Executive summary

This Tax Alert summarizes a recent ruling of the Authority for Advance Rulings (AAR) in the case of Production Resource Group[^1] (Applicant) on the issue of taxation of income received from furnishing of lighting and searchlight services during the Commonwealth Games in India, under the India-Belgium Double Taxation Avoidance Agreement (DTAA). In the facts of the case, the Applicant provided lighting and searchlight services during the opening and closing ceremonies of the Commonwealth Games in India in 2010, on a turnkey basis. The technical scope of work included installation, maintenance, dismantling and removal of the equipment. While the arrangement was entered into for a period of around 114 days, the Applicant’s employees and equipment were present in India for a period of 66 days for preparatory, installation and dismantling of the equipment. For the above services, the Applicant was provided an office space and on-site space to store the equipment at the stadium where the Games were conducted.

[^1]: TS-626-AAR-2017

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In view of the overall facts and the terms of the Agreement, the AAR held that the Applicant had a fixed permanent establishment (PE) in terms of the on-site space provided to store its equipment under a lock. Thus, exclusive access and control over such space lay with the Applicant. Additional factors like a comprehensive physical presence throughout the Games, entering into contracts for employing personnel, ability to subcontract obtaining insurance for the equipment, indicated existence of a place at the disposal of the Applicant. Furthermore, based on the decision of the Supreme Court (SC) in the case of Formula One World Championship Ltd. [2] (FOWC case), it was held that even though presence in India was for a short duration, it may be sufficient to create a PE, given the nature of the business and the continuous presence of the Applicant throughout the period of the Games. Hence, the Applicant’s income, which was attributable to such PE under the DTAA, would be taxable in India.

Furthermore, it was held that the Applicant’s income did not qualify as royalty under the DTAA in the absence of any intellectual property (IP) by the Applicant. By applying the most favored nation (MFN) clause of the DTAA, the income did not qualify as fees for technical services (FTS), since the make available condition was not met though, in the facts, services were held to be technical in nature.

Background and facts

- The DTAA defines PE as, *inter alia*, a fixed place of business through which the business of the foreign enterprise is carried on in the source country (fixed PE). In addition, an installation project or supervisory activities incidental to the sale of the equipment can create a PE if carried on for more than six months and the charges payable exceed 10% of the sale price of the equipment (installation PE).
- The DTAA provides source taxation for FTS and royalty, both of which are defined broadly in line with the domestic laws in India. The Protocol of the DTAA provides the MFN clause to grant the benefit of a more restricted scope of taxation or rate of tax on FTS/royalty present in any subsequent DTAA entered into force by India with another OECD member.
- The Applicant is a company incorporated in Belgium and is engaged in the business of providing technical equipment and services for events, including lighting, sound, video and LED technologies.
- The Applicant entered into a Service Agreement with the Organizing Committee of the Commonwealth Games, India (OCCG), for a term commencing on 9 July 2010 and expiring on 30 October 2010 (around 114 days) (Agreement). Under the Agreement:
  - The Applicant undertook to furnish lighting and searchlight services during the opening and closing ceremonies of the Commonwealth Games in India in 2010, on a turnkey basis.
  - The technical scope of work included installation, maintenance, dismantling and removal. It required an ongoing presence available on call, to service, rectify or repair any equipment supplied by the Applicant.
  - For provision of the services, the Applicant undertook all related activities, such as obtaining all authorizations, permits and licenses, engaging personnel with the requisite skills, ensuring their availability, procuring and/or supplying all necessary equipment for its business, subcontracting, shipping and loading, insurance etc.
  - For carrying on the above activities, the Applicant was provided with an office space, as well as an on-site space for storing its tools and equipment inside the stadium where the Games were held, under a lock.

While the services were rendered for the two days of the opening and closing ceremonies, the Applicant’s employees and equipment were present in India for a period of 66 days for preparatory, installation and dismantling of the equipment.

- The Applicant was of the view that its income was not taxable in India.
- Income did not amount to FTS since the services provided were standard in nature and there was no “rendering” of services, which implied a continued provision of specified, identified services, and not merely an end result. Also, by invoking the MFN clause, the restricted scope of the make available condition under the India-Portugal DTAA[3], can be applied in the present case. Since the make available condition was not met, the income did not qualify as FTS.
- There was no transfer of any IP or right to use any IP by the Applicant to the OCCG. Hence, the royalty definition was not triggered.
- The Applicant did not have a PE in India in the absence of any fixed place of business in India to which it could enter or make use as a matter of right. The premises of the OCCG were used for rendition of contracted services. Mere business relations with the enterprise or other customers is insufficient for the existence of a PE.
- Installation PE was not created since the activity was for less than six months.


[3] The India-Portugal DTAA provides a narrow definition of “fees for included services” to cover cases where technical services are made available to the recipient to enable the latter to apply the technology (“the make available condition”)
The Applicant’s presence was only transient; it didn’t satisfy the characteristics of a PE of continuity, regularity and stability [4].

The Tax Authority alleged that the Applicant had a fixed PE in India at the premises of the OCCG, since it had a comprehensive physical presence, through its key personnel on the ground, throughout the period of the Games. Furthermore, the services were highly technical and sophisticated, amounting to FTS under the Indian Tax Laws (ITL), as well as under the DTAA. The Applicant’s income also qualified as royalty for providing use or right to use of certain IP (like specific design, patent, plan, process which is not known to others) to the OCCG. Hence, the entire payment made to the Applicant was taxable in India at the rate of 10% on gross basis.

