SC Ruling on Taxing Foreign Companies

What is the issue?

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- The Supreme Court has recently ruled that the income of two US companies in India cannot be taxed in India.
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- This has again raised the demand for clarity on identifying and defining the nature of Permanent Establishments (PE).
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What is a Permanent Establishment?

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- A PE is a fixed place of business, wholly or partly carried out by a foreign enterprise operating in India.
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- It could be a branch office, a place of management, a factory, a warehouse, a workshop etc.
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- The complexity is that the definition of PE differs in each tax treaty and the identification of PE itself is a controversial area.
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- The concept of PE determines the taxability of a foreign company in India.
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- Usually, foreign companies get tax concession under Double Taxation Avoidance Treaties, and they pay taxes in their home countries.
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- But if they have PEs in India, they should pay taxes for the income they have created in India i.e. profits that are attributable to the PE.
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What is the recent case?

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- The case relates to two US-based companies, e-Fund Corporation (e-Fund Corp) and e-Fund IT Solutions Group Inc (e-Fund Inc).
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- These companies have paid taxes on their global income in the US.
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- e-Fund Corp is a holding company with almost a 100% stake in IDLX Corporation, another company based in the US.
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- IDLX Holding BV holds a 100% stake in e-Funds International India Private Ltd.
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- IDLX International BV is also a holding company having almost a 100% stake in e-Fund Inc.
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- The revenue department has held that the income of e-Fund Corp and e-Fund Inc was attributable to India as the two assesses had a PE in India.
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- This means that their income should be taxed in India, irrespective of whether they had paid taxes in the US.
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- The Income Tax Appellate Tribunal (ITAT), Delhi, had upheld the position of the revenue department.
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- But, the Delhi High Court had rejected both the revenue department's plea and the ITAT order.
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What is the judgement?

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- The Supreme Court has held that no part of the main business and revenue-earning activity was carried on through a fixed business place in India.
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- The Indian company only rendered support services, which enabled the assesses, in turn, to offer services to their clients abroad.
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- Thus the outsourcing of work to India by MNCs in itself would not give rise to a fixed place permanent establishment (PE).
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- The High Court had also earlier said that a holding company or a subsidiary company by itself cannot constitute a PE.

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- Consequently, the global income of these MNCs attributable to this back-office work cannot be taxed in India.
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- The judgment will perceivably have repercussions for taxing outsourcing businesses as well as subsidiaries of MNCs.
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Source: Business Standard

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