Tax Hotline

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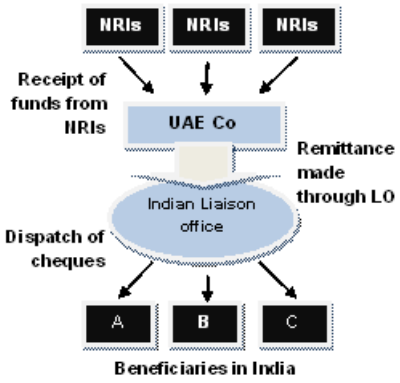
PE AUXILIARY ACTIVITY EXCLUSION: HIGH COURT ADOPTS A LIBERAL APPROACH

It is a settled principle of international tax jurisprudence that the maintenance of a fixed place of business solely for the purpose of carrying on any activity of a preparatory or auxiliary character would not give rise to a permanent establishment (**"PE"**). But, can an activity that is not merely auxiliary and actually forms a core part of the operations of the non-resident enterprise still fall within the scope of this exclusion? The recent decision of the High Court of Delhi seems to answer this question in the affirmative.[1]



To briefly state the facts, a UAE-based company (**"UAE Co"**) offered remittance services to various non-resident Indians for transferring money from UAE to specific individuals in India. The remittance was made electronically by way of (i) telegraphic transfer through banking channels; or (ii) on the request of the remitter, dispatch of instruments / cheques though the Indian liaison office (**"LO"**) of UAE Co to the designated beneficiaries. UAE Co approached, the Authority for Advance Rulings (**"AAR"**) for a ruling on whether its activities in India gave rise to a PE in India.

Since the role of the LO in the first mode of remittance was confined to addressing customer queries and complaints, the AAR held that such auxiliary involvement would not give rise to a PE in India as per the provisions of Article 5(3)(e) of the India-UAE Tax Treaty. However, in the second mode of remittance, the LO undertook the enhanced role of downloading online data regarding the amount to be remitted along with relevant names and addresses, and printing and dispatching the cheques / drafts to the designated beneficiaries by way of courier. The AAR observed that this effectively formed part of the core activity carried out by UAE Co and could not be viewed as auxiliary or incidental in nature. Considering that the LO was a fixed place of business through which UAE Co carried on business in India, the AAR held that UAE Co had a PE in India.

With a view to challenge the AAR's decision, UAE Co then invoked the writ jurisdiction of the Delhi High Court under Article 226 of the Constitution of India. After reviewing the AAR's construction of the domestic and treaty provisions, the Delhi High Court quashed the AAR's decision on the basis that it suffered from 'errors apparent on the face of record'. It may be noted that a contrasting approach was adopted by the Madras High Court in another recent case where the Court limited its judicial review to the legality of the procedure followed by the AAR and refused to venture into the correctness or legal validity of the AAR's order.[2]

The Delhi High Court in the present case, undertook a liberal construction of the auxiliary activity exclusion in the Treaty so as to cover the role played by the LO, which in its view was merely supportive of the main activity of the LO. Accordingly, it was held that the LO could not be considered a PE of UAE Co in India.

If it is presumed that the LO and UAE Co essentially carried out the same activity (i.e. remittance of money), the decision of the Delhi High Court would clearly contradict the OECD view that "a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise, does not exercise a preparatory or auxiliary activity."

The High Court even went a step further to hold that under domestic tax law as well, UAE Co cannot be said to have a business connection in India so as to render its income taxable in India. Under the domestic provisions, business profits earned by a non-resident would be taxable in India only to the extent that it is attributable to a business connection in India.[3] It seems that the Delhi High Court's decision has the effect of narrowing down the scope of the business connection threshold.

The Delhi High Court's liberal interpretation of the auxiliary activity exclusion and the concept of business connection, and its admonition of the AAR's 'errors apparent on the face of record' is likely to give rise to similar

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- Mahesh Kumar & Rajesh Simhan
You can direct your queries or comments to the authors

[1] UAE Exchange Centre Ltd. v. UOI, 2009-TIOL-84-HC-DEL-IT

[2] *Anurag Jain v. AAR*, [2009] 308 ITR 302 (Mad) relying on the principle laid down by the Supreme Court in *ShreeramDurga Prasad v. Settlement Commission*, [1989] 176 ITR 169

[3] The business connection threshold is wider than the PE threshold under the treaty and covers all situations where there is some sort of a real and intimate relationship between the offshore activities of the non-resident with its activities inside India.

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