revenue generating. In this context, the reliance was placed on the decision of ***Linklaters LLP vs DDIT***[2] and ***Clifford Chance vs DCIT***[3].

3.3 The assessee further submitted that services provided by the assessee does not 'make available' any technical knowledge, experience, skill, know-how which may enable the Indian client to be able to apply the same independently and hence these services do not fall within the nature of Fees for Technical Services (FTS) under the provisions of India-Singapore DTAA.

4. Contentions raised by the Revenue

4.1 The main argument advanced by the Ld. AO was that the services rendered by the assessee to clients in India for a duration exceeding 90 days does not require the physical presence of employees in India, and thus constituted a virtual service PE in India in accordance with the nexus rule outlined in Article 5(6) of the India-Singapore DTAA.

[1] 86 taxmann.com 240 (SC)
[2] 106 taxmann.com 195 (Mumbai-ITAT)
[3] 82 ITD 106 (Mumbai-ITAT)

4.2 The Ld. AO further argued that there is no mandate in the tax treaty that the employees providing services within India must be stationed in India and services provided from outside India should also be considered for constitution of service PE in India.

4.3 The Ld. AO has relied on the ruling of the Bangalore Tribunal in the case of ABB FZ LLC and OECD Interim Report 2018 under the OECD/G20 BEPS Project Titled "Tax challenges arising from Digitalization". This ruling and report essentially implies that foreign entities providing services to Indian customers remotely, without a physical presence in India, can still be deemed to have a virtual service PE in India.

5. Decision by the Delhi Income-tax Appellant Tribunal ('ITAT')

5.1 Hon'ble ITAT has observed several unequivocal facts. Firstly, it has been observed that the assessee does not have a permanent base or office in India. Secondly, during the AY 2020-21, certain advisory services were rendered remotely from locations outside of India, while others were provided by assessee employees who travelled to India. Lastly, in the AY 2021-22, services were rendered remotely from outside India, with no staff members visiting India to provide services.

5.2 Hon'ble ITAT after examining the relevant Article 5(2)(6)(a) of the India-Singapore tax treaty and relying on the decision of the Hon'ble Supreme Court in ***ADIT vs. E-Funds IT Solution Inc*** concluded that the services must be furnished 'within India' in order to constitute a service PE in India. The relevant extract of Article 5(2)(6)(a) is reproduced as under:

"An enterprise shall be deemed to have a permanent establishment in a Contracting State if it furnishes services, other than services referred to in paragraphs 4 and 5 of this Article and technical services as defined in Article 12, within a Contracting State through employees or other personnel, but only if:

(a) activities of that nature continue within that contracting state for a period or periods aggregating more than 90 days:

5.3 In terms of the above provision, the following conditions need to be cumulatively satisfied for the constitution of a service PE in India:

(a) Employees or the other personnel of the foreign entity should be present in India,
(b) There should be furnishing of services within the contracting state (India) through employees or other personnel of such foreign entity, and
(c) Activities of that nature i.e. such furnishing of services should continue for a period exceeding 90 days.

5.4 In determining the 90 days threshold, the Hon'ble ITAT concurred with the assessee's argument that only the days in which the assessee actively rendered services should be taken into account. The days that were not utilized for service provision or those designated for business development or other common days should be excluded.

5.5 Regarding the Ld. AO's reliance on the OECD Interim Report concerning virtual service PE, the Hon'ble ITAT concluded that the current service PE provision, which mandates physical rendition of service in India, should be applied in the absence of such a virtual

service PE provision in the India-Singapore tax treaty. The Hon'ble ITAT also noted that the position that physical presence is no longer essential for the application of service PE is officially supported solely by Saudi Arabia and not by India. Further, there are no judicial precedents available on the same.

5.6 Based on the aforementioned discussion, the Hon'ble ITAT concluded that the assessee does not establish a virtual service PE in India. This determination stems from the absence of provisions related to the establishment of virtual service PE within the India-Singapore DTAA. Therefore, the existing service PE provision outlined in the India-Singapore DTAA, which necessitates physical service delivery in India, should be exclusively applied.

6. Our Comments

6.1 This ruling is particularly favorable for foreign entities who offer services to Indian clients remotely, without a physical presence in India.

6.2 Moreover, the ruling additionally upholds the perspective that treaties ought to be construed in accordance with their explicit provisions rather than subjective interpretations.

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