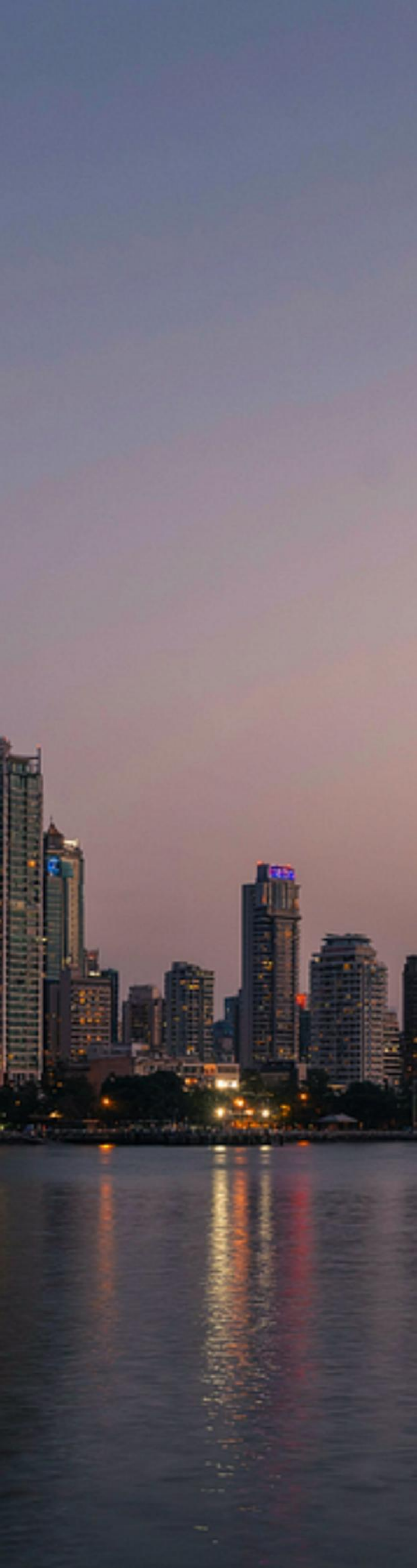

MAKHIJANI GERA & ASSOCIATES LLP

Dependent Agent PE Exposure in India

A Permanent Establishment Risk Exposure on appointing Indian entity/ agent for marketing and sales in India

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Indian Sales Subsidiaries · Liaison Offices · Third-Party Distributors

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Background

A foreign manufacturer or technology enterprise operating outside India frequently relies on an in-country presence to access the Indian market — whether through a dedicated marketing and sales support subsidiary or Liaision Office, an exclusive or near-exclusive distributor, or a freelance sales representative. While these arrangements are commercially essential, they carry a tax risk that is often underestimated: the Indian entity or agent activities may, in certain circumstances, constitute a Dependent Agent Permanent Establishment (DAPE) of the foreign enterprise under Indian tax law read with applicable tax treaty.

In this paper, we have provided an overview of the tax risk / issue relevant for foreign enterprises that manufacture or develop products outside India and sell to Indian customers through one of the following in-country arrangements —

Marketing & Sales Support Subsidiary

Indian wholly-owned or majority-owned subsidiary providing marketing, business development, customer liaison, and/ or after-sales support.

Exclusive or Near-Exclusive Distributor / Agent

Third-party Indian entity acting as distributor or agent, substantially or exclusively for the foreign enterprise.

Freelance Sales Representative

Individual or small firm engaged to identify customers, facilitate introductions, and support contract discussions.

What This Paper Covers

- The legal framework for Dependent Agent PE under Indian tax treaties
- The dependency test — independent vs. dependent agent
- The three statutory PE triggers and how they apply in practice
- The impact of BEPS Action 7 and the Multilateral Instrument (MLI)
- Key Indian judicial precedents and their practical implications
- Overview of permitted and prohibited activities
- Documentation and governance requirements to build a defensible position

What is Dependent Agent PE

Under international tax law, a Permanent Establishment (PE) is the threshold concept that determines whether a foreign enterprise's profits are taxable in a source country. Traditionally, PE required a fixed place of business — an office, factory, or branch. Tax treaties also recognise a second, equally powerful route: the Dependent Agent PE (DAPE). A DAPE arises not from physical presence but from the activities of a person — individual, company, or entity — acting in the source country on behalf of the foreign enterprise in a manner that effectively substitutes for a physical presence.

