

**BEFORE THE AUTHORITY FOR ADVANCE RULINGS
(INCOME TAX) NEW DELHI**

25th Day of February 2010

P R E S E N T

Mr. Justice P.V. Reddi (Chairman)
Mr. J. Khosla (Member)

AAR No. 831/2009

Name & address of the applicant : M/s. Seagate Singapore International Headquarters Private Limited,
7000 Aug Mo Ave,
5, Singapore, 569877.
Singapore

Commissioner concerned : Director of Income Tax
(International Taxation)II, New Delhi

Present for the Applicant : Mr. Mukesh Butani, [Partner BMR & Associates]
Mr. A. Jain, Partner BMR & Associates
Mr. Abhay Sharma, Manager BMR & Associates
Mr. Mohit Agarwal, Associates, BMR & Associates
Mr. Ankita Rungta, BMR & Associates.

Present for the Department : Ms. Nandita Kanchan,
Addl. DIT, R-II, Int. Tax, Delhi.

R U L I N G

(By Hon'ble Chairman)

1. This application for advance ruling under Section 245Q(1) of the Income- tax Act, 1961 (hereafter referred to as IT Act) has been filed by a non-resident Company incorporated under the laws of Singapore. It is engaged in the business of manufacture and sale of Hard Disk Drives. It has been supplying Disks to Original Equipment Manufacturers (OEMs) in India. The applicant states that in order to minimize the delays in the procurement of inputs from the applicant, the OEM has proposed to put in place a Vendor Managed Inventory (VMI) model. Under the VMI model, the applicant would enter into

agreements with 'Independent Service Providers' (ISPs) in India who would stock disks in India on behalf of the applicant and deliver the same to the OEM on a 'Just-in Time' basis. The typical steps involved in this arrangement are narrated by the applicant as follows:

- The OEM would raise a purchase order on the Applicant pursuant to which the Applicant would ship the goods to the ISPs in India;
- The ISPs would clear the goods from the customs port as the Importer on Record and would, thereafter store the same in a bonded warehouse. The ISPs would also furnish the bond with the customs authorities of India for clearing the goods without payment of customs duty. The ownership of the goods would remain with the Applicant;
- Whenever the OEM places a 'pull request' for the goods on any ISP, it would immediately deliver the goods to the OEM and inform the Applicant of such delivery having been made;
- After receiving a pull request from the OEM, such ISP would clear the goods from the bonded warehouse by following the required procedures and deliver the same at the OEM's premises. The Applicant would, at this point, raise its invoice for the goods delivered by ISP to the OEM;
- The OEM would, in turn, make the payment directly to the Applicant outside India;
- The ISPs would operate from bonded warehouses (operated and controlled by them) and would raise their invoices on the Applicant for services performed in India;
- The ISPs would also obtain registration with the Value Added Tax authorities in their names in the relevant State in India, pay applicable taxes and would file related returns in connection with delivery of goods to the OEM. The ISPs would be remunerated on an arm's length basis by the Applicant.

1.1. The applicant submits that it does not have any presence in India in the form of an office or any other place of business and the applicant will not have employees based in India. It is further stated that the applicant holds 20 shares (equivalent to 0.01%) of the shareholding of an Indian Group Company which has no role to play in the delivery of Disks under the VMI Model.

1.2. The applicant then states the details of similar arrangement proposed to be put in place by entering into an Agreement with YCH, a private Company incorporated in India. The said company would stock goods in India on behalf of the applicant and deliveries will be effected to Dell India (Pvt.) Ltd. The features of the proposed Agreement (which bears the nomenclature “third Party Hub Agreement”) and the typical steps that are involved in connection with the Agreement are detailed below:

- Dell would raise a purchase order on the Applicant pursuant to which the Applicant would ship the goods to YCH in India;
- YCH would clear the goods from the customs port as the Importer on Record and would, thereafter, store the same in a bonded warehouse. YCH would also furnish the bond with the customs authorities of India for clearing the goods without payment of customs duty. The ownership of the goods would remain with the Applicant;
- Whenever Dell would place a ‘pull request’ for the goods on YCH, it would deliver the goods to Dell and inform the Applicant of such delivery having been made;
- YCH would clear the goods from the bonded warehouse by following the required procedures and deliver the same at Dell’s premises. The Applicant would, at this point, raise its invoice for the goods delivered by YCH to Dell;
- Dell would, in turn, make the payment directly to the Applicant outside India;
- YCH would operate out of a bonded warehouse (operated and controlled by YCH) and would raise an invoice on the Applicant for services performed in India;
- YCH would also obtain a registration with the Value Added Tax authorities in Tamil Nadu in India, pay applicable taxes and file the related returns in connection with delivery of goods to Dell.
- YCH, being an independent third party, would be remunerated on an arm’s length basis by the Applicant.

