No tax on foreign companies if no core activity

Double tax avoidance agreements (tax treaties) made with various countries provide that business income of an enterprise which is a tax resident of a foreign country is taxable only if it has or is deemed to have a permanent establishment (PE) in India. A PE is defined in article 5(1) of each tax treaty as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Further, article 5(2) provides that if the foreign enterprise has a place of management, a branch, an office, a factory, workshop, mine or quarry, or a construction or installation project, in India it will be deemed to have a PE in India. Other sub-clauses of article 5 set out exceptions under which a PE is not deemed to exist, such as where the Indian establishment of the foreign enterprise is engaged only in activities of a preparatory and auxiliary character.

The recent Supreme Court decision in *Director of Income Tax v Samsung Heavy Industries Co. Ltd*. held that the condition precedent for the applicability of article 5(1) of the tax treaties is that the Indian establishment of the foreign enterprise should be one through which the business of the enterprise is wholly or partly carried on. The court went on to hold that a fixed place of business which is only of a preparatory or auxiliary character would not constitute a PE. Where the project office of a foreign enterprise was only engaged in activities which were of a preparatory and auxiliary character not the core business activities of the enterprise, it is not a PE of the foreign enterprise.

A consortium including the taxpayer, Samsung Heavy Industries Co. Ltd., was awarded a turnkey contract by the Oil and Natural Gas Corporation (ONGC). The work included surveying, designing, engineering, procurement, fabrication, installation and modification at the existing facilities, and the start-up and commissioning of the Vasai East Development Project (VEDP) of ONGC. The taxpayer set up a project office in Mumbai, which it said was to act as a communication channel with ONGC. The taxpayer carried out the pre-engineering, surveying, engineering, procurement, and fabrication of offshore oil platforms outside India, after which they were transported to be installed at the VEDP. The tax authorities noted that the resolution of the board of directors of the taxpayer company setting up the project office and the application that it filed with the Reserve Bank of India (RBI) stated that the project office was opened for coordination and execution of the ONGC project. In the absence of any restriction in those documents the project office was a fixed place of business of the taxpayer carrying out wholly or partly the contract with ONGC. The tax authorities held that the taxpayer had a PE and assessed that 25% of the profit of the project was attributable to the PE and liable to tax. The finding regarding the existence of the PE was upheld in appeals up to the High Court though the estimate of profit attributable to the PE was remitted for a fresh determination.

The Supreme Court cited its earlier judgment in the case of *Assistant Director of Income Tax v E-Funds IT Solution Inc*. and noted that the initial burden of proving that a foreign enterprise has a PE in India lay with the tax department. The court held that the tax authorities had ignored the second paragraph of the board resolution stating that the project office was established to coordinate and execute delivery of documents in connection with the construction of the offshore platform [and] modification of the existing facilities for ONGC. The tax authorities had also ignored the fact that there were only two persons working in the project office neither of whom was qualified to perform any core activity of the taxpayer. It, therefore, held that the project office could not be said to be a fixed place of business through which the core business of the taxpayer was wholly or partly carried on. The project office of the taxpayer fell within article 5(4)(e) of the India-Korea tax treaty as it was carrying out activities solely of an auxiliary nature.

Similarly, in the case of *Union of India v UAE Exchange Centre* the Supreme Court, relying on the permission granted to the taxpayer by the RBI to set up a liaison office, held that the liaison office was engaged only in fund remittance services, which were of an auxiliary nature, and was not a PE of the UAE company.

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