

**Sudit K.  
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Chartered  
Accountants

**Taxation of Permanent  
Establishment (Article 5)**

**3 July 2015**

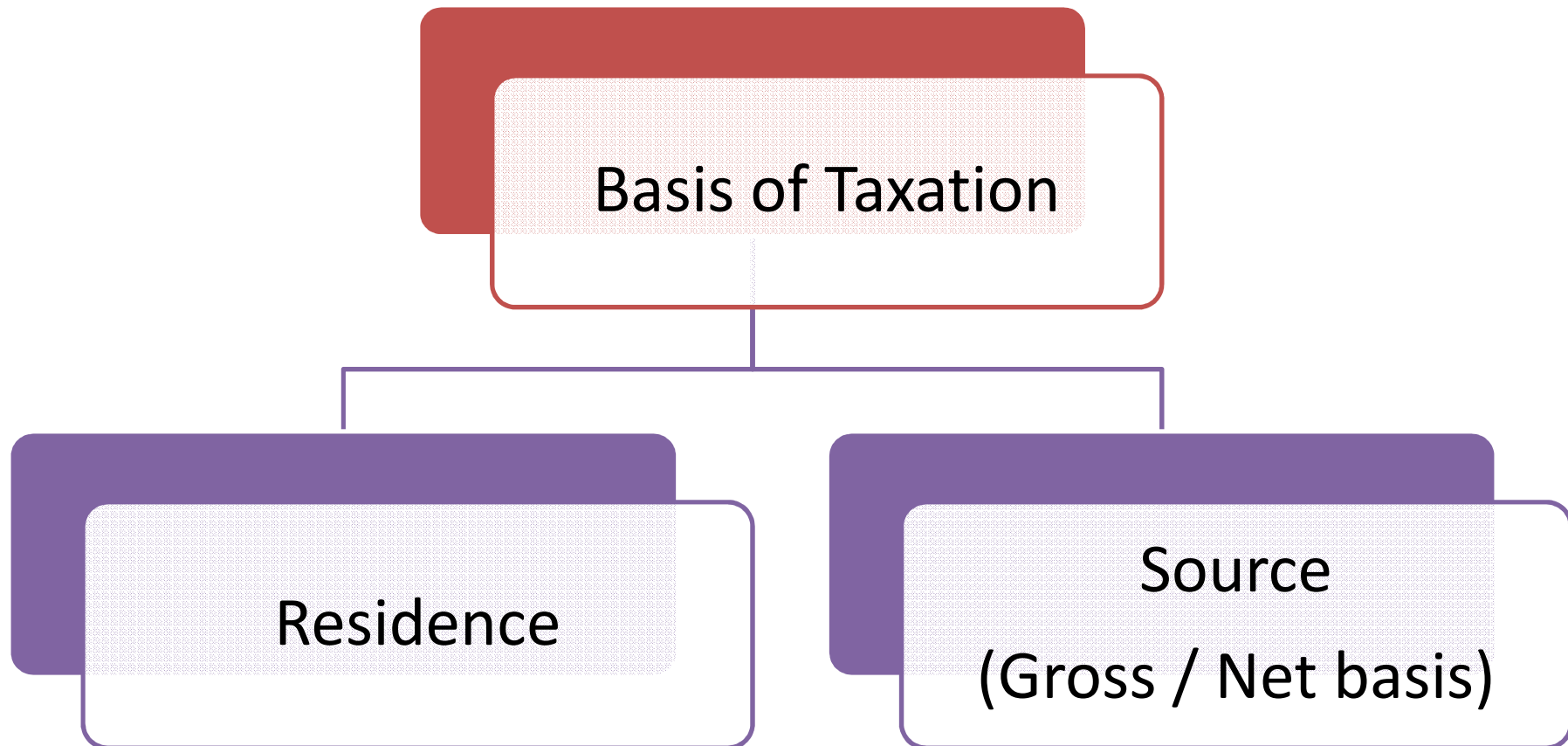
**Manish Shah, Partner – Direct Tax**

## Terms used

Abbreviation	Full-form
Act	Income-tax Act, 1961
BC	Business Connection
DTAA	Double Taxation Avoidance Agreement
PE	Permanent Establishment
CBDT	Central Board of Direct Taxes
AO	Assessing Officer
CIT(A)	Commissioner of Income-tax (Appeals)
NR	Non-resident
LO	Liaison Office
RBI	Reserve Bank of India
FTS / FIS	Fees for Technical Services / Fees for Included Services
AAR	Authority for Advance Rulings
HC	High Court
SC	Supreme Court
SLP	Special Leave Petition
ITAT	Income-tax Appellate Tribunal
DAPE	Dependent Agent PE

## What makes PE so important

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India follows hybrid model of taxation – Business profits are taxed only if non-resident entity has some degree of permanence of its operations in India

## Concept and Interpretation

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- Under the Act, business profits of a non-resident enterprise are taxable in India if it has a “Business Connection” in India
  - Concept of BC is very wide and subject to interpretation as it is an “inclusive” definition
  - BC is subject of considerable litigation with tax authorities

- SC in case of R. D. Aggarwal and Co. (56 ITR 20) held that

*BC involves a relation between a business carried on by a non-resident which yields profits or gains, and some activity in India which contributes directly or indirectly to the earning of those profits or gains. It predicates an element of continuity between the business of the non-resident and the activity in India.*

- *SC in case of Ishikawajma-Harima Heavy Industries Ltd [2007] 158 TAXMAN 259 (SC)*

*Mere existence of business connection may not result in income, to the non-resident assessee from transaction with such a business connection, accruing or arising in India....*

*The distinction between the existence of a business connection and the income accruing or arising out of such business connection is clear and explicit. In the instant case, the permanent establishment’s non-involvement in transaction in question excludes it from being a part of the cause of the income itself, and thus there is no business connection.*

## Importance

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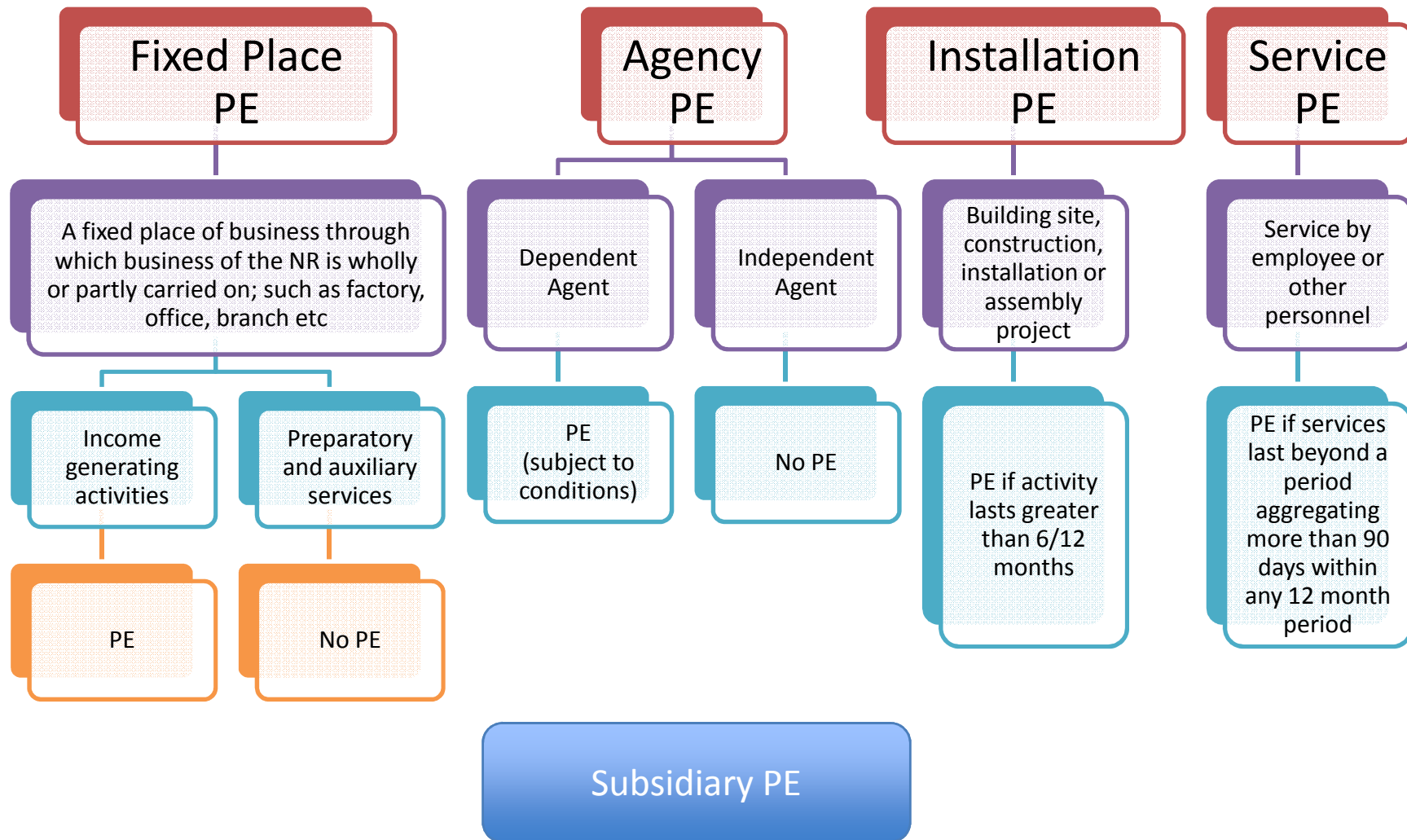
- While determining the tax liability of a non-resident taxpayer, the provisions of the Act or the DTAA, whichever are more beneficial shall apply [Sec 90(2)]
- Generally, article 7 (Business Profits) of India's DTAA provides that a non-resident enterprise is not liable to pay any income-tax on its business profits from India unless
  - It has a "PE" in India and
  - the profits are attributable to such "PE"
- Existence of PE also enables Source State to tax, dividends, interest and royalties that are effectively connected / attributable to such PE
- Gains on alienation of moveable property forming part of PE can also be taxed
- "PE" has been referred to in the definition of "enterprise" in section 92F(iii) of the Act by the Finance Act, 2001 and subsequently in Section 44DA of the Act
  - CBDT circular clarifying Finance Act 2001 stated that the term be understood with reference to India's DTAA's