> "An enterprise shall be deemed to have a PE in a Contracting State if a person — other than an agent of an independent status — is acting in that State on behalf of the enterprise and has, and habitually exercises, an authority to conclude contracts in the name of the enterprise."
>
> — ***Article 5(5), OECD Model Tax Convention***

Important Terms :

1. **A Person Acting in India** — The agent need not be an individual; it can be a company, subsidiary, or any entity operating in India and carrying out activities connected to the foreign enterprise's business.

2. **Not an Independent Agent** — Genuine independent agents — brokers, general commission agents serving multiple principals — fall outside DAPE.

3. **Authority to Conclude Contracts** — The agent must habitually exercise authority to bind the foreign enterprise.

4. **Habitual Exercise** — A single or isolated act does not create DAPE. The authority must be exercised repeatedly and as a matter of course; frequency and pattern of conduct are the operative evidentiary standard.

Under India's OECD reservation, merely participating in negotiating essential elements (price, quantity, delivery terms) may suffice to create a DAPE — formal signing authority is not required.

The Dependency Test

The first question in any DAPE analysis is whether the Indian entity is independent of the foreign enterprise. An entity that acts independently — in the ordinary course of its own business, serving multiple clients, and bearing its own commercial risk — should not create a DAPE

What Independence Means

Independence has two dimensions.

a) **Legal independence** means the entity has its own management, makes its own decisions, and is not subject to detailed instructions or approval requirements from the foreign enterprise.

b) **Economic independence** means the entity has a business of its own — it is not financially reliant on a single foreign enterprise and bears real commercial risk.

Factors That Point Towards Independence

- The entity is a separate legal entity with its own management and employees, free to make day-to-day decisions without requiring the foreign enterprise's approval
- It serves multiple clients and is not financially dependent on the foreign enterprise for the majority of its income
- It is compensated at arm's length — on a cost-plus or fixed-fee basis — and does not share in the foreign enterprise's sales revenue or profits
- It bears its own business risks and is not indemnified or guaranteed by the foreign enterprise

Factors That Point Towards Dependence

- The entity is a wholly-owned or majority-owned subsidiary subject to instructions from the parent on pricing, hiring, and key commercial decisions
- Substantially all of its activities are performed for the foreign enterprise, with no meaningful independent business of its own
- It is compensated on a commission or revenue-share basis tied to the foreign enterprise's sales performance
- The foreign enterprise exercises approval rights over its day-to-day operations or customer-facing conduct

> Once it is concluded that agent is dependent, DAPE is triggered if such agent
> 1. Has authority to conclude contract on behalf of foreign enterprise
> 2. Habitual secured order for/ on behalf of foreign enterprise
> 3. Maintain stock from which it delivers to customers on behalf of foreign enterprise

Authority to Conclude Contracts, meaning

This is the most commonly disputed DAPE trigger in India. The question is whether the Indian entity has — authority to conclude contracts in the name of the foreign enterprise.

What This Means in Practice

As per Indian courts and rulings, even negotiating key elements of a contract — price, quantity, delivery terms, etc. — without formal signing authority, may also be seen as having authority to conclude contracts.

When the Trigger Does Not Apply

If the foreign enterprise reviews and approves every transaction on its own terms — and the Indian entity has no authority to agree to anything without that approval — the trigger is generally not met. The Indian entity's role must be limited to passing information and facilitating communication, not agreeing discussing/ commercial terms.

> The key evidence in any dispute will be emails, meeting notes, and call records showing who actually decided the commercial terms. If you are unable to show the Indian entity is negotiating price or scope — and foreign entity had been actively involved - that creates risk.

Habitually Securing Orders, meaning

This trigger applies where the Indian entity regularly secures orders in India wholly or almost wholly for the foreign enterprise. It is most relevant where the Indian entity effectively functions as a sales office — finding customers and channelling orders to the foreign enterprise on a routine basis.

The Important Conditions/ Guidance under India-USA Tax Treaty

1. The agent regularly accepts orders in India on behalf of the foreign enterprise — not just one-off.
2. Substantially all of the agent's sales activity in India is for the foreign enterprise, with no meaningful independent business.
3. The agent indicates buyers that its acceptance of an order is the foreign enterprise's agreement — **implying** authority to bind.
4. The foreign enterprise's own conduct gives buyers reasonable grounds to believe the agent can commit it.

> The Indian entity must be able to substantiate that —it can not accept or confirm an order on the foreign enterprise's behalf. All proposals and quotations should be drafted carefully and communicated in a proper channel.

