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Supreme Court holds that outsourcing services provided by E-Funds Corporation, USA to its Indian affiliate does not constitute Permanent Establishment under the India-USA Tax Treaty

Facts and background of the case

- E-Funds Corporation ("E-Funds US")and E-Funds IT Solution Group Inc. ("E-Funds IT USA") [Jointly referred to as Taxpayers] are companies incorporated under the laws of the USA and are part of group engaged in the business of (i) ATM Management Services, (ii) Electronic Payment Management, (iii) Decision Support and Risk Management and (iv) Global Outsourcing and Professional Services.

- E-Funds International India Private Limited ("E-Funds India") is an Indian company and a step down wholly owned subsidiary of E Funds US. E-funds India was involved purely in back-office/auxiliary services. For provision of aforesaid services, the taxpayers provided access to database stored on servers located outside India to E-Funds India and compensated the Indian company by way of an agreed remuneration on arm's length basis.

- During the course of the assessment proceedings, the assessing officer relying upon the Functions, Assets and Risks analysis ("FAR Analysis") observed that the taxpayers allowed E-Funds India to use its technology and infrastructure for provision of IT enabled services for free. Further, the taxpayers undertook marketing activities for E-Funds India and the latter did not bear any significant risks in respect of the services provided. Accordingly, the assessing officer held that E-Funds India constituted a Permanent Establishment (PE) of the taxpayers in India and a portion of the income earned by the taxpayers was attributable to tax in India in the hands of such PE. The assessing officer had relied upon the Mutual Agreement Procedure (MAP) under the India-US tax treaty invoked by the taxpayers for tax years preceding the years in dispute wherein it was held that the taxpayers had a PE in India.

- The aforesaid view of the assessing officer was upheld by CIT(A) and Tribunal. However, the Tribunal did not agree with the method of attribution adopted by the assessing officer in estimating profits attributable to the PE. The Delhi High Court set aside the order passed by the Tribunal and held that PE of the taxpayers was not

constituted in India. Aggrieved by the order of the Delhi High Court, the Revenue filed an appeal before the Supreme Court.

Ruling of the Supreme Court

Whether fixed place PE of the taxpayers is constituted in India?

- Relying upon its recent decision, in the case of **Formula One World Championship Ltd. vs. CIT,** the Court, observed that in terms of Article 5(1) of the Tax Treaty, a fixed place PE is constituted in India, if such fixed place of business is at the disposal of the foreign enterprise in India; and the business of the foreign enterprise is wholly or partly carried on through such fixed place.

- The apex Court affirmed the findings of the High Court that neither E-Funds US nor E-Funds IT US had any assets or any premises in India at their disposal through which their business was carried on in India. The apex Court affirmed the finding of the High Court that mere existence of subsidiary company does not automatically constitute fixed place PE of the taxpayers in India; the fact that E-Funds India provided various services to taxpayers and was dependent for its earning on the taxpayers or did not bear sufficient risk was irrelevant. MAP agreement wherein, for purpose of settlement, it was agreed that PE of the taxpayers is constituted in India could not be considered as a binding precedent for subsequent years.

- The Court further held that since E-Funds India only rendered support services, which enabled the taxpayers in turn to render services to their clients abroad, such outsourcing of work to India would not give rise to fixed place PE of the taxpayers in India. In coming to the said conclusion, the Court relied on its earlier decision in the case of DIT v. Morgan Stanley & Co. 292 ITR 416, wherein it was held that back office operations by the Indian subsidiary to the parent company to support the main office functions of the parent company does not constitute fixed place PE of the parent company in India.

Whether service PE of the taxpayers is constituted in India?

- The Court observed that in terms of Article 5(2)(l) of the India-US Tax Treaty, service PE is constituted in India if the services are furnished by the US company to its customers in India. In the instant case since none of the customers of the taxpayers were located in India or had received services in India, therefore, service PE of the taxpayers was not constituted.

- It was held that since only auxiliary operations facilitating rendering of services to the taxpayers' customers were

carried out in India, merely because the taxpayers, in order to protect their interest, by ensuring quality and confidentiality, had sent their employees in E-Funds India to provide stewardship services, would not make E-Funds India, PE of the taxpayers in India. The Court followed their earlier decision in the case of DIT v. Morgan Stanley & Co. (supra) for the aforesaid conclusion.

No attribution of profits of the taxpayers to India

- The Court relied upon its earlier decision in the case of DIT vs. Morgan Stanley & Co Inc. (supra) and observed that even if for sake of argument it was held that E-Funds India constituted a PE of the taxpayers in India, since E-Funds India had been remunerated at arm's length price, no further profits could be attributed to tax in India in the hands of such PE.

For any details and clarifications, please feel free to write to:

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