# Importance

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- The term PE thereafter defined by section 92F(iiiia) by the Finance Act 2002 w.e.f. 01.04.2002 to include  
—
  - “a fixed place of business
  - through which the business of the enterprise
  - is wholly or partly carried on”
- However, there are various types of PE under the tax treaties which makes definition of PE under tax treaties more specific, narrower in scope and beneficial than BC under the Act

## Types of Permanent Establishments




### UN v. OECD

UN MC		OECD MC	
1.	Assembly and supervisory activities are specifically covered under PE	1.	Under Construction PE, assembly and supervisory activities are not covered
2.	Threshold for construction PE is 6 months	2.	Threshold for construction PE is 12 months
3.	Provides for "Service PE" clause	3.	Does not provide for "Service PE" clause
4.	Maintenance of stock for delivery, even without authority to conclude contracts, will trigger "Agency PE"	4.	Maintenance of stock for delivery does not create "Agency PE" without authority to conclude contracts



## Structure of Article 5 - UN Model



- Article 5(1) – Fixed Place PE



- Article 5(2) – Specific inclusions



- Article 5(3) – Construction PE/ Service PE



- Article 5(4) – Exclusions from PE



- Article 5(5)- Dependent Agent PE



- Article 5(6) – Deemed PE for Insurance Business



- Article 5(7) – Independent Agent



- Article 5(8) – Subsidiary Company

## Article 5(1) – Basic rule

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- Under Article 5(1), Fixed Place PE exists only if **all** the following conditions are satisfied **cumulatively**:
  - There is a place of business (“place of business test”)
  - Such place of business is at the disposal of enterprise (“disposal test”)
  - Such place of business is fixed (“location test” and “permanence test”)
  - The business of the enterprise is carried on (“business activity test”) wholly or partly through such fixed place of business

## Article 5(2) – Specific Inclusions

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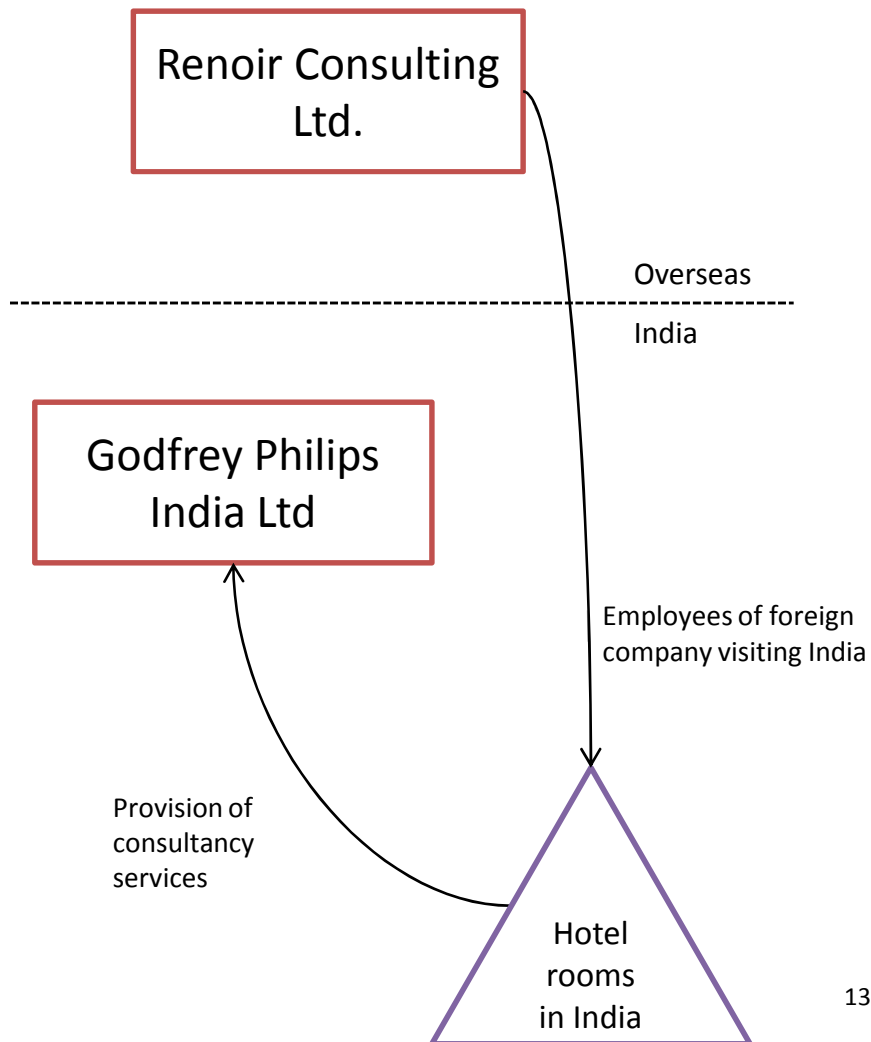
- Article 5(2) – the term “Permanent Establishment” includes especially:
  - a place of management;
  - a branch;
  - an office;
  - a factory;
  - a workshop;
  - sales outlet;
  - warehouse in relation to a person providing storage facilities for others;
  - a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on;
  - a mine, an oil or gas well, a quarry or any other place of extraction of natural resources;
  - an installation or structure, or plant or equipment, used for the exploration for or exploitation of natural resources

## Examples of place of business

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- A factory
- An oil platform or oil pipeline
- A fully equipped diving support / fishing vessel
- A computer server
- A hotel room
- An automatic vending/gaming machine at a fixed place and operated and maintained by the enterprise or its dependent agent.

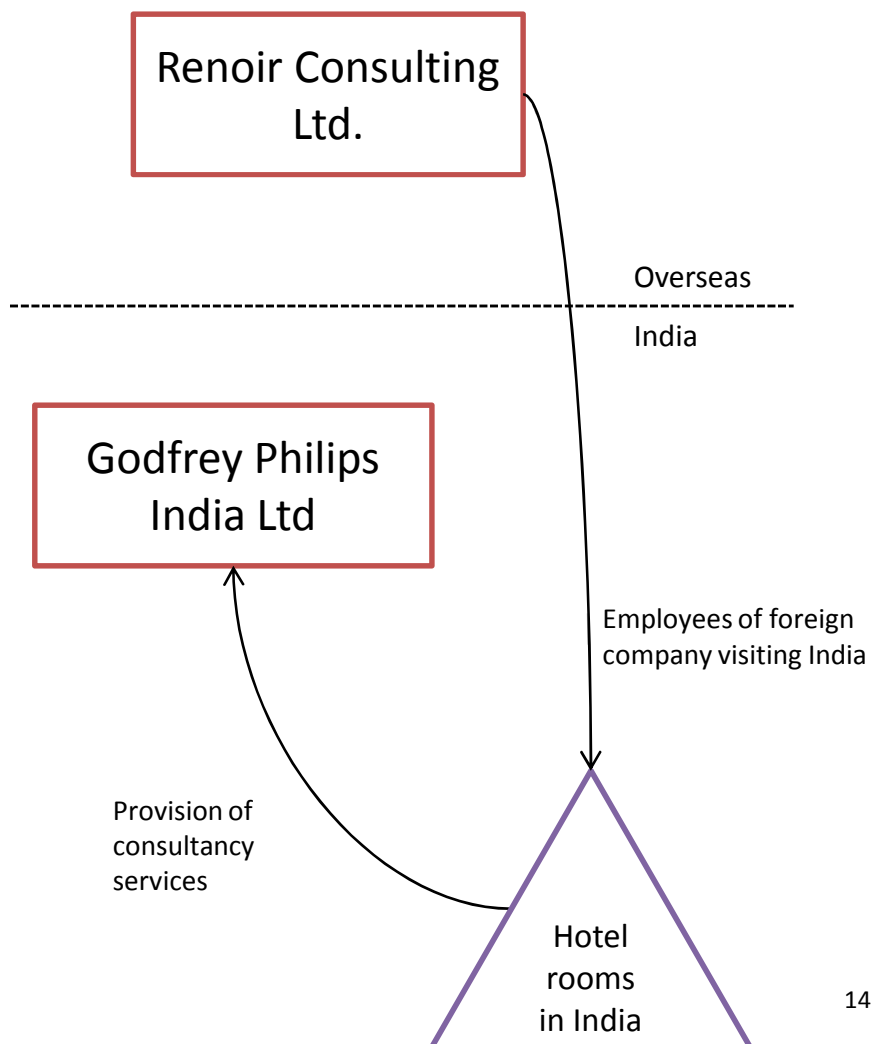
## ITA No. 4323/Mum/2011 dated 11 April 2014 (Mum Tribunal)