Aggrieved by the above, the Applicant sought an advance ruling on the issue of taxability of its income from the OCCG, under the DTAA.

AAR’s ruling

Fixed PE

In the scheme of the provisions of the DTAA, it is necessary to first examine the fixed PE before, straightaway, looking at the installation PE. The Applicant had a fixed PE in India, based on the aspects mentioned hereunder:

- The provision of a lockable space for storing its tools and equipment inside the stadium implies that the Applicant had access to and control over this space to the exclusion of other service providers engaged by the OCCG, including the OCCG itself. This space was not merely for storage alone but, looking into the nature of the business, for carrying out the business itself.

- Given the expensive equipment, time lines, precision and the highly technical nature of the work involved, it is inconceivable that the space provided to the Applicant, along with the required security, would not be at the Applicant’s disposal, with the exclusive right to access and control.

- Provision of an empty workspace to the Applicant implies that such workspace was placed at the disposal and under access and control of the Applicant. Also, in the facts, the business had to be carried out on-site. Reliance was placed on Klaus Vogel to hold that it is immaterial that the place of business is located in the business facilities of another enterprise which may be the owner.

- Additional factors of the arrangement, which support that the disposal test was satisfied are:

  - Subcontracting of some activities by the Applicant is indicative of the fact that the Applicant had an address, an office from which it could call for and award subcontracts.

  - Without any premises under its control, hiring and housing key technical and other personnel who would need regular and ongoing instructions during the entire period, was difficult.

  - The Applicant entered into various contracts for the purpose of its business in a contracting state, and was employing technical and other manpower for use at its site. The site was, thus, an extension of the foreign entity on Indian soil, as referred to in the case of Vishakapatnam Port Trust (supra).

- Undertaking comprehensive insurance of its equipment is also indicative of having a fixed place of business, since that is the place where it kept, assembled and created the end products required for rendering the services. No insurance company would insure any equipment, structures etc., against any risk of fire, damage or theft, unless the place was safe and in the exclusive custody and at the disposal of the customer, and in a well-defined address or physical care. Goods are not ordinarily insured when lying at a third person’s premises.

- It was mandatory for the Applicant to acquire all authorizations, permits and licenses. This indicates that the Applicant had a definite place at its disposal, as it could, otherwise, not be made liable for any default in the absence of the same.

- The act of carrying out fabrication, maintenance and repair functions, or even operating the same at the opening and closing ceremonies at/from a premises in someone else’s control and custody, is impossible.

- For a PE to emerge, the fixed place need not be enduring or permanent, in the sense that it should be in its control forever. The context in which a business is undertaken is relevant. Relying on the SC decision in the FOWC case, the duration for which the fixed place was at the disposal of the Applicant was sufficient for the business required. Furthermore, there was a continuous effort by the Applicant till the Games were over. Hence, the permanence test was satisfied.

Royalty

- There exists a vital distinction between a consideration received for assigning the rights for use of the final product, on the one hand and for assigning the rights to use IP i.e., the know-how, technical experience, skill, processes and methodology etc.

- In the present case, there was no right to use any IP which was assigned to the OCCG. Hence, the payment did not amount to royalty.

[4] Reliance was placed on the Andhra Pradesh High Court in the case of CIT v. Vishakapatnam Port Trust (1983) 144 ITR 146
In fact, it is usual to assign exclusive rights to the client to use the equipment and services to keep intact the element of uniqueness and novelty in experiencing the lighting display. But, how this experience was created, remains a trade secret with the creator of the same.

**FTS**

- Services rendered by the Applicant were not standard in nature, since they were one of a kind, customized for use by a particular customer. Provision of the services of lighting, search lights, LED technology, along with technical personnel to operate the same, did not involve mere pressing of a button to receive the services, but the services were complex activities that could not be availed of without the assistance of highly trained technical personnel, as they were not routine and mechanical.
- “Rendering” does not necessarily imply going on forever. If services of highly technical, complex nature are rendered from the very beginning till the entire period of presence in India, it shall be a sufficient test to treat the services as technical services.
- By applying the MFN clause and the narrow definition in the India-Portugal DTAA, the income of the Applicant did not qualify as FTS (or fees for included services), since the services were not made available to the OCCG in a manner that it acquired the know-how or the ability to use it, or that the service rendered enabled or empowered it to carry out the task in future all by itself.

**Comments**

Examination of fixed PE is highly fact centric and often a contentious issue, especially in terms of the subjective test of disposal over the fixed place. In this ruling, the AAR noted that the test of disposal is satisfied at the on-site space provided to the Applicant to store its equipment under a lock, thereby granting exclusive access and control to the Applicant. Similar view had been taken by Indian and foreign Courts[5], where an identified and distinct space was held as meeting the disposal test. In addition, the AAR appears to infer a greater power of disposition by conduct of the Applicant in terms of its comprehensive physical presence in India and entering into contracts to subcontract work, hiring personnel etc. Furthermore, the AAR applied the principles of the SC ruling in the FOWC case for creation of a short duration PE while determining the threshold of presence, having regard to the nature of activity and presence throughout the period of the Games.

While determination of a PE is a factual exercise, this ruling would be relevant for service arrangements which do not last for a significant period of time. MNCs with similar business arrangements may examine the impact of this ruling on their actual arrangements.

A ruling by the AAR is binding only on the applicant and on the Tax Authority, in respect of the transaction for which it is sought. However, it does have persuasive value and the courts in India, the Tax Authority and the Appellate Authorities do recognize the principles and ratio laid down by the AAR while deciding similar cases.

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