Supervisory services provided by a foreign company through its technicians do not constitute a PE in India, however it is taxed as FTS

2 July 2014

Background

Recently, the Hyderabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of GFA Anlagenbau GmbH¹ (the taxpayer) held that supervisory services rendered by the taxpayer through foreign technicians do not constitute a Permanent Establishment (PE) in India under the Income-tax Act, 1961 (the Act), as well as under the India-Germany tax treaty (tax treaty).

The Tribunal observed that since the taxpayer rendered services at project sites of its clients and does not own or operate such sites independently, it would not be considered as a PE in India. Further, the Tribunal observed that as per Article 5(2)(i) of the tax treaty, supervisory services provided by the taxpayer themselves cannot constitute a PE of the taxpayer, since such services were not provided in connection with building, construction or assembly activities of the taxpayer.

The Tribunal further held that supervisory services would be taxed as Fees for Technical Services (FTS) under Article 12 of the tax treaty since such services were technical in nature.

Facts of the case

- The taxpayer is a German company engaged in the activity of supervision, erection, commissioning of plant and machinery for steel and allied plants in India. It entered into an agreement with four Indian purchasers² for the supervision, erection, ramp up, commissioning, demonstration of performance, performance guarantee test, etc., of various 'plant and machinery' for their steel and allied plants.

- During the years³ under consideration, the taxpayer had received receipts from Indian purchasers for rendering technical and supervision services.

---


² Tata Steel Ltd., SMS Demag P. Ltd., SAIL, Jindal Steel and Power Ltd. (Assessment Years 2005-06, 2006-07, 2007-08, 2008-09, 2009-10)

© 2014 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
• The taxpayer had rendered services to the Indian purchasers by engaging foreign technicians at the worksites in India, and the total stay of these technicians on one project (out of four projects) had exceeded 183 days.

• The Assessing Officer (AO) held that since the activities carried on by the taxpayer through its employees exceeded six months, it was liable to be assessed under Section 44D5 or Section 44DA5 of the Act. The AO also held that since the taxpayer was having PE in India under Article 5 of the tax treaty, its income was liable to be taxed under the head ‘business profits’ under Article 7 of the tax treaty.

• The Disputes Resolution Panel (DRP) held that the clauses of the contract agreement as well as the provisions of the tax treaty establish that the taxpayer was having a PE in India. Further, with regard to the deduction of expenditure, it was held that the taxpayer was entitled to a deduction of 50 per cent of gross receipts from all projects towards expenditure. Accordingly, the DRP directed the AO to impose tax, applying a rate of 40 per cent in addition to surcharge and education cess, as per Section 44DA of the Act.

**Tribunal’s ruling**

• Relying on the decision of the Andhra Pradesh High Court in the case of Clouth Gummiwerke Akrinegesellschaft,6 the Tribunal observed that supervisory activities are to be considered as FTS under Section 9(1)(vii) of the Act. The Tribunal held that this rationale would also apply to the present case and therefore, the taxpayer’s supervisory activities have been correctly offered to tax under Section 9(1)(vii) read with Section 44D/Section115A of the Act.

• As per the definition of a PE under Section 92F(iii) of the Act, the supervisory activities do not constitute a fixed place of business, in as much as the taxpayer renders its services at the project sites of its clients. Further, the taxpayer does not own or operate such sites independently but rather such sites were provided by its clients under the contractual obligation.

• The Andhra Pradesh High Court in the case of Visakhapatnam Port Trust7 had observed that the expression PE used in the tax treaty postulates the existence of substantial element of enduring or permanent nature of a foreign enterprise in another country, which can be attributed to fixed place of business of that country. The High Court had held that mere supervisory activities would not form a PE. In the instant case, the Tribunal observed that though the rationale of the Andhra Pradesh High Court’s ruling can be adopted, the India-German tax treaty at that point in time was different from the current tax treaty.

• Relying on the decision of Motorola Inc8 it was observed that the concept of ‘fixed place of business’ in the Act is not different from the general provision of Article 5(1) found in the Model Conventions and the other Indian tax treaties.

• The Tribunal referred to the decision of Motorola Inc. which has made a reference to the OECD Commentary. The Commentary refers to a ‘fixed place’ as a link between the place of business and a specific geographical point. It has to have a certain degree of permanency. In order to constitute a ‘fixed place of business’, the foreign enterprise must have at its disposal certain premises or a part thereof.

• In the present case, the taxpayer was supervising the project of an Indian company and had no fixed place of business. Only its technicians deputed to India, in the case of one project, stayed for more than 180 days. Nothing was brought on record to show that the technicians were operating from a fixed place in the custody of the taxpayer.

