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EY Tax Alert

Delhi Tribunal holds offshore services provided by the German entity are connected to its Indian PE, but exempt from tax in terms of Protocol to India-Germany tax treaty

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Executive summary

This Tax Alert summarizes a recent Delhi Tribunal (Tribunal) decision in case of Fraport A.G. Frankfurt Airport Services Worldwide[1] (Taxpayer) wherein the issue arose on the taxability of income earned by the Taxpayer in relation to services provided by it from Germany, under the India-Germany Direct Taxation Avoidance Agreement (tax treaty). In the facts of the case, the Taxpayer, a German corporate entity, was engaged in providing airport management and operation services to its customers in India, for which it had set-up a project office in India which constituted a permanent establishment (PE) of the Taxpayer. In this respect, certain consultancy services were provided directly by the Taxpayer from Germany (offshore services) which were inextricably connected to the overall services of management of the airport for Indian customers. Indian tax authority considered the income from offshore services as Fees for Technical Services (FTS), which is not effectively connected to Indian PE. Such offshore income was thus held taxable as FTS in India under the tax treaty as well as Indian tax laws (ITL).

On appeal, accepting the claim of the Taxpayer, the Tribunal held that even though offshore services may be technical in nature so as to trigger taxation as FTS, such FTS is effectively connected to the PE due to its integral nature wherein the offshore services cannot be rendered without the involvement of the PE. Accordingly, such services are to be taxed under the provisions of the tax treaty as business income and not under a special article of FTS. Further, in terms of Paragraph 1(b) of the Protocol[2], income derived from planning, project, construction or research activities and income from technical services exercised in Germany needs to be excluded from being attributed to PE in India. Such services, hence, are neither chargeable as FTS nor as business income, thus rendering them tax free. Consequently, the Tribunal remanded the matter back to the tax authority to examine the nature of services and whether it falls under the scope of the Protocol.

[1] [TS-185-ITAT-2023(DEL)]; Judgement dated 3 April 2023
ITA No.3257/Del/2014 (AY 2007-08), ITA No.3869/Del/2015 (AY 2008-09), ITA No.3870/Del/2015 (AY 2009-10), ITA No.3871/Del/2015 (AY 2010-11), ITA No.1115/Del/2016 (AY 2011-12), ITA No.287/Del/2017 (AY 2012-13)
[2] Protocol amending the Agreement between the Government of the Federal Republic of Germany and the Government of India for the Avoidance of Double Taxation of Income

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Background

- FTS under the ITL as well as tax treaty is defined to mean consideration for rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel).
- Article 12 of the tax treaty provides for taxation of FTS at the rate of 10%. However, Para 5 of Article 12 of the India-Germany tax treaty provides carve out from applicability of FTS Article in case where the income arising in India is 'effectively connected' with a PE in India in which case, such FTS will be dealt with as per Article 7.
- Article 7 of India-Germany tax treaty provides that business profits earned by a German-resident are only taxable in India if such business profits are attributable to a PE in India.
- Significantly, Para 1(b) of the Protocol provides that income derived by a German resident from planning, project, construction or research activities as well as income from technical services exercised in Germany in connection with a PE situated in India, shall not be attributed to that PE.

Facts

- The Taxpayer, a German resident corporate entity, is a global airport operator offering comprehensive airport management services. In the tax year under consideration, it earned various types of income under an Airport Operator Agreement with Delhi International Airport Ltd. (DIAL) whereby it was contracted to provide host of airport management services (involving general, manger and consultancy services).
- For this purpose, the Taxpayer had also set up a project office in India. The project office is regarded as PE of the Taxpayer in India and such fact was undisputed.
- Certain services were provided by the Taxpayer directly from Germany viz. providing (a) consultancy services to DIAL (referred to as 'offshore services') and Indian PE, (b) internal services like HR, payroll, legal, administrative services. The income earned in lieu of the offshore services was not offered to tax in India by the Taxpayer by relying on the Para 1(b) of the Protocol[3].
- Such claim of non-taxability was, however, not accepted by the tax authority who sought to bring the consideration for the offshore services to tax as FTS under Article 12 of the tax treaty and the issue was appealed before the Tribunal.

Taxpayer's contention

Before the Tribunal, the Taxpayer resisted taxation as FTS based on the following:

- Offshore services are attributable to the PE and exempt from tax by virtue of the Protocol.
- The PE was dependent on the German Head Office (HO) regarding planning, information, data-base and know-how. Further, in relation to the PE, the HO has also undertaken all human resource activities including payroll, invoicing, legal and administration etc.
- Accordingly, the activity of airport management services to DIAL is a single integrated activity and the services cannot be exclusively rendered by the HO or PE in the absence of the other as both are supporting and dependent on each other due to which it cannot be bifurcated between HO and PE. The work has been done by HO through active participation of the PE. The dominant services of airport management are rendered through the PE.

Tribunal's ruling

- Tribunal agreed with the Taxpayer that though some of the offshore services rendered can be covered in the category of 'managerial or technical or consultancy services', thus falling within the definition of FTS under Article 12 of tax treaty, income from services effectively connected with PE is expressly excluded from taxation as FTS and is taxable as business profits under Article 7 of the tax treaty.
- In this respect, the Tribunal noted that income from offshore services would ordinarily be attributable to Indian PE. Such services are rendered by the Taxpayer in connection with operation of airport and cannot be rendered from the HO [viz. the Taxpayer] without active involvement of the PE in India.
- Further as per Paragraph 1(b) of the Protocol to the tax treaty, income from planning, project, construction or research activities and technical services exercised in Germany even if in

[3] In this regard, Para 1(b) of the Protocol states as follows:

"Income derived by a resident of a Contracting State (Germany) from planning, project, construction or research activities as well as income from technical services exercised in that State (Germany) in connection with a permanent establishment situated in the other Contracting State (India), shall not be attributed to that permanent establishment"

connection with PE situated in India, cannot be attributed to PE. Such income will not be taxable in India.

- Accordingly, in the present case, the Tribunal held that even where the income earned from the offshore services is rendered through the Indian PE, due to the Protocol, services in the nature of planning, project, construction or research activities and technical services cannot be attributed to the Indian PE for the purpose of taxability.

- Tribunal thus directed the Tax Authority to examine the nature of offshore services and applicability of Paragraph 1(b) of the Protocol and exclude income in the nature of planning, project, construction or research activities and technical services covered by the Protocol from being taxed in India.

Comments

In the present ruling, the Tribunal, having noted the facts and the contentions of the Taxpayer, reached its conclusion that the offshore services were effectively connected to the PE by noting that the offshore services could not be rendered without "active involvement" of the PE. The Tribunal, thereafter, invoked the Protocol to exempt from tax in India the income from such services of such a nature as covered by the Protocol and rendered from Germany. Accordingly, the instant case may benefit taxpayers with similar facts who are in the course of litigation to suggest non-taxability of offshore services of the specified nature under the Protocol.

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