Maintenance of Stock, meaning

This get triggered where the Indian entity maintains a stock of goods in India from which it regularly delivers goods on behalf of the foreign enterprise. This is highly relevant where Indian entity holds consignment stock, operates a warehouse, or functions as a distribution hub for the foreign enterprise's products.

What the Trigger Requires

Two elements must be present. First, the Indian entity must maintain a stock of goods — meaning it physically holds inventory in India that belongs to or is held on behalf of the foreign enterprise. Second, it must regularly deliver those goods to customers on the foreign enterprise's behalf. Both elements must be satisfied; holding stock without making deliveries, or making deliveries without holding stock, is insufficient on its own.

When This Trigger Is Not Engaged

In a standard offshore supply arrangement — where the foreign enterprise contracts directly with the Indian customer, goods are manufactured and shipped from outside India, and the Indian entity has no role in warehousing or delivery — this trigger is simply not engaged. The Indian entity may provide after-sales support, warranty services, or spare parts under a separate principal-to-principal arrangement without triggering this condition, provided it does so in its own name and for its own account.

When Risk Arises

The trigger becomes relevant where the commercial arrangement evolves — for example, where the Indian entity begins holding demonstration units, spare parts inventory, or buffer stock that is effectively owned by or held for the foreign enterprise. Even informal arrangements — such as the foreign enterprise pre-positioning goods at the Indian entity's premises for faster delivery to customers — can engage this trigger if the Indian entity is making deliveries on the foreign enterprise's behalf.

> The risk is primarily a structural one: businesses should ensure that any spare parts, demonstration equipment, or inventory held by the Indian entity is clearly held in the Indian entity's own name, for its own account, and not as agent or custodian for the foreign enterprise.

BEPS Action 7

BEPS Action 7, adopted by the OECD in 2015, significantly expanded the scope of Dependent Agent PE. India has incorporated these changes through the Multilateral Instrument (MLI), which modifies India's tax treaties with countries that have also signed and ratified the MLI. It is relevant to note that these changes apply only where the relevant treaty has been updated — they do not automatically override treaties that remain unmodified.

What Changed

- **Expanded 'conclude contracts' test:** An agent now creates DAPE if it habitually plays the principal role leading to contract conclusion — even without formally signing or concluding the contract. The foreign enterprise's routine acceptance of those contracts without material change is sufficient.
- **Narrowed independence exception:** The independent agent exception no longer applies where the agent acts exclusively or almost exclusively for enterprises that are closely related to it — such as a parent company. A subsidiary acting solely for its parent cannot claim to be an independent agent under MLI-modified treaties.
- **Closely related enterprise:** An entity is closely related to the foreign enterprise if one controls the other, or both are under common control. This captures most subsidiary relationships.

⚠ **Indian Courts on 'Authority to Conclude':** Even before BEPS, Indian courts have consistently interpreted the 'authority to conclude contracts' trigger narrowly. Merely participating in the contract discussion and negotiation are at times have been held to create a DAPE in India

Decisions Favouring No DAPE

B4U International Holdings Ltd. (137 ITD 346, Mumbai ITAT)

The Indian agent worked from a fixed rate card and had no authority to offer different terms without the foreign enterprise's approval. The foreign enterprise could reject any contract at any time. The tribunal found no DAPE — the agent simply had no independent authority to conclude anything.

Daimler Chrysler AG (39 SOT 418, Mumbai ITAT)

The Indian subsidiary's only role was to pass messages between the parent company and Indian customers. All prices and terms were set by the parent. The tribunal found no DAPE — relaying information is not the same as concluding contracts.

TVM Ltd. v CIT (102 Taxman 578, AAR)

The Authority for Advance Rulings held that an agent can only create a PE if it can act freely and without control from the foreign enterprise. Where the foreign enterprise controls what the agent does, the agent cannot be said to have authority to conclude contracts.

These decisions share a common thread: the foreign enterprise retained real control over all commercial decisions, and the Indian entity's role was genuinely limited. That combination — properly documented — remains the strongest defence against a DAPE allegation.

Decisions finding DAPE

Daikin Industries Ltd. v. ACIT (171 ITD 301, Delhi ITAT, 2018)

Daikin, a Japanese manufacturer of air-conditioning equipment, sold goods directly to Indian customers while its wholly-owned Indian subsidiary provided marketing support under a commission agreement. The agreement stated that all customer identification, negotiation, and pricing were done exclusively by Daikin from Japan. The tribunal rejected this characterisation. No email evidence showed the Japanese entity was involved at every stage The tribunal held that it was inconceivable for a foreign enterprise to make large-scale direct sales in India without active local involvement, and found the subsidiary to be a DAPE. It also held that the transfer pricing study was inadequate as it did not capture the full range of functions performed by the Indian entity. Key takeaway: what the agreement says and what actually happens can be two very different things. Email records are critical; actual conduct relevant.