1.3. A copy of the proposed Agreement between the applicant and the YCH is annexed to the application.

2. The questions raised in the application broadly relate to the existence or otherwise of a Permanent Establishment (PE) within the meaning of Art.5(1) and 5(8) of the India-Singapore Double Taxation Avoidance Agreement (hereafter referred to as DTAA or Treaty). The questions as recast are as follows :

- (a) Whether the applicant in the stated facts and circumstances, would have a Permanent Establishment (“PE”) in India under Article 5(1) or 5(8) of the India-Singapore Double Taxation Avoidance Agreement (“India-Singapore DTAA” or “Treaty”) in relation to the activity of delivering goods through a customs bonded warehouse owned and operated by an independent service provider in India.
- (b) In case the answer to Question (a) is in the affirmative, but the service provider is remunerated on an arm’s length basis, would any further income be attributable to the PE of the Applicant in India in terms of Article 7 of the India-Singapore DTAA?
- (c) Whether the Applicant, in the stated facts and circumstances, would have a PE in India under Article 5(1) or 5(8) of the India-Singapore DTAA, in relation to the activity of delivering goods through a customs bonded warehouse owned and operated by YCH Logistics (India) Pvt. Ltd. (“YCH”) in India.
- (d) In case the answer to Question (c) is in the affirmative, considering that the YCH would be remunerated on an arm’s length basis, would any further income be attributable to the PE of the Applicant in India in terms of article 7 of the India-Singapore DTA.”

Questions (a) and (c):

3. Section 5(2) of the IT Act lays down that a non-resident is liable to be taxed in India on income which accrues or arises in India or on income which is deemed to accrue or arise in India and on the income received in India. Section 90(2) of the Act provides that the provisions of the I.T.Act or of the DTAA whichever are more beneficial to the assessee shall apply. The applicant therefore seeks to invoke the provision in Art.7(1) of the India-Singapore DTAA according to which the business enterprise being a tax-resident of Singapore would be liable to be taxed in India in respect of its business profits only if the enterprise has a Permanent Establishment (PE) in India. Art.5 of the Treaty contains the definition of PE. Para (1) of Art.5 defines the term PE as a fixed place of business through which the business of the enterprise is wholly or partly carried on. A place of management, a branch, an office, a factory, a workshop and a warehouse in relation to a person providing storage facilities for others etc. are especially included in the definition of PE (vide Art.5.2). Paras (8) and (9) of Art.5 which deal with agency PE are extracted below :

“8. Notwithstanding the provisions of paragraphs 1 and 2, where a person – other than an agent of an independent status to whom paragraph 9 applies – is acting in a Contracting State on behalf of an enterprise of the other Contracting State that enterprise shall be deemed to have a permanent establishment in the first-mentioned State, if -

(a) he has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise,

unless his activities are limited to the purchase of goods or merchandise for the enterprise;

(b) he has no such authority, but habitually maintains in the first-mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that enterprise.

9. *An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise itself or on behalf of that enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.”*

3.1. It is the contention of the applicant that it does not have a fixed place PE or agency PE within the meaning of Art.5 of DTAA and therefore the business profits derived by it on account of supplies of goods to the customers in India through the media of ISPs or YCH are not liable to be taxed in India. The Department in its comments takes the stand that the applicant has a PE in India and that the warehouse of the ISPs or YCH shall be treated as PE. In the alternative it is submitted that an agency PE exists. These contentions were reiterated by the departmental representative in the course of hearing.

3.2. In the Third Party Hub Agreement between the applicant and YCH, YCH is described as ‘warehouse provider’.

The YCH will provide warehouse space for Seagate at the locations specified in Ext.A (para 1.1).