### Facts

- Assessee, Mauritius company, contested taxability of income received from Indian company on contracts executed in India as business income.
- Assessee claimed that there was no PE in India for taxation of income
- AO as well as the CIT(A) observed that assessee had PE in India within the meaning of India-Mauritius DTAA and accordingly, the business income was taxable in India

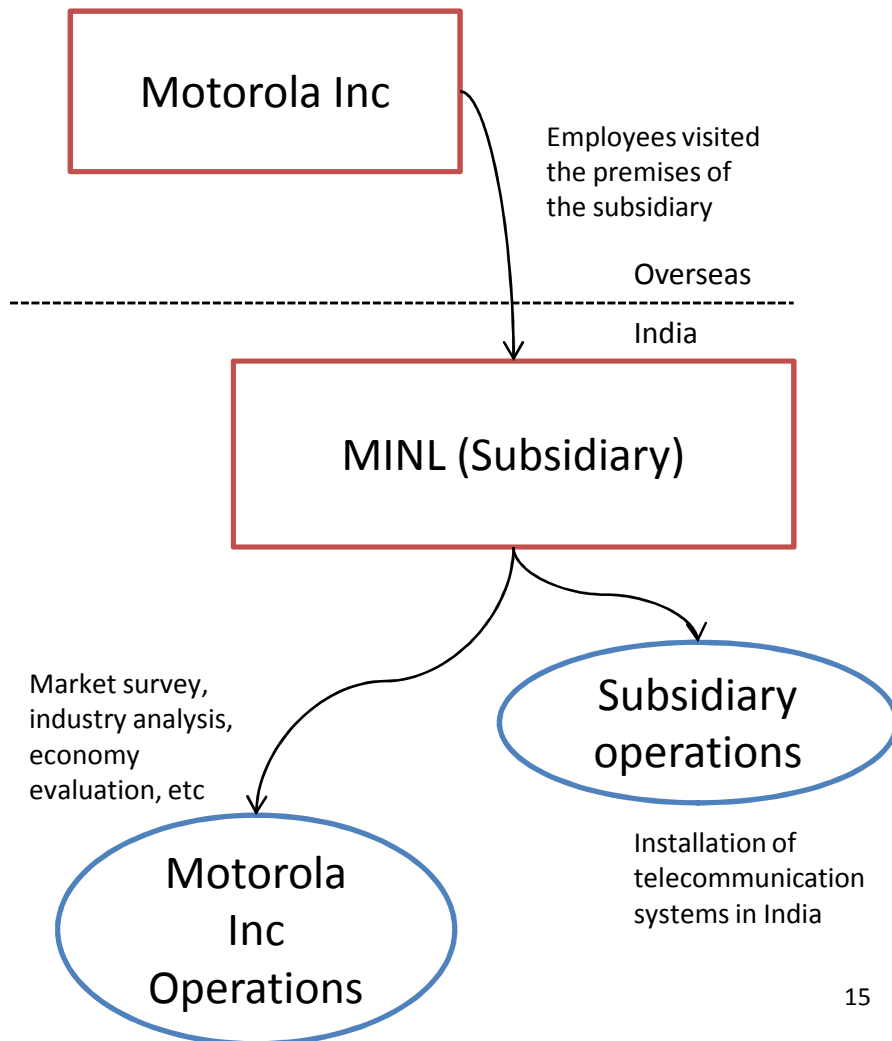
## ITA No. 4323/Mum/2011 dated 11 April 2014 (Mum Tribunal)



### Held – Fixed Place PE in India

- Extensive services rendered for improving management performance quotient, work methods/ service etc.
- Regular interaction between parties requiring assessee's continued presence in India over indefinite contract period needed for implementation of project
- Assessee's contention that hotel rooms used by employees (in rotation) in India were only for residence rejected
  - In the facts of the case employees' continued stay evidences that hotels served as their work place
- Assessee's contention that since top management was in Mauritius, no PE in India was rejected
- Some place at disposal of foreign company as there was a stay of 874 man days for consultants.

[2005] 95 ITD 269



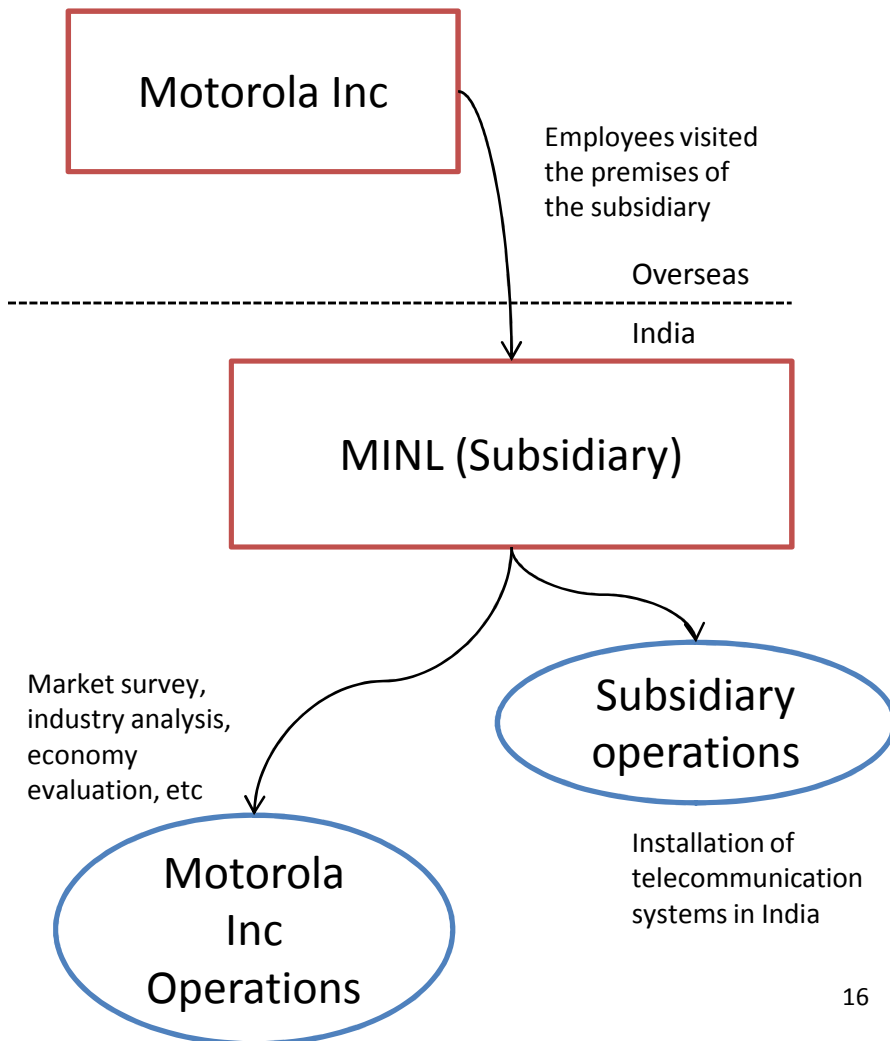
**Facts**

- Employees of Motorola Inc were using the premises of the subsidiary MINL for the work of both Motorola Inc. and MINL
- Employees of Motorola Inc. had a right to enter the office of MINL in India for work of either
- However, the services provided for Motorola Inc. were in nature of market survey, industry analysis, economy evaluation, furnishing of product information, ensuring distributorship and their warranty obligation, ensuring technical presentations to potential users, development of market opportunities, providing services and support information, procurement of raw materials and accounting and finance services etc.

[2005] 95 ITD 269

**Held – Fixed place PE but preparatory & auxiliary**

- Since employees of Motorola Inc. had a right to enter the office of MINL in India for work of either, there was a projection of Motorola Inc. in India in the form of the place of business of MINL and hence, fixed place PE of Motorola Inc. in India
- However, activities were of preparatory or auxiliary character before the commencement of actual business of Motorola Inc. in India.





