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Tax Flash News



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Mere presence of expatriates does not create a supervisory PE in absence of a qualifying project and satisfaction of the six-month threshold

Executive summary

In a recent ruling,[1] the Delhi Bench of the Income-tax Appellate Tribunal ('the Tribunal') held that the taxpayer, a Japan-based company, did not constitute a supervisory Permanent Establishment ('PE') in India under the India-Japan tax treaty ('the Treaty') merely because its expatriates were present in India for providing services to Indian customers.

The Tribunal noted that the supervisory PE clause requires two cumulative conditions to be satisfied: (i) supervisory activities must be carried out in India for more than six months; and (ii) such activities must be carried out in connection with a building site, construction, installation or assembly project ('construction project').

The Tribunal noted that, while the duration threshold was not met in certain projects, the remaining project did not qualify as construction project. Consequently, the conditions for constituting a supervisory PE were not cumulatively fulfilled for any project.

[1] ITA No.1828/Del/2018 – Cross appeals for multiple years

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The Tribunal also held that the duration test is required to be examined project-wise and not employee-wise, and that the stay of different employees cannot be aggregated to determine the duration of a project.

Facts of the case[2]

The taxpayer, a tax resident of Japan, earned income from providing supervision and other technical services and offshore supply of goods.

The Revenue held that the taxpayer had a supervisory PE in India under the Treaty[3] on account of the presence of its expatriates in India and accordingly attributed the service receipts to the alleged PE and also attributed a portion of the profits from offshore supplies to the PE.

Relevant provisions

Article 5(4) of the Treaty provides that a Japanese enterprise is deemed to have a PE in India if it carries on supervisory activities in India for more than six months in connection with a building site or construction, installation or assembly project being undertaken in India ('supervisory PE clause').

Revenue's contentions

The aggregate number of days spent in India by different expatriates exceeded the six-month threshold, thereby constituting a supervisory PE in India.

The offshore supplies and supervisory services formed part of the composite arrangements and, therefore, a portion of the profits from offshore supplies was attributable to the alleged PE.

Taxpayer's contentions

The six-month threshold and the requirement that the supervisory activities be carried out in connection with a construction project are cumulative and mandatory conditions under the supervisory PE clause. Mere presence of employees in India would not result in a supervisory PE unless both of these conditions are met.

The duration test had to be applied project-wise rather than employee-wise, and the overlapping days of different employees could not be counted multiple times.

[2] Other grounds of appeal have not been covered in this note

[3] Article 5(4)

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In the instant case, none of the projects (other than the project involving services rendered to one of its customers, X Pvt Ltd) exceeded the prescribed six-month threshold.

In relation to the services provided to X Pvt Ltd, though the two expatriates were present in India for more than six months, the taxpayer argued that X Pvt Ltd was not undertaking any construction project but was engaged in automobile dealership activities only. Accordingly, the services provided to X Pvt Ltd were not covered by the supervisory PE clause.

Tribunal's decision



The Tribunal accepted the taxpayer's argument relating to twin conditions for the constitution of supervisory PE and held that the taxpayer did not have supervisory PE in India. It further held that the profit from offshore supply was not taxable in India.

Key observations of the Tribunal included:

No supervisory PE merely on account of presence of expatriates

Following the Delhi High Court decision in *Sumitomo Corporation*,[4] the Tribunal held that the duration test has to be applied project-wise and not employee-wise. Accordingly, the Revenue could not aggregate the stay of different employees and treat the resulting cumulative employee-days as the duration of the project.

Except for the services rendered to X Pvt Ltd, none of the projects met the six-month threshold.

Presence exceeding six months at X Pvt Ltd did not create a PE

Relying on the judicial precedents,[5] the Tribunal held that where employees merely render technical services and there is no qualifying construction project in India, a supervisory PE cannot arise merely because the employees have stayed in India beyond the prescribed period.

Accordingly, the Tribunal held that the taxpayer did not have a supervisory PE in India and, consequently, no income could be attributed to such PE.

Offshore supply profits not taxable in India

Based on the invoices, bills of lading, bills of entry and import documentation, the Tribunal noted that:

- the supply contracts were concluded outside India;

[4] *CIT* v. *Sumitomo Corporation* [2016] 382 ITR 75 (Delhi)

[5] *FCC Co. Ltd*. v. *ACIT* [2022] 136 taxmann.com 137 (Delhi Tribunal); *National Petroleum Construction Co*. v. *DIT* [2016] 383 ITR 648 (Delhi); *GFA Anlagenbau GmbH* v. *ADIT* [2014] 34 ITR(T) 73 (Hyderabad Tribunal)

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- title to the goods passed outside India;
- consideration was received outside India;
- the Indian buyers imported the goods in their own capacity; and
- the transactions were undertaken on a principal-to-principal basis.

No part of the operations relating to the offshore supplies was carried out in India. Moreover, a significant portion of the supplies comprised raw materials, traded goods and spares, in respect of which no supervisory services could have been rendered.

Following the Supreme Court decision in *Ishikawajima-Harima Heavy*,[6] the Tribunal held that the profits from such offshore supplies were not taxable in India.

Our comments

The decision is significant as it reiterates that the mere presence of expatriates in India, even beyond six months, does not, by itself, give rise to a supervisory PE. The Tribunal also reaffirmed that the duration test must be applied on a project-wise basis and not by aggregating employee-days.



[6] *Ishikawajima-Harima Heavy Industries Ltd*. v. *DIT* [2007] 288 ITR 408 (SC)

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