YCH will perform warehousing services as listed in Ext.B (para 1.2).

YCH will have to comply with Seagate's minimum security requirements (para 1.3).

The fee payable by Seagate to YCH is as per Ext.A (vide para 2).

Para 3 bears the heading 'third party products and claims'. Para 3.1 says that YCH shall segregate the Seagate products from the other products in its warehouse management system and also ensure that the Seagate products are not subject to encumbrance, seizure or possession of any third party.

Para 6.2 provides that YCH will be liable to make good the loss or damage to Seagate products arising out of neglect or default committed by the agents or employees of YCH to the extent of 'full release value' of the product upto a maximum of 100,000 dollars per occurrence. 'Full release value' is defined.

Para 7 deals with 'insurance'. YCH will obtain and maintain sufficient insurance for Seagate products while they are in company's

possession in an amount sufficient to cover the liability of YCH under para 6.2 (referred to above).

Para 10.9 says that the Agreement creates no relationship of joint venture or partnership between the parties and neither party is to be considered as representative, agent or employee of the other party for any purpose.

YCH will act as a logistics service provider and it shall be responsible for warehousing the Seagate products and to deliver the same to Seagate's customer Dell at its SEZ premises warehouse at Sipcot Industrial Park near Chennai (para 10.11).

Para 10.12 stipulates that YCH shall act as Seagate's 'importer of record' for all Seagate products imported into India through the facilities of YCH listed in Ext.A.

3.3. Some of the provisions in Ext.B – '**Scope of warehousing services**' are also relevant. They are :

YCH will make adequate space available including the provision of racks to store Seagate products and YCH will bear the capital expenditure to improve the capacity of the facilities (para 1.3).

Right to enter the warehouse is dealt with in para 1.4. It says that Seagate's designated agent or contractor may enter into YCH facility for physical inventory, inspection and audit and for other auxiliary or preparatory activities.

The obligations in regard to receiving incoming product are provided for in para 2. Para 3 deals with inventory control. YCH will receive all Seagate products and send an electronic receipt signal to Seagate before YCH will allow Seagate products to be pulled from the warehouse. YCH will establish the necessary operating systems to support electronic data interchange and furnish receipt, sale advice and inventory report. YCH will segregate each Seagate account in its warehouse management system, undertake inventory tracking and conduct physical inventories on monthly basis. As per para 4 which deals with “outgoing product pulls”, ICH will pull Seagate product on a “first in – first out basis”. Para 5 deals with “record retention and reporting”. Inbound, inventory and outbound reports should be part of its standard service offering. YCH will allow Seagate access to and copies of any records with legal, regulatory, operational or informational significance (para 5.3).

4. The Agreement with Independent Service Providers in India who would stock Disks on behalf of the applicant and deliver the same to the OEM has not been filed. However, it is stated that the Agreement or arrangement will be on similar lines as the Agreement entered into with YCH.

5. The core question in the instant case is whether the applicant which operates through ISPs such as YCH in India can be said to have a Permanent Establishment in India as defined in Art.5 of India-

Singapore DTAA. The profits derived by the applicant from its business in India will be taxable in India under the I.T. Act only if it carries on business through a PE located in India but not otherwise. If it has a PE, the next question will arise as to how the attribution of income has to be done. Therefore, we have to consider whether the applicant carries its business through a PE. That takes us to Art.5 which defines PE, which we have already referred to.

Art.7 of the India-Singapore DTAA *inter alia* lays down :

5.1 ARTICLE 7 : BUSINESS PROFITS

1. *The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment.*
2. *Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.”*

6. Now, we shall discuss whether para (1) of Art.5 is attracted in the instant case. A ‘fixed place of business’ through which the business is wholly or partly carried on is the criterion laid down in Art.5.1. A distinct situs or an earmarked place with certain degree of permanence from where any business activity is carried on is what is envisaged by Art.5.1. It is not necessary that the fixed place should

be owned or hired by the foreign enterprise. The applicant has referred to the Commentary of OECD Committee on Fiscal Affairs¹ according to which the definition in paragraph 1 of Art.5 contains the following conditions:

