SEMINAL DECISION OF THE DELHI HIGH COURT ON CONSTITUTION OF SERVICE PERMANENT ESTABLISHMENT

The Delhi High Court vide recent judgment in the case of Clifford Chance Pte Ltd[1] ("**taxpayer**") has recorded illuminating findings on the issue of constitution of Service Permanent Establishment ("**PE**"), which will have significant bearing on assessment of tax positions taken by foreign taxpayers.

The taxpayer, a resident of Singapore, was assessed to tax in respect of receipts for legal advisory services rendered to clients in India. While employees of the taxpayer were present in India for a total period of 120 days (including vacation days, business development days and common days) during assessment year ("**AY**") 2020-21, no employee was physically present in India during AY 2021-22 and the services were rendered by taxpayer to Indian clients virtually, i.e., from outside India.

On the question of computation of number of days of stay in India for the purposes of for computing the threshold limit of 90 days in terms of Article 5(6)(a) of the Tax Treaty[2], the High Court held that only the days on which actual services were rendered by the employees of the taxpayer in India were to be included. It was further held that what is relevant is that the employees of the foreign enterprise must be rendering services to third parties while being present in India; mere stay of employees in India without rendering services to third parties would not suffice for constituting Service PE. The High Court, accordingly, held that the Tribunal, relying upon the documents submitted by the taxpayer, viz., attendance records, leave records, time sheets, etc. of the employees visiting India, correctly held that the days on which the employees, though present in India, were on vacation and the days spent on business development were to be excluded. Also, in case of days on which 2 or more employees were present in India, the High Court affirmed the decision of the Tribunal that such days were to be taken into account only once and not on the basis of man days spent.

On the question of constitution of Virtual Service PE of the taxpayer in India for AY 2021-22, the High Court observed that the language of the Tax Treaty must be interpreted strictly. It was

[1] CIT v. Clifford Chance Pte. Ltd. ITA No. 353/2025 and 354/2025
2 India-Singapore DTAA

categorically observed that the words *"within a contracting state"* and *"through its employees or other personnel"* in Article 5(6)(a) of the Tax Treaty contemplates the rendition of services in India through physical presence of employees; thus, the submissions of the Revenue to the effect that physical presence was not mandatory so long as receipts had nexus with India, was squarely rejected.

While appreciating that the concept of Significant Economic Presence ("**SEP**") was introduced by the Finance Act, 2018 in the domestic law, which reflects efforts made by the Legislature to include the virtual economic participation from abroad within the purview of tax in India, the High Court categorically held that in absence of any such change or amendment in the tax treaties, the said concept could not be interpreted/ read into the existing language of the tax treaties. It was, thus, not open to the tax authorities to import the concept of Virtual Service PE from the OECD Interim Report[3] to bring to tax, the profits of the non-resident taxpayer in India from services rendered virtually, *sans* any specific provision in the Tax Treaty to that effect.

VA Comments

It is pertinent to note that this is the first judgment by a High Court clarifying that the number of days for computing threshold limit prescribed in Service PE clause of the tax treaties must be computed with reference to the days on which "services are rendered" in India to another enterprise, thereby, eliminating vacation days and business development days.

By virtue of the present decision, the High Court has also reinforced and reiterated the principle that the language of the tax treaties must be read strictly, and it is not open for the tax authorities to read unilateral amendments in the domestic law into the tax treaties, which are entered into after bilateral negotiation and discussion between two sovereign nations.

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3 OECD interim report (2018)

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