ITAT rules no emergence of Permanent Establishment on mere storage of goods

Executive Summary

This alert summarizes the recent ruling of Mumbai Income Tax appellate Tribunal (ITAT) [ITA No. 3254/Mum/06] in case of **Airlines Rotable Limited, UK** on an issue whether storage of goods by the Taxpayer in a warehouse in India belonging to the Indian resident customer – Jet Airways Ltd. (JA),which held the goods as a bailee, for its (JA's) own use, leads to emergence of a Permanent Establishment (PE) under the Double Tax Avoidance Agreement (DTAA) through which the income accrues or arise in India, as is chargeable under the Income Tax Act, 1961 (ITA). The Tax Authority held that the said warehouse was a PE. The Tax Authority, alternatively, contended that, the JA being dependent agent of the Taxpayer, constituted a PE. As the income was earned through PE in India, it was chargeable to tax under the ITA. The ITAT, on the Taxpayer's appeal held that mere storage of goods by the Taxpayer in a warehouse of JA, in itself, did not constitute the warehouse a PE. Also, JA who held the goods as bailee was not a dependent agent of the Taxpayer who could be its PE in India. However, the ITAT remanded the matter to the first appellate authority to examine whether the income is liable to tax in India as fees for technical services (FTS).

Background

In terms of DTAAs business income of a non-resident is not chargeable to tax in India unless it is earned through a PE in India. The scope of the term PE is defined in an inclusive manner in the DTAAs entered into by India with various jurisdictions.

In the instant case, the Taxpayer, a company resident of UK undertook repairs/ restoration of the defective components of the air crafts of the JA, including the facility of providing stand-by replacements. To facilitate the replacements, the Taxpayer maintained the stock of such components with the JA as its bailee. JA was authorized to take delivery of a replacement component until the original component was repaired and restored. The Taxpayer receives the consideration for the above services. The Tax Authority held that the warehouse in India was a PE through which the air craft components were supplied. Alternatively, it was contented that the JA who is a dependent agent of the Taxpayer, constitutes PE. Hence, the Tax Authority held that 10% of the gross amount of charges received by the Taxpayer is an estimated profit attributable to the PE in India and the same is chargeable to tax under the ITA.

The first appellate authority with whom the Taxpayer filed the appeal, upheld the Tax Authority's order. Hence, the matter referred to ITAT.

Taxpayer's contentions

- In the given facts, storage of goods with JA in its warehouse does not lead to emergence of PE in India.
- Without prejudice to the above, quantification of the income by applying rate of profit at 10% of the gross receipts is not justified.

Contentions of the Tax Authority

- The Taxpayer's stocks are permanently kept at fixed place in India and therefore it has a PE in India.
- The delivery by the Taxpayer of the stand-by replacement components and the repaired components of the air crafts amount to the sale of the goods and therefore the warehouse is PE.
- Alternatively, JA through its employees acts as agent of the Taxpayer which relationship causes emergence of dependent agent PE.
- It would be but fair that 10% of the gross receipts is the income of the Taxpayer arising in India from its business operations attributable to the PE.

ITAT ruling

- The Taxpayer did not have any place in India at its disposal such that it could carry out business from that place. It did not have any right to use the warehouse for its own business.
- There is no projection of the Taxpayer's business at the location of the warehouse that can be regarded as its virtual business presence in India so that the place can be regarded as a PE.[1]
- The activity of storage of goods, *per se,* does not constitute the warehouse a PE. It is only when the warehouse is for storage of goods by the outsiders that the PE would be emerge. In the facts of the case the warehouse is not meeting with above test.
- The consideration for the services rendered by the Taxpayer included the consideration for repairing or overhauling the air craft components which activity was entirely performed outside India. Even assuming that there is a PE, the receipts relatable to the said activity could not attributed to the PE and the principle of force of attraction could not be inferred to bring to tax all the profit of the non-resident enterprise, whether or not related to the PE.
- The delivery of goods from the warehouse does not amount to sale. The contract of the Taxpayer with JA does not involve sale of goods in any manner.
- The JA, for the reason that it is permitted in terms of the agreement to use the stand-by replacement components (belonging to the Taxpayer) stored in its own warehouse for its own business, was not a dependent agent of the Taxpayer leading to emergence of dependent PE.
- So far as the consideration relatable to permitting the use of stand-by components are concerned, the location thereof was not a place of carrying on of business.
- In view of the foregoing, there is no emergence of PE to which the profits of the Taxpayer may be attributed to bring the same to tax under the ITA as business profits.

  However this position in law, by itself, does not rule out the taxability of the income as fees for technical services. Since the lower authorities have not examined this aspect of the taxation, the case be remanded back to the Tax Authority[2] to decide from the above limited perspective.

[1] Reference made to Vishakhapatnam Port Trust (144 ITR 146) And Western Union Financial Services Inc. (104 ITD 34)

[2] Commissioner of Income Tax (Appeals)

Our comments

- The emergence of PE is complex subject largely driven by the facts of a particular case. A PE, as held by the apex court (Supra), is a virtual projection of business of the non-resident in India. This ITAT ruling reiterates the accepted canons of taxation of cross border transactions that for emergence of PE, the passive activity such as storage of goods is not sufficient, more so when the place is as such not available to the non-resident for carrying on of the business. Generally DTAA provides that a warehouse, unless it is used for storage of goods for outsiders, does not constitute a PE. Similarly a place hired for mere display of goods also does not constitute a PE. In the instant case, the ITAT rightly observed that the warehouse was not at the disposal of the Taxpayer and storage of the goods, *per se*, does not constitute the warehouse, a PE. The ITAT also rejected the Tax Authority's contention that because JA was authorized to lift the stand-by replacement components under the agreement was a dependent PE, for, it is difficult to suggest that JA, the customer of the Taxpayer, was its dependent agent through whom the business was carried on.
- The ITAT however clearly stated that the income though not taxable as business income accruing or arising in India through a PE, does not mean that it is not liable to tax as fees for technical services, for, the taxation of FTS in India does not require presence of PE. Accordingly the matter has been remanded back to the Tax Authority to examine from the above perspective.
- The readers may like to refer our tax alert of ITAT ruling in the case of Ashapura Minichem Ltd. [International Tax Alert dated 1 June, 2010] where it was held that post the amendment of ITA by the Finance Act of 2010, technical services even when wholly rendered from outside India is liable to tax. Of course, the Taxpayer is entitled to claim that the taxability of the income be governed by the provisions of applicable DTAA when the same is more beneficial to him.

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