• Relying on the decision of Motorola Inc., it cannot be said that the taxpayer had a fixed place of business for its supervisory activities. In order to support its view the Tribunal also relied on the decision of Airlines Rotables Ltd.9

• The Tribunal observed that a literal reading of Article 5(2)(i) of the tax treaty indicates that supervisory activities by themselves cannot constitute a PE since the activities are required to be in connection with a building, construction or assembly activity of the non-resident, which is not the case here as the taxpayer provides only supervisory activities.

• Drawing support from the Klaus Vogel book (Third Edition), the Tribunal observed that though Article 5(2)(i) of the tax treaty talks about supervisory activities, it does not cover the instant case, as the taxpayer does not have any building site or construction site of its own. The activities being technical in nature would fall under FTS Article of the tax treaty.

---

4 Special provisions for computing income by way of royalties, etc., in the case of foreign companies
5 Special provision for computing income by way of royalties, etc., in case of non-residents
6 Clouth Gummiwerke Akrinegesellschaft v. CIT [1999] ITD 280 (Del)
7 CIT v. Visakhapatnam Port Trust [1983] 144 ITR 146 (AP)
8 Motorola Inc vs. DCIT [2005] 95 ITD 269 (Del) (SB)
9 Airlines Rotables Ltd v. JDIT [2011] 131 TTJ 385 (Mum)
• In order to apply Article 12(5) of the tax treaty, the taxpayer should have a PE, through which its activities are carried on. However, such a condition was not met in the present case. Therefore, Article 12(5) of the tax treaty does not apply to the taxpayer’s case.

• The AO has not invoked the service PE concept while considering the PE of the taxpayer in India. The basis for the AO invoking the provisions of Article 5 of tax treaty is on the basis of the fact that three technicians deputed for supervising the activities in the case of one project, has stayed more than 183 days and filed their tax returns.

• Just because technicians stayed in India while supervising the work undertaken by the taxpayer, it cannot be said that their place of stay can be a ‘fixed place of business’ for the taxpayer. Had the AO examined the total period of deputing technicians to India and also examined whether there was an establishment where the taxpayer had any ‘permanent place’ to supervise the activities, then, the issue could be examined in the light of service PE considerations. However, the AO only examined the issue of the stay of technicians in India, which cannot be considered for examining the PE of the taxpayer in its supervising work.

• Thus the Tribunal held that the taxpayer’s supervisory activities did not constitute a PE in India under the Act, as well as under Article 5 of the tax treaty. The taxpayer should be assessed for its supervisory activities as FTS under Article 12 of the tax treaty.

• With regards to the issue of whether the period of supervisory activities did not exceed a period of six months in all projects and if such projects of the taxpayer constituted a PE, the Tribunal did not adjudge on that ground as it was already held that supervisory activities have to be in connection with the taxpayers’ ‘building site, construction or assembly project. Since it was already held that the receipts were in the nature of FTS and not in the nature of business income, the Tribunal did not deal with this issue.

• The Tribunal, however noted that it was incorrect to aggregate all contracts of the foreign company in India and consider it as one. Unless otherwise linked with each other, contracts should be individually assessed with respect to the duration test. This ratio is supported by the decision of the Mumbai Tribunal in the case of Valentine Maritime (Mauritius) Ltd.\textsuperscript{10}.

Our comments

The issue with respect to supervisory activities comprising PE in India has been a matter of debate before the courts. The Hyderabad Tribunal in the present case has held that supervisory services provided by a foreign company through its employees at the project sites of an Indian company did not constitute PE in India. The Tribunal observed that the taxpayer did not itself own or operate any project sites independently. Further, such services were not provided in connection with building, construction or assembly activities of the taxpayer. Therefore, supervisory services did not result into taxpayer’s PE in India under the Act, as well as under India-Germany tax treaty.

On the other hand, the Delhi Tribunal in the case of Steel Authority of India Ltd\textsuperscript{11} while dealing with the supervisory services provided by the German company to an Indian company for the modernisation of a steel plant in India held that the building site or construction, installation or assembly project need not be that of the taxpayer, and supervisory activities carried out in connection therewith constitute PE of the taxpayer if they continue for a period exceeding six months. Therefore, even if the installation or assembly project did not belong to the taxpayer, it was a fact that it had been providing supervisory services for installation purposes and such services had been provided for a period exceeding six months. Accordingly, supervisory activities by themselves, in such a situation, would constitute PE.

\textsuperscript{10} ADIT v. Valentine Maritime (Mauritius) Ltd. (ITA No.1532/Mum/05 dated 5 April 2010)

\textsuperscript{11} Steel Authority of India Ltd v. ACIT [2006] 10 SOT 351 (Del)
The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

© 2014 KPMG, an Indian Registered Partnership and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.

The KPMG name, logo and “cutting through complexity” are registered trademarks of KPMG International Cooperative (“KPMG International”), a Swiss entity.