## Article 5(4) – Specific exclusions

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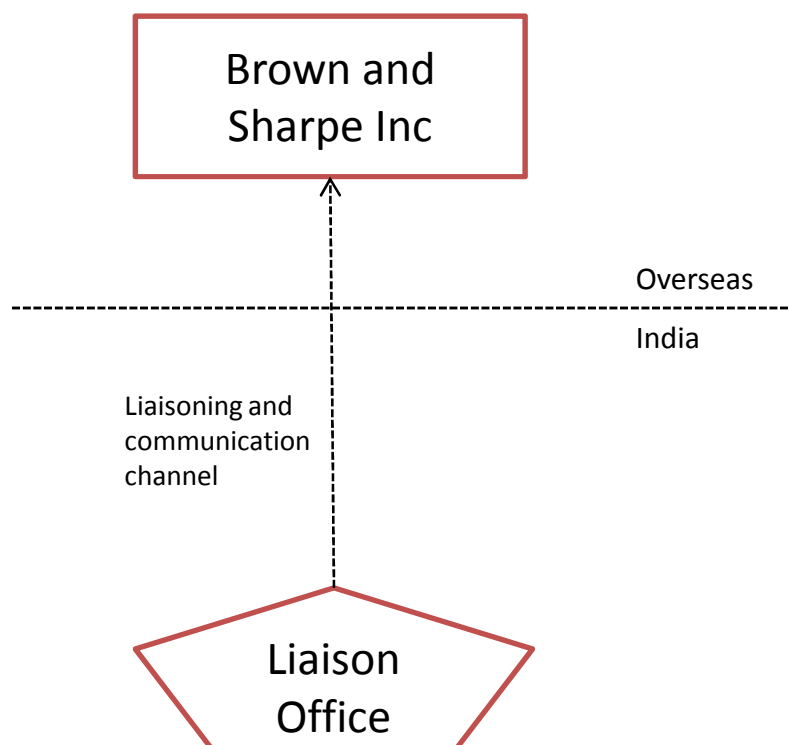
- Use of facilities solely for purpose of storage/display of goods/merchandise belonging to NR;
- Maintenance of stock of goods/merchandise belonging to NR solely for purpose of storage/display;
- Maintenance of a stock of goods/merchandise belonging to NR solely for purpose of processing by another enterprise
- **Maintenance of fixed place of business solely for the purpose of purchasing of goods/merchandise or of collecting information, for the NR;**
- Maintenance of fixed place of business solely for the purpose of carrying on, for the NR, any other activity of a preparatory or auxiliary character.
- Maintenance of fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character

## Article 5(4) – Examples of ‘preparatory and auxiliary’ activities

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- Industry analysis / economy evaluation
- Market survey
- Interface with potential business partners
- Development of market opportunities
- Accounting / finance services
- Maintenance of books of accounts
- Providing quotations to customers on the basis of instructions from the HO

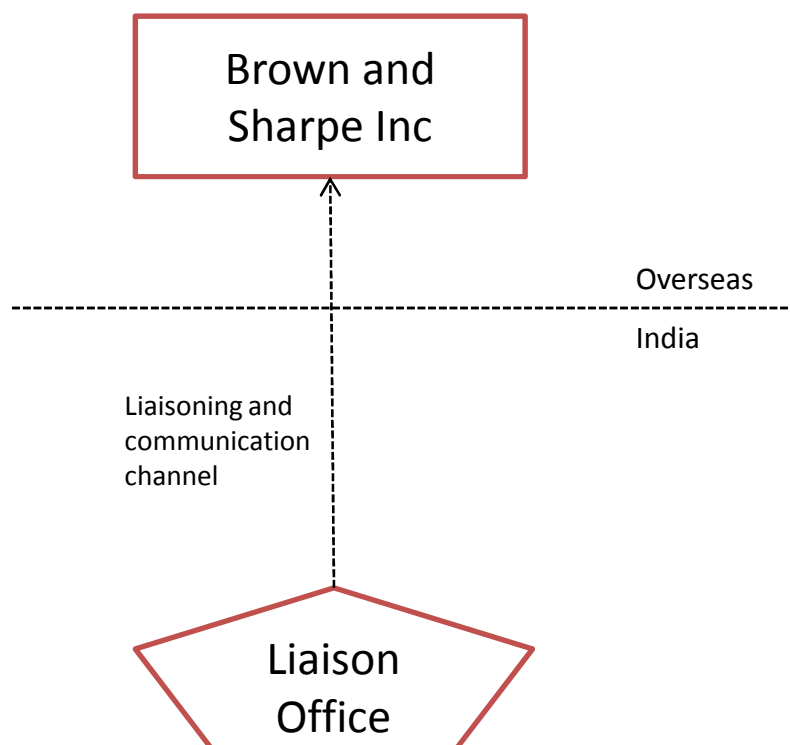
## (ITA No. 219 of 2014) (All-HC)



### Facts

- Assessee is a USA tax resident having a LO in India
- Assessee claimed that it maintained LO and receipts by LO were on account of remittance of expenses incurred which included the salary of its Consultants and Chief Representative Officer. Besides, remuneration was paid to the Technical Support Manager.
- It also had a sales incentive plan under which the employees were entitled to receive upto 25% of their annual remuneration as an incentive.
- AO held that assessee's activities involved marketing activities in India and carried on business activities which were taxable in India

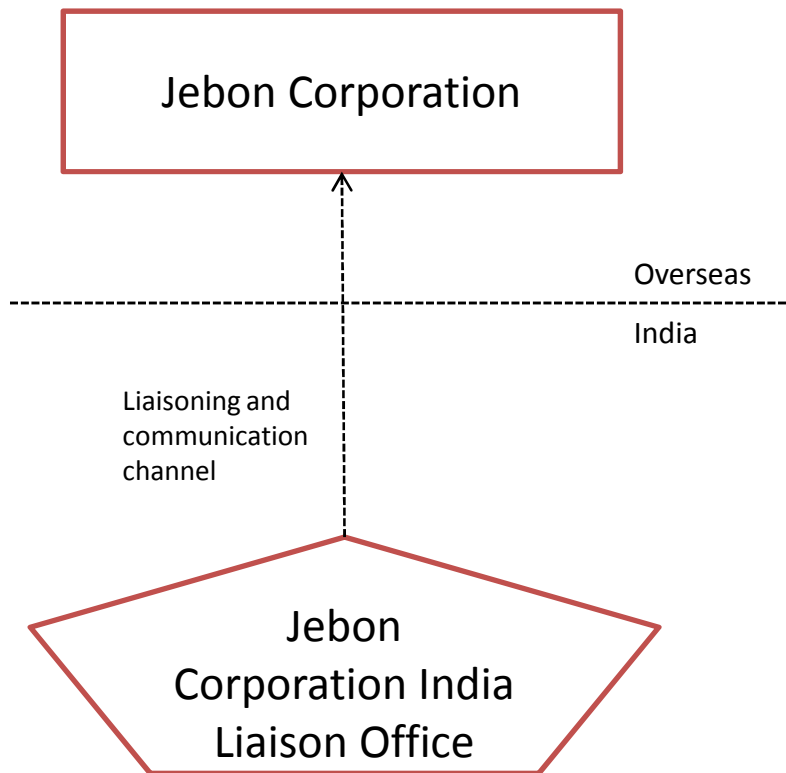
## (ITA No. 219 of 2014) (All-HC)



### Held –LO as a PE

- LO not covered by specific exclusion by Article 5(3)(e) of Indo-US DTAA on ground of being merely a communication link between HO in the US and prospective buyers in India
- LO's activities included explaining of products to buyers in India, discussion of commercial issues etc and LO in effect was involved in marketing activities
- Noting that assessee had a sales incentive plan, HC concluded that purpose of the LO in India was not merely to advertise the products of the assessee or to act as a link of communication between the assessee and a prospective buyer but involved actual marketing of the products of the assessee in India

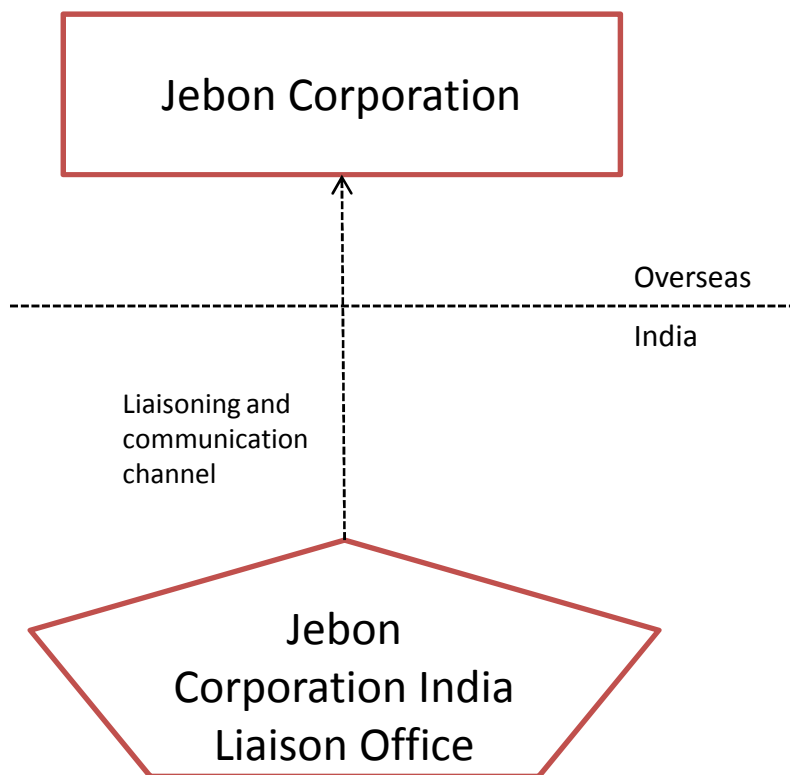
## (55 DTR 113) (Kar)



