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Analysis of Dependent Agent Permanent Establishment (DAPE) and Recent Judicial Trends

Case Law | Court: HIGH COURT OF DELHI | Case No.: W.P.(C) 12847/2024 and CM APPL. 53630/2024 | Date: 17.02.2025

Introduction

The concept of Dependent Agent Permanent Establishment (DAPE) is crucial in international taxation, particularly under Article 5(5) of the UN Model Tax Convention. The determination of whether a foreign enterprise has a PE in a source country due to a dependent agent is based on various factual considerations, including authority to conclude contracts and habitual exercise of such authority. This analysis examines these principles in light of the recent Delhi High Court ruling in the case of *SFDC Ireland Limited v. Commissioner of Income Tax** and its implications on withholding tax and agency PE.

*W.P.(C) 12847/2024 and CM APPL. 53630/2024

KEY INSIGHTS

- DAPE happens when an agent regularly makes deals for a foreign company.
- The agent must be dependent on the foreign company.
- If DAPE exists, the foreign company may have to pay tax in that country.
- Indian tax law includes DAPE under the "business connection" rule.

KEY INSIGHTS

- The OECD sets global tax rules for DAPE.
- New tax laws are making DAPE rules stricter to stop tax avoidance.
- DAPE is different from a regular office or branch – it depends on the agent's role.
- Agents like sales representatives and distributors can create DAPE.
- Selling warranties, insurance, or services through agents may lead to DAPE.
- Indian courts say that just facilitating a deal does not always mean DAPE.
- A recent Indian case ruled that if contracts are made directly with customers, no DAPE exists.
- Some countries consider companies DAPE even if they only help in contract-making.
- If the agent is independent, payments to the foreign company may not be taxed.

Key Considerations under Article 5(5)

1. Definition of a Dependent Agent PE
Article 5(5) states that an enterprise is deemed to have a PE in the source country if a person acting on its behalf:

- Has and habitually exercises authority to conclude contracts in the name of the enterprise.
- Habitually maintains a stock of goods for regular delivery on behalf of the enterprise.
- Habitually secures orders for the enterprise.

The ruling in *SFDC Ireland Limited* emphasized that mere dependency of an agent is insufficient; rather, specific conditions under Article 5(5)(a) and (b) must be met for an Agency PE to be established.

2. Substance Over Form Approach
A fundamental principle in determining a DAPE is looking beyond contractual nomenclature and evaluating the substance of the relationship. In cases where an agent signs contracts only after obtaining approval or acts within pre-defined limits, they may not qualify as having authority to conclude contracts.

For instance, in *GE Energy Parts Inc.,* the Delhi Tribunal held that an Indian entity constituted a DAPE because expatriates deputed to India had the authority to conclude contracts. However, in *eBay International AG,* the Mumbai Tribunal found that Indian group entities of eBay were dependent agents but did not satisfy the conditions under Article 5(5), thus failing the PE test.

Analysis of SFDC Ireland Limited Case

The Delhi High Court's judgment in *SFDC Ireland Limited* addressed the issue of whether SFDC India constituted a DAPE for its Irish parent company. The key considerations were:

1.Reseller Agreement and Principal-to-Principal Relationship:

- The agreement between SFDC Ireland and SFDC India characterized the Indian entity as a non-exclusive reseller operating on a principal-to-principal basis.

- SFDC India did not have authority to conclude contracts on behalf of SFDC Ireland; rather, it procured products for resale

2. Taxability and Withholding Tax Implications:

- The court reaffirmed that business income under Article 7 of the India-Ireland DTAA is taxable only if there is a PE.
- Since SFDC India was not authorized to bind SFDC Ireland to contracts, the court rejected the Revenue's contention of DAPE.
- It directed the Assessing Officer (AO) to issue a Nil withholding tax certificate, emphasizing that a mere business relationship does not establish PE.

3. Distinction from Cases Where DAPE Was Found:

- Unlike *GE Energy Parts Inc.*, where expatriates had direct involvement in contract negotiations, SFDC India's role was restricted to reselling and providing local support.
- The court also negated the argument that involvement in price determination created dependency, ruling that pricing discussions do not establish PE unless accompanied by contractual authority.

Implications of Section 197 of Income Tax Act,1961 and Rule 28AA of the Income Tax Rules, 1962

The Delhi High Court judgment also touched upon the provisions of Section 197 and Rule 28AA of the Income Tax Rules, 1962, which govern the issuance of lower or Nil withholding tax certificates. Section 197 empowers the Assessing Officer (AO) to issue such certificates if satisfied that the total income of the recipient justifies it. Rule 28AA lays down the methodology for determining the tax liability, considering factors such as the assessed or estimated income of previous years and existing tax liabilities.

In *SFDC Ireland Limited*, the AO had initially rejected the Nil withholding tax certificate, arguing that SFDC India's role indicated a possible DAPE. However, the court ruled that the AO had not provided any prima facie evidence supporting a DAPE finding and directed the issuance of a Nil withholding certificate. The judgment reinforced that withholding tax obligations arise only if receipts are chargeable to tax under the Act, thereby requiring a thorough examination under Rule 28AA.

Conclusion and Implications

The ruling in *SFDC Ireland Limited* reinforces that:

- A reseller relationship, even with pricing coordination, does not automatically create a DAPE.
- The presence of a dependent agent must be substantiated by material evidence of contract conclusion authority.

KEY INSIGHTS

- International tax rules (MLI) are making it harder to avoid DAPE taxes.
- Only the profit made from the agent's work is taxed under DAPE.
- Companies try to ensure their agents don't directly make deals to avoid DAPE.
- Proper contracts and clear roles help avoid DAPE issues.
- More countries are changing tax rules to cover digital businesses under DAPE.
- Regular tax reviews help companies avoid unexpected DAPE tax problems.
- If an agent only helps in negotiations but doesn't finalize deals, DAPE may not apply.
- A subsidiary company can be considered a DAPE if it regularly acts on behalf of the parent company.
- Even if a contract is formally signed abroad, it can still be considered DAPE if the agent plays a key role.

KEY INSIGHTS

- Many tax treaties include DAPE rules to prevent tax evasion.
- Some businesses restructure their operations to avoid creating DAPE.
- If an agent works exclusively for one foreign company, DAPE risk is higher.
- Even part-time agents can create DAPE if they meet the necessary conditions.
- DAPE rules apply to both service-based and product-based businesses.
- Tax authorities closely examine company-agent relationships to detect DAPE cases.
- Companies must be careful while drafting contracts to avoid unintentional DAPE risks.

- Tax authorities must adopt a holistic approach, considering previous rulings and transactional substance.

This judgment provides valuable guidance for multinational enterprises operating in India through distributors and resellers, underscoring the importance of contractual clarity and adherence to international tax principles.

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