



Supreme Court holds that Liaison offices do not constitute a Permanent Establishment in India

In a recent decision¹, the Supreme Court has held that Liaison Offices ('LOs') will not constitute a Permanent Establishment ('PE') as they rendered mere remittance related services which were preparatory or auxiliary in nature

Background

- U.A.E. Exchange Centre ('the taxpayer') is a limited company incorporated in the United Arab Emirates ('UAE') and was engaged in the business of offering remittance services from UAE to India.
- The taxpayer had opened few LOs in India for supporting the remittance activities. In cases where the remittances to the beneficiaries were to be made by way of cheque or drafts, the LOs would download the particulars of such remittances through electronic media, undertake printing of cheques or drafts, and courier the same to the beneficiaries in India.
- The taxpayer had approached the Authority of Advance Rulings ('AAR') with a question whether any income accrued or shall be deemed to be accrued for the taxpayer in India on account of the activities carried by its LOs in India. The AAR had ruled that the activities of the LOs in India constituted a PE and the profits to the extent attributable to such activities of the LOs were taxable in India.

¹ UOI & Anr. v. U.A.E. Exchange Centre (Civil Appeal No. 9775 of 2011)



- The taxpayer had challenged the ruling of the AAR by way of a writ before the jurisdictional High Court which ruled in favour of the taxpayer. The High Court had held that the activities carried on by the LOs were preparatory and auxiliary in nature and hence did not create a PE leading to taxation incidence in India.
- Aggrieved by the order of the High Court, the tax department had preferred an appeal before the Supreme Court. The limited question before the Supreme Court was whether the activity of LOs i.e. downloading of the list of remittances and issuing cheques or draft in favour of beneficiaries would qualify as “Preparatory and Auxiliary Activities” under the India – UAE Double Tax Avoidance Agreement (‘Tax Treaty’) and hence would not constitute a PE for the taxpayer.

Ruling of the Supreme Court

- The Supreme Court confirmed the ruling of the High Court and held that the activities of the LO were preparatory and auxiliary in nature and hence the LO will not constitute a PE for the taxpayer under the Tax Treaty.
- The Supreme Court observed that for determining whether an activity is preparatory and auxiliary in nature, a functional test of the activity would need to be undertaken. Further, it has been mentioned that the terms ‘preparatory’ and ‘auxiliary’ need to be understood as used in common parlance since the terms were neither defined in the Income-tax Act, 1961 (‘Act’) nor the Tax Treaty. Accordingly, the Supreme Court referred to the Black’s Law Dictionary and Oxford Dictionary which define the term auxiliary to mean ‘aiding or supporting’.
- The Supreme Court observed that as per the approval given by the RBI, the LOs were permitted to carry on only limited activities in India such as responding to queries of banks in India, undertaking bank reconciliation, acting as a communication channel between the branches of the taxpayer and Indian banks, printing and dispatching cheques or drafts to beneficiaries. The RBI approval specifically prohibited the LOs from entering into any contract or rendering any consultancy or other services in India. Further, the LOs were not permitted to borrow or lend any money from or to any person in India without prior approval of RBI or earn any commission for the services rendered by it.
- Given the onerous restrictions placed on the activities of the LOs, the Supreme Court held that the activities of the LOs could only be considered as being preparatory and auxiliary



in nature as had been held by the High Court. The Supreme Court also agreed with the High Court in its reliance on its decisions in the case of DIT (IT) v. Morgan Stanley & Co² and ADIT v. E-Funds IT Solution Inc.³ wherein support activities were held to be not resulting in a PE.

- Further, the restrictions imposed by the RBI meant that no business connection was established by the taxpayer in India. Even if a business connection is deemed to exist on account of the business activities carried on by the LOs in India, given that the activities are preparatory and auxiliary in nature, the taxpayer would not constitute a PE in India and hence no income should be taxable in India.

Dhruva Comments

Whether the activities of LOs constitute a PE or not is a vexed issue. This decision seems to lay down a broad guideline that where the activities of an LO are restricted to the approvals granted by the RBI, such activities should qualify as preparatory and auxiliary in nature and should not constitute a PE. However, the determination of the question as to whether any activity qualifies as preparatory or auxiliary in nature would depend on facts of each case and the nature of business engaged in by the taxpayer.

With MLI coming into force and India being a signatory thereto, going forward business models may need to be independently analysed under the provisions of MLI, for ascertaining whether a PE is established or not.

² (2007) 7 SCC 1

³ (2018) 13 SCC 294



ADDRESSES

Mumbai

11th Floor, One IndiaBulls Centre,
Tower 2B, 841, Senapati Bapat Marg,
Elphinstone Road (West),
Mumbai 400 013
Tel: +91 22 6108 1000 / 1900

Ahmedabad

B3, 3rd Floor, Safal Profitaire,
Near Auda Garden,
Prahlanagar, Corporate Road,
Ahmedabad - 380 015
Tel: +91-79-6134 3434

Bengaluru

Prestige Terraces, 2nd Floor
Union Street, Infantry Road,
Bengaluru 560 001
Tel: +91-80-4660 2500

Delhi / NCR

101 & 102, 1st Floor, Tower 4B
DLF Corporate Park
M G Road, Gurgaon
Haryana - 122 002
Tel: +91-124-668 7000

Pune

305, Pride Gateway, Near D-Mart, Baner,
Pune - 411 045
Tel: +91-20-6730 1000

Kolkata

4th Floor, Unit No 403, Camac Square,
24 Camac Street, Kolkata
West Bengal – 700016
Tel: +91-33-66371000

Singapore

Dhruva Advisors (Singapore) Pte. Ltd.
20 Collyer Quay, #11-05
Singapore 049319
Tel: +65 9105 3645

Dubai

WTS Dhruva Consultants
U-Bora Tower 2, 11th Floor, Office 1101
Business Bay P.O. Box 127165
Dubai, UAE
Tel: + 971 56 900 5849

New York

Dhruva Advisors USA, Inc.
340 Madison Avenue, 19th Floor, New York,
New York 10173 USA

KEY CONTACTS

Dinesh Kanabar (Mumbai)

Chief Executive Officer
dinesh.kanabar@dhruvaadvisors.com

Vishal Gada (Mumbai/Ahmedabad)

vishal.gada@dhruvaadvisors.com

Ajay Rotti (Bengaluru/U.S)

ajay.rotti@dhruvaadvisors.com

Vaibhav Gupta (Delhi / NCR)

vaibhav.gupta@dhruvaadvisors.com

K. Venkatachalam (Pune)

k.venkatachalam@dhruvaadvisors.com

Aditya Hans (Kolkata)

aditya.hans@dhruvaadvisors.com

Mahip Gupta (Singapore)

mahip.gupta@dhruvaadvisors.com

Nimish Goel (Dubai)

nimish.goel@dhruvaadvisors.com

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