### Facts

- Assessee is a Korean enterprise having LO in India
- LO's role was limited to finding out prospective buyers for the assessee's products, obtaining enquiries and passing it on to HO in Korea
- AO held that the LO performs the functions such as identifying new customers, pursuit and follow up of the customer, price negotiation and finalization, securing orders, processing of orders, etc. Thus, the LO is seen to perform about 57 per cent of the functions, leaving only the balance 43 per cent to the HO
- Therefore, it was contended that LO had all the characteristics of a PE

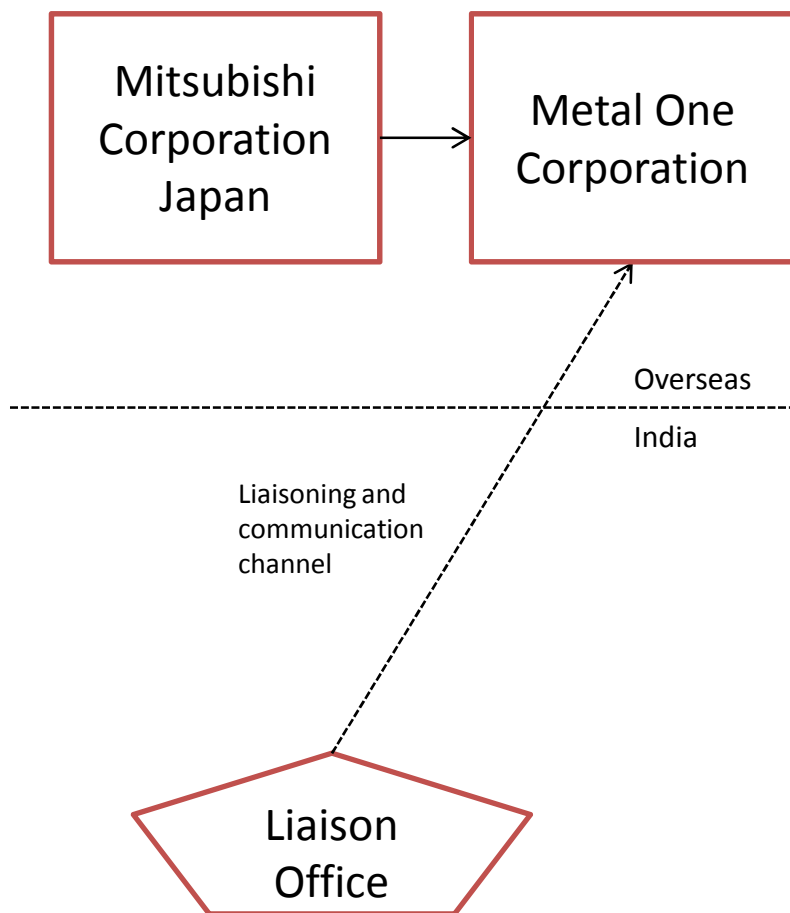
## (55 DTR 113) (Kar)



### Held – LO as a PE

- ITAT has found that activities carried on by LO are not confined only to liaison work but are commercial activities as identified by AO
- Merely because buyers place orders directly with the HO and make payment directly to HO and it is HO which directly sends goods to buyers does not mean that work done by LO is only liaison work
- Even if no action has been initiated by RBI against LO for undertaking commercial activities it does not render the findings of the tax authorities erroneous or illegal
- Liaison office is a PE and the business profits earned in India through this liaison office are taxable in India

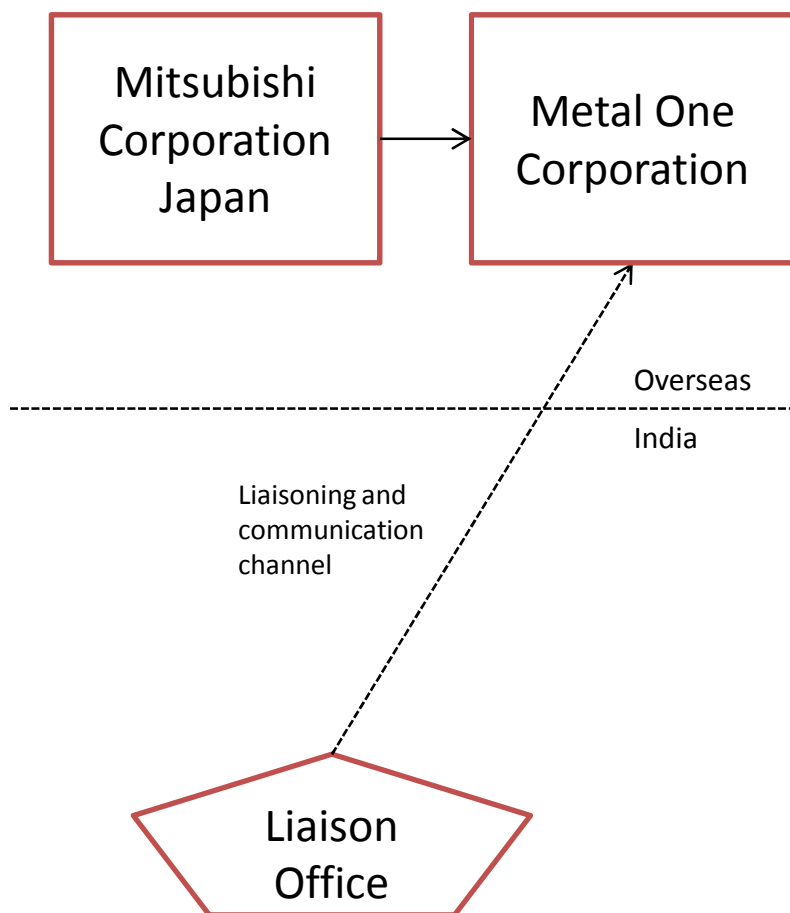
## (52 SOT 304) (Del Trib)



### Facts

- Mitsubishi Corporation Japan (MCJ) created a separate entity, Metal One Corporation (MOC) with a view to conduct metal business in the same manner MCJ was conducting its business earlier.
- Assessee claimed that LO had carried out only preparatory and auxiliary activities in India
- AO held that LO was engaged in undertaking revenue generating activities and LO was engaged in locating potential buyers, negotiating and selling the goods in the market. The fact that actual trading was done through an entity outside India was immaterial in its business model
- Accordingly, AO concluded that LO's activities **could not** be treated as preparatory and auxiliary services and hence created a PE

## (52 SOT 304) (Del Trib)

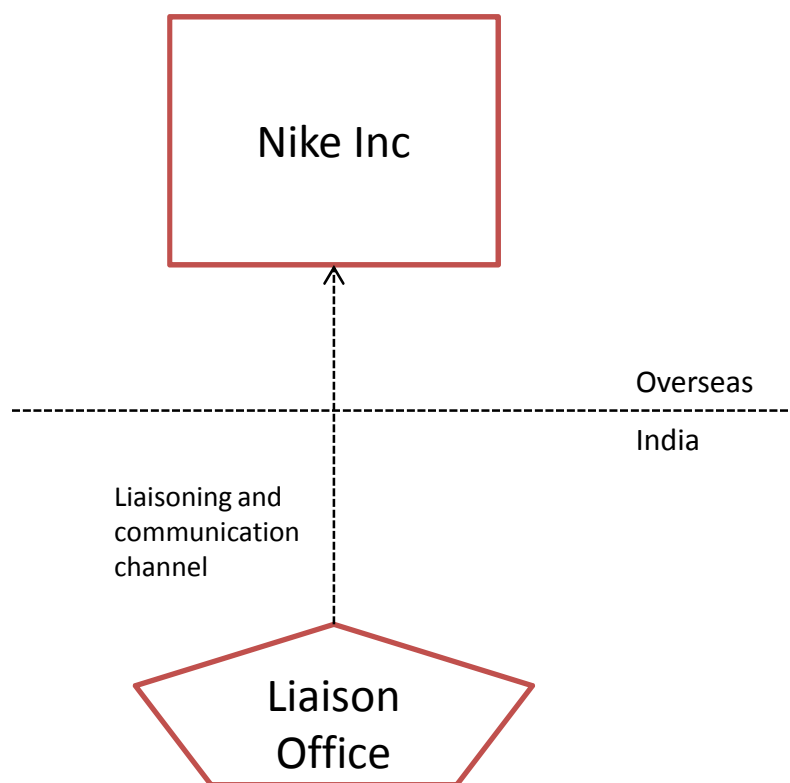


### Held – LO as NOT a PE

- LO cannot be taken to be a PE unless its activities exceed the permitted activities
- Presumption – LO does not constitute a PE as no violation was noticed by the RBI
- No positive material brought on record to show that any substantive business activity was carried on by the LO in India
- No evidence on record to show that LO was given a chance to rebut the inference of similarity of functioning
- Although the assessee has a fixed place of business in India, no evidence on record that any substantive business activity has been carried on from this place