GE Energy Parts Inc. & Others v. CIT (Delhi High Court, 2018 — [2019] 101 taxmann.com 142)

The Delhi High Court upheld both fixed-place PE and Dependent Agent PE for 24 GE group entities. Expatriate employees seconded to India worked from a liaison office in New Delhi — with dedicated rooms, secretarial support, and equipment — and participated in negotiating contracts including pricing, warranty, and delivery terms. The court held that the liaison office was at the disposal of the overseas entities and that the Indian entity had authority to conclude contracts on their behalf. Key takeaway: a liaison office whose employees participate in commercial negotiations — not merely auxiliary activities — will constitute both a fixed-place PE and a DAPE.

Rolls Royce Singapore (P.) Ltd. v. Asstt. DIT [2011] 13 taxmann.com 81 (Delhi)

UK parent used an Indian agent for marketing and sales support.. The court observed that an agent working almost exclusively for one principal with non-arm's length remuneration - this indicates economic dependence, creating an Agency PE. Additional profits can be attributed if ALP remuneration doesn't cover all functions.

> India has formally stated that mere participation in negotiations — not just formal signing authority — can be sufficient to establish authority to conclude contracts. This position is routinely relied upon by the Income Tax Department in assessments. Key takeaway: involvement in negotiating price, scope, or commercial terms creates exposure even where the Indian entity does not sign contracts.

Overall Judicial Trend

Courts have generally check for independent authority to conclude contracts before concluding a DAPE — and have rejected PE claims where the foreign enterprise demonstrably retained control over all material commercial decisions. However, the evidentiary burden on the taxpayer is high, and tax authorities have become increasingly sophisticated in examining the substance of the Indian entity's role rather than its contractual label.

What Courts Look For

- What the Indian entity actually does in practice — not what the agreement says it does
- Whether the foreign enterprise's approval of contracts is substantive
- The degree of economic dependence of the Indian entity on the foreign enterprise
- Whether dedicated staff, office space, or resources are effectively at the disposal
- The Indian entity's outward representations to customers — particularly whether it implies authority to bind the foreign enterprise

Where the Risk Is Highest

- Liaison offices whose employees participate in commercial negotiations, pricing discussions, or contract terms — GE is the clearest warning
- Indian subsidiaries that are wholly economically dependent on the foreign enterprise with no independent business;
- Indian subsidiaries engaging in discussion of contract terms
- Arrangements where the foreign enterprise's approval process is not documented or appears automatic
- Situations where the Indian entity's staff use the foreign enterprise's branding, email domains, or visiting cards

The Documentation Gap

In many decided cases, the outcome has turned not on the structure itself but on what could be proved. Businesses with well-documented approval trails, clear functional profiles, and contemporaneous records of the foreign enterprise's decision-making have fared significantly better than those relying on contractual characterisation alone. The gap between a defensible position and a PE finding is often a documentation gap.

What Should the Company Do?

Managing DAPE risk requires attention to how the Indian entity operates in practice, how interactions with customers are conducted, and how the foreign enterprise's decision-making is documented. Important aspect to consider :

1. Before reviewing any treaty or agreement, document who finds the customer, who attends meetings, who discusses price, who sends the quotation, and who gives final approval.

2. Review all customer-facing communications such as emails, proposals, and meeting notes involving the Indian entity's staff.

3. Ensure the foreign enterprise's approval is substantive. The approval should be documented and should reflect that the foreign enterprise considered and accepted the specific terms.

4. Train the Indian entity's staff: the people who attend customer meetings and send emails are aware of the concept of DAPE risk.

6. Align the transfer pricing analysis with the PE position: if the Indian entity is characterised as a limited-function marketing support entity for transfer pricing purposes, its actual functions must match that characterisation. Inconsistency between the TP study and the entity's real activities is a significant red flag, as the Daikin case demonstrated.

7. An entity that started as a genuine marketing support function can gradually take on more commercial responsibility without anyone noticing. An annual review of the Indian entity's actual activities against the agreed functional profile is essential.

> Business should be able to demonstrate — with clear evidences and activities — that the foreign enterprise retained real control over all material commercial decisions.

Contact Us

For any queries, please feel free to reach out

Makhijani Gera & Associates LLP

Info@mgallp.in

MGALLP.IN

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