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Delhi High Court upholds non-taxability of fees paid to international law firm, overrules Virtual PE theory

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In the case of *CIT v Clifford Chance Pte Ltd*, *ITA 353-354/2025*, a Division Bench of the High Court of Delhi (High Court) delivered a significant ruling rejecting the theory of virtual presence and held that fees received from India clients by an international law firm is not taxable in India.

The High Court noted that Taxpayer's physical presence in India for rendering services to clients did not exceed the 90-day threshold (as required by Article 5(6) of the India-Singapore Tax Treaty) and hence, it did not create a permanent establishment (PE) in India.

Background

- The Taxpayer is an international law firm which earned income from rendering legal services to clients in India.

- As a Singapore tax resident, the Taxpayer opted to be governed by the provisions of double taxation avoidance agreement between India and Singapore (India-Singapore Tax Treaty). As per Article 5(6)(a) of the India-Singapore Tax Treaty, a Singapore resident is established to have a PE in India (and hence, liable to tax in India), if it renders services in India through its employees or other personnel for a period aggregating to more than 90 days within any fiscal year (Service PE).

- For the financial year FY 2019-20, the employees of Taxpayer were present in India for an aggregate of 120 days. However, this stay comprised of (a) 36 vacation days (b) 35 days when the employees were involved in business development activities and (c) 5 common days spent by more than one employee and hence, effectively, the employees rendered services in India for 44 days. For FY 2020-21, the Taxpayer did not render any services in India. Accordingly, the Taxpayer had claimed the income earned from India clients as not taxable in India.

Tax Authority's objections

The tax officer disagreed with the position of the Taxpayer and held that Taxpayer created a Service PE in India. Key arguments by the tax authority are as set out below:

- For the FY 2019-20, the employees rendered services in India for more than 90 days. The taxpayer did not furnish adequate documentary evidence to substantiate that such employees in India were on vacation or leave for 36 days.

- Referring to the decision of the Supreme Court of India in Hyatt *International Southwest Asia Ltd* v *ADIT*, 2025 INSC 891, it was alleged that the intermittent days of leave cannot be excluded as the Taxpayer has been continuously rendering services in India since FY 2016-17.

- The Service PE provisions under Article 5(6) of the India-Singapore Tax Treaty do not require physical presence in India. The 90-day threshold is to be tested from the perspective of continuance of services and not physical presence in India. In this case, the Taxpayer continued rendering services including from outside India beyond the 90-day threshold and hence, created a virtual Service PE in India for both FYs under consideration.

- Reliance was placed on the Interim Report issued by Organisation for Economic Co-operation and Development (OECD), 2018, the Madras High Court ruling in *Verizon Communications Singapore Pte Ltd* [2014] 361 ITR 575(Madras) and the ruling of the Income Tax Appellate Tribunal, Bangalore in *ABB FZ-LLC v DCIT*, (2017) 166 ITD 329 (Bang), to claim that the rapid digitalisation does not require physical presence in India and the hence, the services provided virtually can also create a Service PE in India.

The aforesaid position was affirmed by the Dispute Resolution Panel but subsequently overturned and ruled in favour of the Taxpayer by the Income Tax Appellate Tribunal, Delhi. Aggrieved, the tax department filed an appeal before the High Court of Delhi.

High Court Ruling

The High Court concurred with the decision of the Delhi Tribunal and dismissed the appeal of the tax department. Key findings and observations of the High Court are as set out below:

- The High Court noted that the Taxpayer had furnished time-stamp sheets of the employees as well as leave records from its internal system along with a declaration that employees did not perform any project related activity while on vacation. Therefore, the vacation days are to be excluded while computing the 90-day threshold.

- Further, the High Court agreed with the Tribunal's finding that the days on which employees carried out business development activities and the common days spent by more than one employee are to be excluded in the computation of 90-day threshold.

- The High Court acknowledged the concern around ability to render the services virtually and the diminishing requirement to have physical presence. However, the High Court categorically noted that taxability needs to be determined in accordance with the applicable tax provisions.

- The High Court observed that the tax treaties are carefully drafted and negotiated between countries and therefore must be interpreted strictly. The Court cannot artificially read in a concept which is absent under the tax treaty. Article 5(6) of the India-Singapore Tax Treaty necessarily requires physical performance of services in India and does not extend to services rendered virtually from outside India. Accordingly, the tax officer's claim of Taxpayer having created a virtual Service PE was rejected.

- On the reference made by the tax officer to OECD's Interim Report, the High Court noted that in the absence of any legislative changes to the tax treaties, the Service PE provision cannot be interpreted differently. Similarly, the High Court distinguished the rulings relied upon by the tax officer.

Comments

The High Court applied well-settled principle of literal interpretation of a statute (where the provision is unambiguous) to interpret the India-Singapore Tax Treaty. The Court unequivocally clarified that the global discussions around expanding the scope of PE to include services rendered virtually has no impact unless there is an express legislation to this effect. Offering a balanced view, the High Court appreciated the reality of businesses operating virtually but held that taxability is to be assessed in accordance with the applicable provisions of the tax laws and tax treaties.

This ruling also emphasises on the significance of maintaining a robust record of employees visiting India including the number of days of their stay in India, purpose of visit, nature of activities undertaken and leave or vacation days, to assist with the determination of PE in India.

- *Rahul Jain (Partner) and Jinisha Jain (Senior Associate)*

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