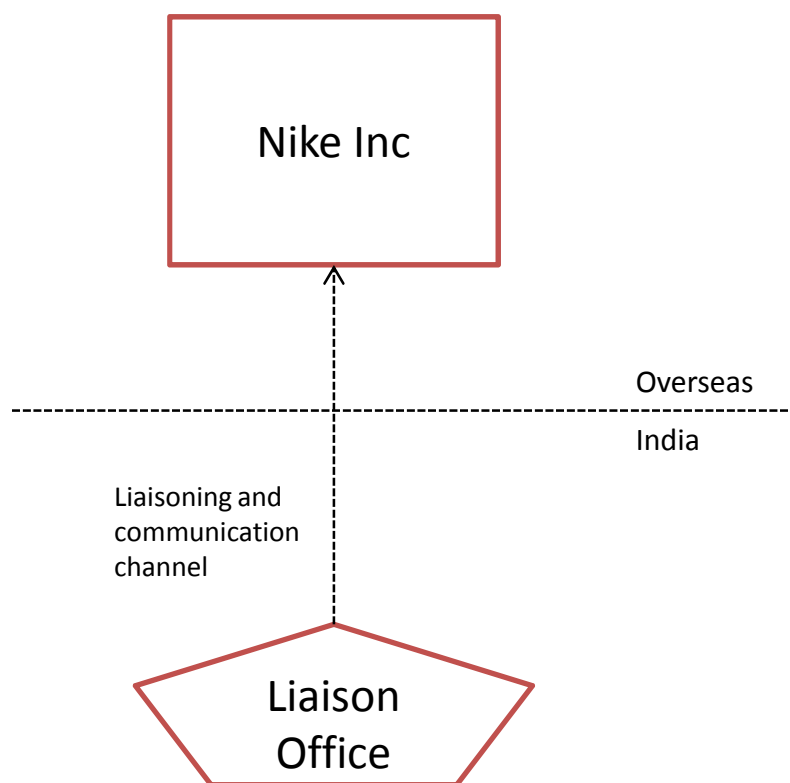
## (264 CTR 508) (Kar HC)



### Facts

- Assessee engages various manufacturers all over the world on a job to job basis and makes arrangements with its subsidiaries for purchasing manufactured goods directly and pay for same to respective manufacturers
- LO only proposes and gives its opinion about the reasonability of price and all related issues etc., US office decides about the price; quality, quantity
- LO keeps a close watch on progress, quality, etc., at manufacturing workshop
- AO held that activities of assessee was actually beyond its activities as required as a LO. A part of entire business was done in India, more specifically by Apparel Product Integrity Department and quality checks, through the LO

## (264 CTR 508) (Kar HC)



### Held – LO as NOT a PE

- Mere activity of purchase from India confined to exports does not create deeming charge u/s 9. Object of the law is to encourage exports and earn foreign exchange
- Definition of term 'business connection' inserted by Finance Act, 2003 w.e.f. April 1, 2004 clarificatory & has retrospective effect.
- Nike USA not carrying on any business and activities of LO not taxable in India under section 5 as well as section 9

## Do's and Don'ts for LO

Do's	Don'ts
Act as communication channel – collecting information about Indian market and relay to HO	Negotiating Price
Market Survey	Although contracts signed by HO, in substance, contract to be concluded by LO
Advertisement	Agreeing to price and binding HO
Propagation	Follow-up activities for realisation of payments
Co-ordination and liaison	Marketing activity
Hold seminars and trade conferences	Providing performance linked incentives to employees in India for sales generated in India
Receive trade enquiries and pass on to HO	
Receive information from HO and pass it on to customers	
Collect feedback from customers and pass on to HO	

## Article 5(3) – Overview

- Service PE exists if the following conditions are satisfied:
  - Services, including consulting services, are furnished by NR;
  - Services are furnished through employees or other personnel engaged by the NR for such purpose;
  - Activities of that nature continue (for the same or a connected project) within a contracting state;
  - Such activities continue for a period or periods aggregating more than 90 days within any twelve-month period commencing or ending in the fiscal year concerned

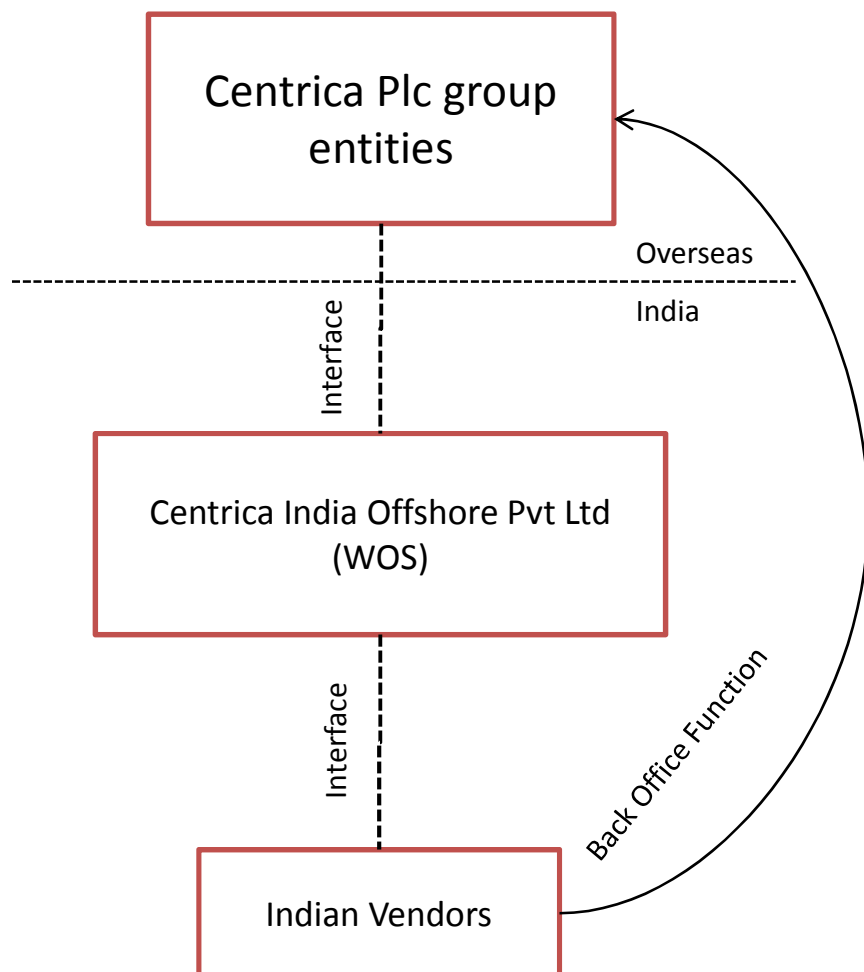
Particulars	Service PE = 90 days in concerned fiscal year	Service PE = 90 days in any twelve month period
FY 2014-15 – Stay from Feb 15 to Mar 15 = 59 days	No service PE as stay in India in FY 2014-15 < 90 days	Yes, as stay during 12 month period (Feb 15 to Jan 16) > 90 days
FY 2015-16 Stay from Apr 15 to May 15 = 60 days	No service PE as stay in India in FY 2015-16 < 90 days	Yes, as stay during 12 month period (May 15 to June 14) > 90 days

## Article 5(3) – Overview

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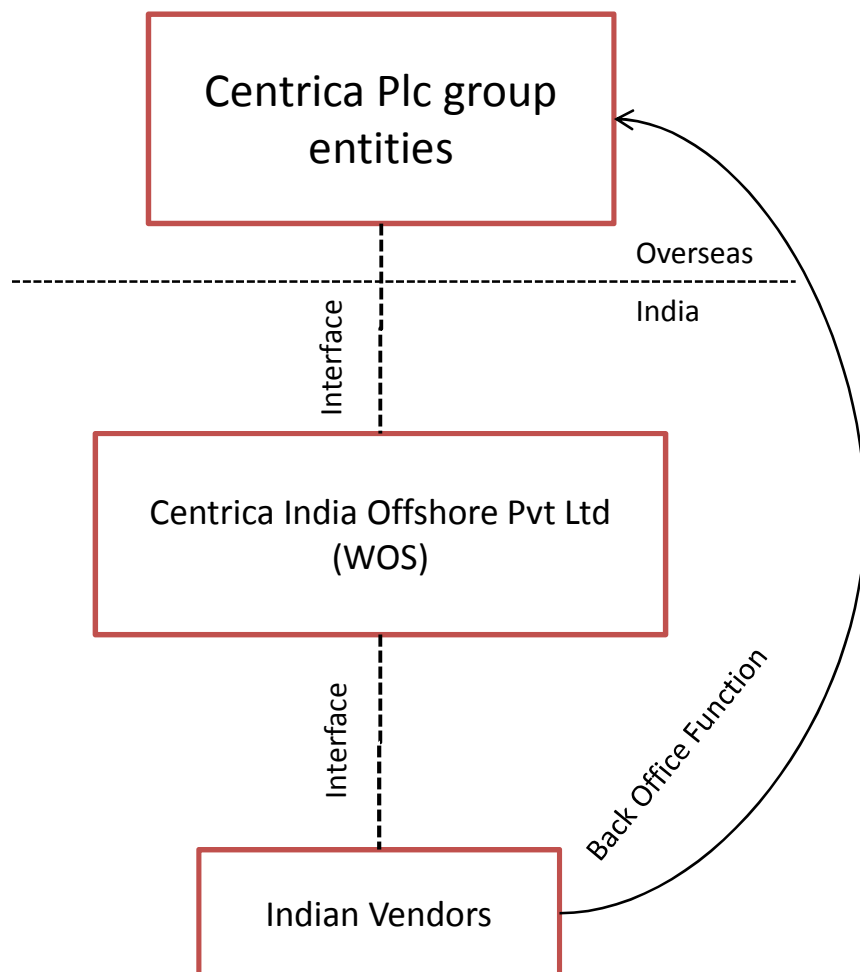
- Merely having an employee in other country does not create Service PE if employee is not providing service to 3<sup>rd</sup> party but only to employer
- Treaties with “make available” clause, provide for Service PE only for services which are not covered under definition of “FTS / FIS” under the tax treaty

