Tax Hotline

January 13, 2023

DELHI ITAT INTERPRETS THE TERM "HABITUALLY SECURES CONTRACTS" TO FIND NO PERMANENT ESTABLISHMENT IN INDIA

The definition of an agency permanent establishment in a significant number of Indian tax treaties varies from the mainstream OECD and UN Model Tax Conventions. Two additional clauses stipulate that an enterprise is deemed to have a PE in India if an agent (other than an agent of an independent status). This happens, first, if the agent "habitually maintains in [India] a stock of goods or merchandise", which it regularly delivers on behalf of the enterprise, and secondly, if an agent "habitually secures orders [in India] wholly or almost wholly for the enterprise itself or for [related enterprises]".

Whilst the first clause on the maintenance of a stock raises largely questions of fact, the latter raises the question of interpretation – what does one mean by "habitually secures orders"? Although the provision is not new,[1] case law on how to interpret this peculiar provision has been scarce.[2]

The Delhi Bench of the Income Tax Appellate Tribunal has recently had occasion to interpret this clause in the case of *Krones Aktingesellschaft*.[3]

The Taxpayer was a company which was a tax resident of Germany. It is leading provider of beverage filling and packaging technology. Upon being approached by clients directly, the taxpayer plans, develops and manufactures machinery and complete systems for filling and packaging beverages for its clients. These activities are carried out entirely outside the territory of India. Thereafter it arranges to supply and install the machinery and systems at its clients' place of business. The taxpayer had several clients in India.

The taxpayer has a wholly owned subsidiary, which is a tax resident of India. This subsidiary is engaged in procuring and trading in spare parts, engineering and installation of the taxpayer's products. Its functions include also after-sales services, marketing, and payment collection on behalf of the taxpayer.

It was evident from the contracts as well as the books of accounts that neither did the subsidiary have the authority to conclude contracts on behalf of the taxpayer, nor did it maintain a stock of its goods or merchandise in India. The spares it did stock were on its own account, and not on behalf of the taxpayer.

The important question, however, was whether the taxpayer secured orders habitually for the taxpayer. The tribunal opined that an agent must bear one of two "essential" characteristics to be seen as "securing orders" on behalf of the principal. First, the agent must accept orders frequently on behalf of the principal. Alternatively, the agent may represent frequently to clients that the agent has the authority to bind the principal. The subsidiary's functions in the instant case, including marketing activities, did not either standard, as the clients approached the taxpayer directly, and contracts were finalized by the taxpayer outside India. Therefore, the taxpayer did not have a PE in India on account of the subsidiary's functions in India.

Obiter Dicta: Although not material to the outcome of the case, the court did explore whether the Indian subsidiary was an independent agent and rules of attribution to PE.

– Ipsita Agarwalla & Dhruv Sanghavi

You can direct your queries or comments to the authors

[1] The 1958 Sweden-India tax treaty was the first to include such a provision.

[2] The provision has been examined previously in *Rolls Royce v. ACIT*, (2008) 19 SOT 42 (Del ITAT), which was affirmed by the Delhi High Court in (2011) 339 ITR 147, ACIT vs Mitsui & Co Ltd (ITA No. 4764/Del/2016). The AAR relied on the Rolls Royce case in MasterCard [AAR No 1573 of 2014].

[3] *M/s Krones Aktiengesellschaft v. DCIT*, ITA No. 907/DEL/2017.

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