- *the existence of a “place of business”, i.e. a facility such as premises or, in certain instances, machinery or equipment;*
- *this place of business must be “fixed”, i.e. it must be established at a distinct place with a certain degree of permanence;*
- *the carrying on of the business of the enterprise through this fixed place of business. This means usually* that persons who, in one way or another, are dependent on this enterprise (personnel) conduct the business of the enterprise in the State in which the fixed place is situated.*

6.1. The applicant contends that it has no premises or facilities or installations owned, leased or kept at its disposal in India nor does it have any other kind of physical presence in India. It only has its goods stored in India in a warehouse owned and operated by Independent Service Providers and the applicant has only a restricted right of entry into the warehouse for the purpose of inspecting the goods during business hours. We find it difficult to accept this contention. It seems to us that the applicant does have a fixed place of business which is the focal point of its business operations in India. The fact that the fixed place of business is owned or possessed by the logistics service provider does not detract from the position that the applicant has a distinct, earmarked and identified place which caters to its business. In one sense, it is the business place of

¹ Model Tax Convention (Condensed version,2008)

* emphasis supplied

warehouse/service provider and in another sense, it is also the fixed place of business of the applicant from where the sales activities are carried on. It is seen from the Agreement that YCH will have to provide warehouse space at a specified location. The obligation to make adequate space available to store the applicant's products is cast on YCH. Further, YCH is under an obligation to install racks to increase the storage capacity or efficiency of operations. As per para 3.1 of Ext.B, YCH is required to provide the necessary systems to facilitate electronic data interchange so that the products can be pulled from the warehouse promptly and the necessary business informations are exchanged. There are enough indications in the Agreement that there should be earmarked space in the warehouse with racks and electronic devices. The Agreement also speaks of inventory control apart from storage, handling, repacking etc. Moreover, the applicant's agent or representative has a right to enter the warehouse for the purposes of physical inventory, inspection, audit, repackaging etc. (vide para 1.4 of Ext.B). May be, such entry is preceded by advance notice. Such advance notice is apparently required for the reason that the entire warehouse is not at the disposal of the applicant and the workmen of the ISP should be present at the time of such entry. Even the security requirements as stipulated by the applicant are required to be provided at the place. The fact that a service provider instead of the applicant's employee

carries on various operations leading to the delivery of products to the customers does not, in our view, rule out the application of para (1) of Art.5. Both the applicant and the warehouse/service provider act in cohesion to ensure the product delivery to the customers promptly. By merely outsourcing the operations leading to supplies of products, it cannot be said that the applicant does not carry on any business in India from a fixed place. The ground realities cannot be disregarded. The question whether the person carrying on business operations on behalf of or pursuant to the instructions of the applicant is a dependent or independent agent is not very material in considering the applicability of Art.5.1. The business of the applicant at a fixed place is being carried on through the media of the warehouse provider who can also be characterized as service provider. Having regard to these facts and features, we have to accept the contention of the Revenue that the demarcated space in the warehouse of ISP constitutes the fixed place of business within the meaning of Art.5.1 of DTAA.

7. In the result question nos. (a) and (c) are answered partly in the affirmative by holding that the applicant has a PE in India within the meaning of Article 5.1. However, we consider it unnecessary to discuss whether the agency PE within the meaning of Article 5.8 exists.

Questions (b) & (d):

8. The attribution of profit to the permanent establishment is governed by paras 2 and 3 of Article 7 which is extracted below:

“2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment. In any case where the correct amount of profits attributable to a permanent establishment is incapable of determination or the determination thereof presents exceptional difficulties, the profits attributable to the permanent establishment may be estimated on a reasonable basis.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the business of the permanent establishment including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and subject to the limitations of the taxation laws of that State.”

For the purpose of computation of profits of the PE in relation to the sales activity in India, it should be treated as a separate and distinct enterprise wholly independent of the enterprise of which it is a PE. The amounts paid to ISP/YCH and other expenses, if any, incurred should be deducted.

Accordingly, ruling is given and pronounced on this the 25th day of February, 2010.

**Sd/-
(J.Khosla)
Member**

**Sd/-
(P.V. Reddi)
Chairman**

F.No. AAR/831/2009 dated

This copy is certified to be a true copy of the Order and is sent to:

1. The applicant
2. The Director of Income-tax (International Taxation)II, New Delhi.

(Batsala Jha Yadav)
Addl. Commissioner of Income-tax, AAR