## (SLA 22295/2014) dated 10 October 2014 (SC)

**Facts**

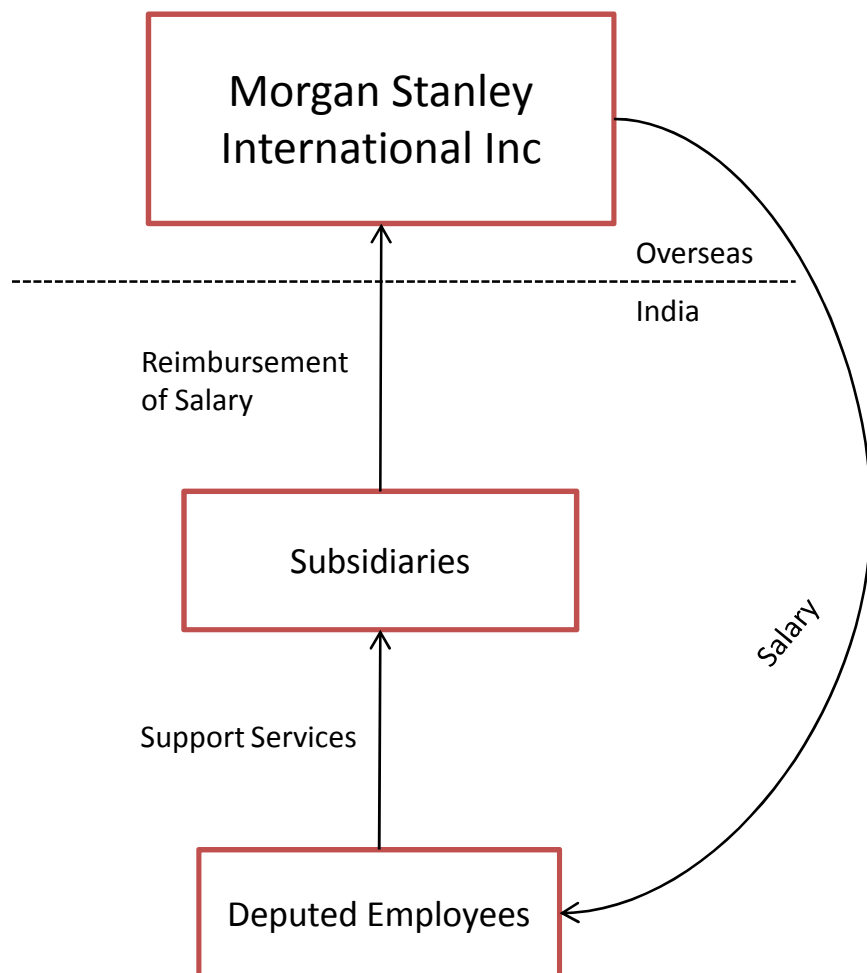
- The assessee is a WOS of Centrica Plc, UK
- To seek support during initial year of operation, assessee sought some employees from the overseas entities vide secondment agreement
- Employees were to work under assessee's direct control and supervision and assessee would bear all risks & rewards of work of such employees
- Assessee sought an advance ruling on whether the payment made to the overseas entities was "income accruing in India" to the overseas entities and whether tax was liable to be deducted at source u/s 195 of the Act on the payments made
- AAR ruled against assessee.

## (SLA 22295/2014) dated 10 October 2014 (SC)

**Held – Service PE**

- Delhi HC had held that secondment of employee Group companies to assessee creates PE
- HC rejected assessee's plea of being economic employer & that salary paid was reimbursement
- HC concluded that real employer continued to be foreign companies and deputed employees work could not be regarded as stewardship
- HC held that services rendered by deputed employees "made available" technical knowledge to Indian entity and as such taxable as FIS
- HC also rejected assessee's arguments on 'diversion of income by overriding title
- **SC dismissed assessee's SLP**

## (ITA No. 6882/Mum/2011) 18 December 2014 (Mum Tribunal)

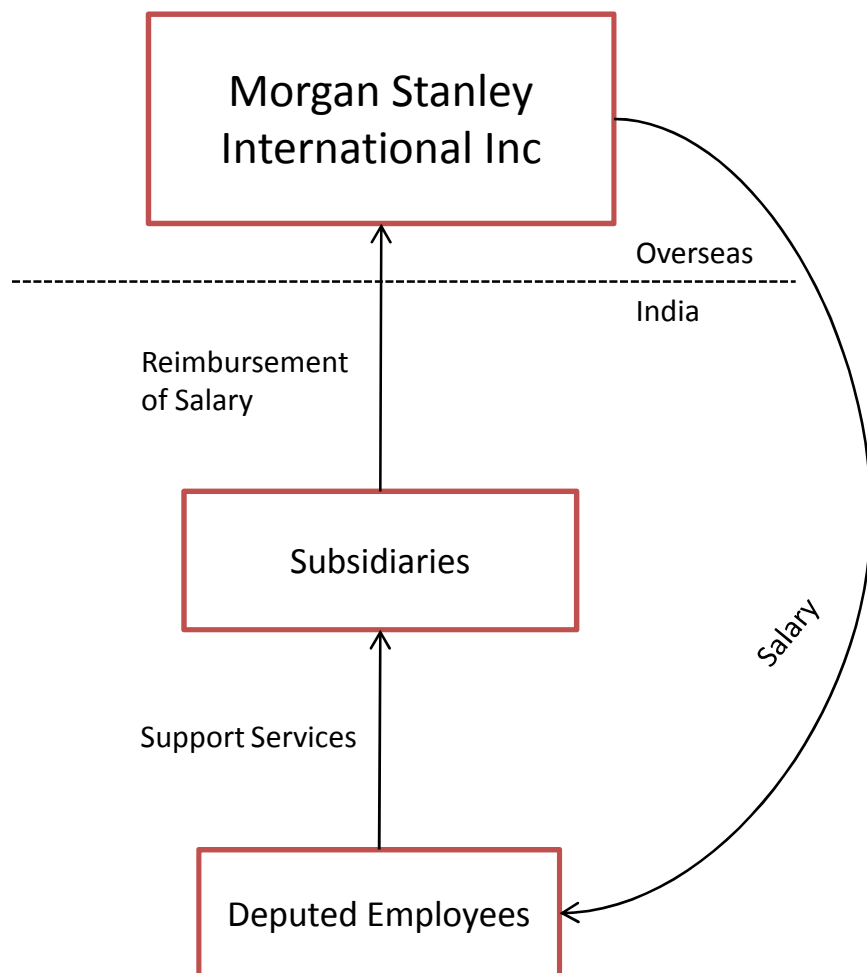


### Facts

- Assessee a US company, deputed its employees to India to render their services to the Indian Subsidiaries under supervision and control of the Board of Directors of the Indian companies and their day to day responsibility and activities were managed by the Indian company.
- However, their salary were paid by the assessee company after deducting TDS u/s 192 of the Act and duly deposited in the Indian Government Treasury. The entire salary paid by the assessee had been reimbursed by the Indian company to the assessee.
- However, department taxed the amount received by assessee towards reimbursement of Salary cost as FIS



## (ITA No. 6882/Mum/2011) 18 December 2014 (Mum Tribunal)



### Held – Service PE

- Employee secondment created service PE.
  - However, such recharge not FIS, but business profits
- Revenue’s reliance on Delhi HC ruling in Centrica India Offshore Pvt Ltd to hold reimbursement taxable as FIS rejected,
  - Held that Delhi HC did not take into account para 6 of Article 12 for determining taxability of such payment under treaty
- Held that if the taxability of such payment has to be examined and determined on the basis of computation of business profit under Article 7, then the salary paid by the assessee would amount to cost to the assessee, which is to be allowed as deduction while computing the business profit of the PE in India.

## Solar v. Man days for computing limit

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- Company A (a NR) sent 5 employees for furnishing services in India:
  - Scenario 1 – Total stay of 5 employees in India as per solar/calendar days is 80
  - Scenario 2 – Total stay of 5 employees in India as per man days is 400
- Whether Solar days are to be considered for computation of Service PE or man days?
- Mumbai Tribunal in case of Clifford Chance [2002] 82 ITD 106 (MUM.) in context of Article 15 (IPS):

*In our opinion multiple counting of the common days is to be avoided so that the days when two or more partners were present in India, together, are to be counted only once. Multiple counting would lead to absurd results. For example, if 20 partners were present in India together for 20 days in one fiscal year, multiple counting would result in 400 days. There cannot be more than 365 days in a year. Therefore this system of multiple counting leads to absurdity. Therefore it should be avoided.*

- Mumbai Tribunal in case of MSEB [2004] 90 ITD 793 (MUM.) by relying on decision in Clifford Chance:

*Suffice to say that we are in considered agreement with the above views and that we see no reasons to take any other view of the matter than the view so taken by our esteemed colleagues. In our considered view, multiple counting of days would indeed go against the object of Article 15(1)(a) of the India UK DTAA which is to provide criterion for substantial and permanent presence in a contracting state, as opposed to a transient and fleeting one.*

- Better view seems to be to consider solar / calendar days

## Article 5(3) – Overview

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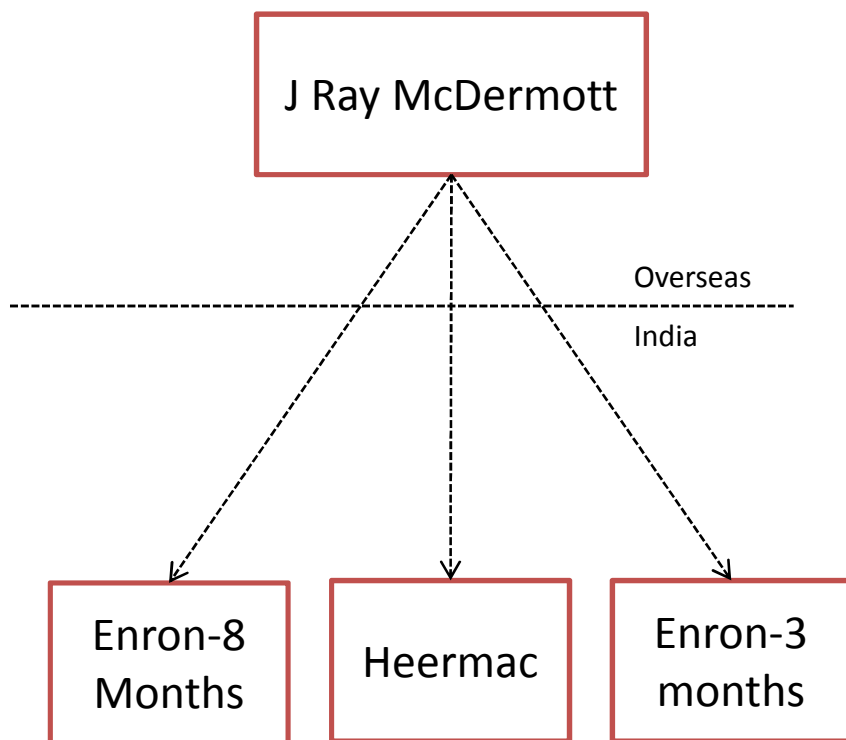
- Building site or construction or installation project constitutes a PE only if it lasts more than
  - 12 months (OECD Model Convention)
  - 6 months (UN Model Convention)
- Site exists from the day from which work begins, including any preparatory work;
- A site exists until the work is completed or permanently abandoned;
- Temporary interruptions not to be excluded - bad weather, lack of raw materials, labour problems, etc;
- If the part of the contract is subcontracted – Period spent by sub-contractor also to be considered - CIT Vs Visakhapatnam Port Trust [1983] 144 ITR 146 (Andhra Pradesh HC)
  - However, in case of Hyosung Corporation [2009] 181 TAXMAN 270 (AAR) it was held that Foreign enterprise did not have construction PE since onshore work was assigned to independent contractor
- Twelve month test applies to each individual site or project – Sumitomo Corpn Vs DCIT [2007] 110 TTJ 302 (Del ITAT); OECD (2010), Para 18
- A building site should be regarded as a single unit, even if it is based on several contracts

## “Building site or construction / installation / assembly project”

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- Construction of buildings, dams, roads, bridges or canals
- Renovation of buildings, etc.
- Laying of pipelines
- Excavating, dredging and incidental activities
- Setting up, fitting, placing and positioning of the fabricated equipment at site
- Services related to burial of pipelines in the sea bed
- Installation of gas pipelines under the river

## (54 SOT 63) (Mum Trib)

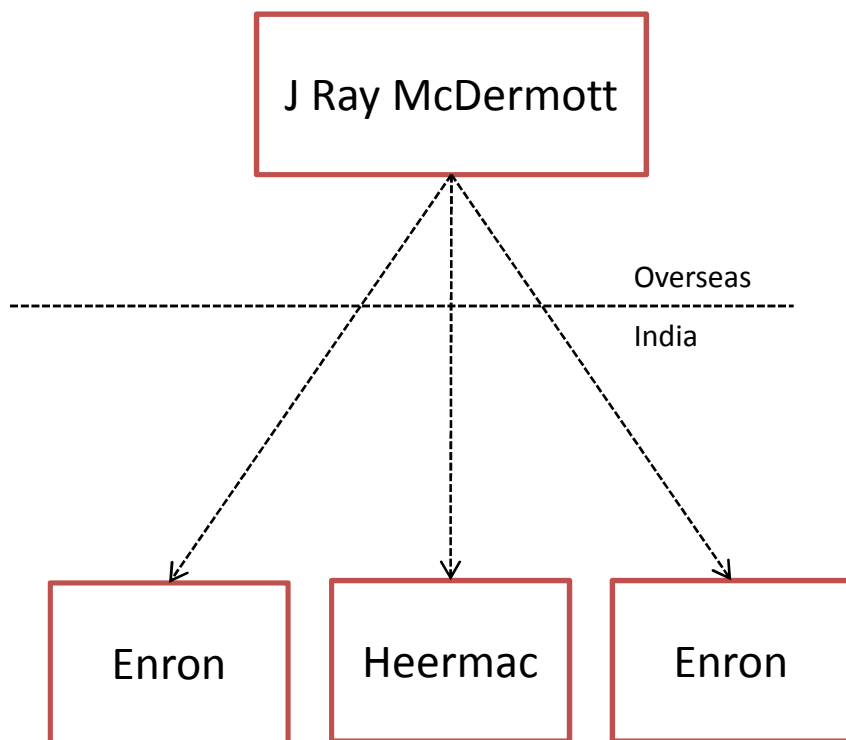


Various projects in India in nature of construction / assembly / supervision

### Facts

- The AO held that the duration of work in India exceeded 9 months and the period for all the contracts should be taken together under Article 5 of Indo-Mauritius treaty to constitute the PE of assessee in India.

## (54 SOT 63) (Mum Trib)

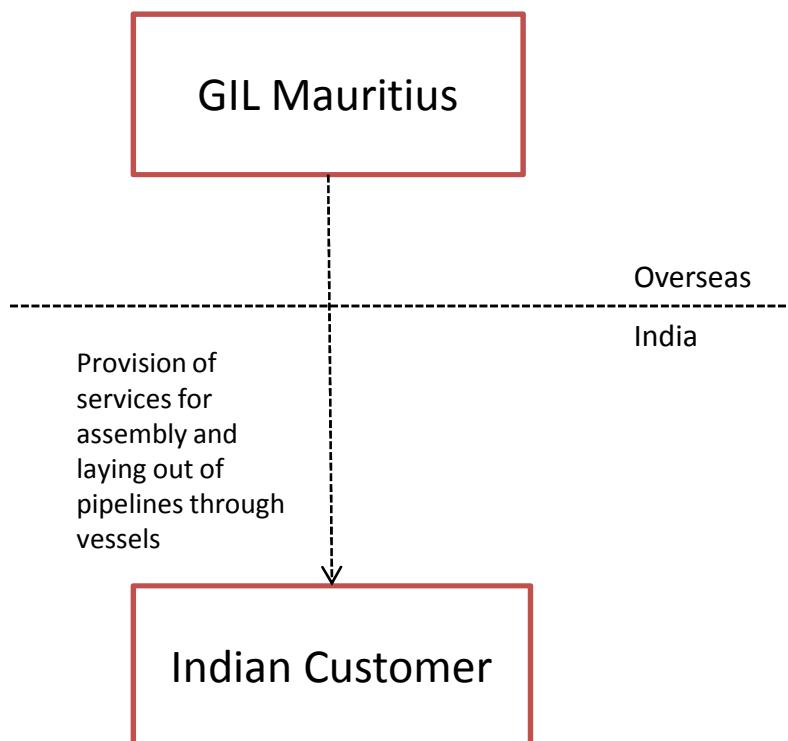


Various projects in India in nature of construction / assembly / supervision

### Held – No Construction PE

- For determination of existence of permanent establishment (PE), "duration test" to be applied vis-a-vis "each contract" and not on "aggregation of contracts";
- Dates of commencement and completion of work as mentioned in contracts are only indicative;
- Duration test to be applied vis-a-vis work at site, actual or preparatory;
- No PE in present case under Indo-Mauritius DTAA as duration of each contract held to be less than 9 months

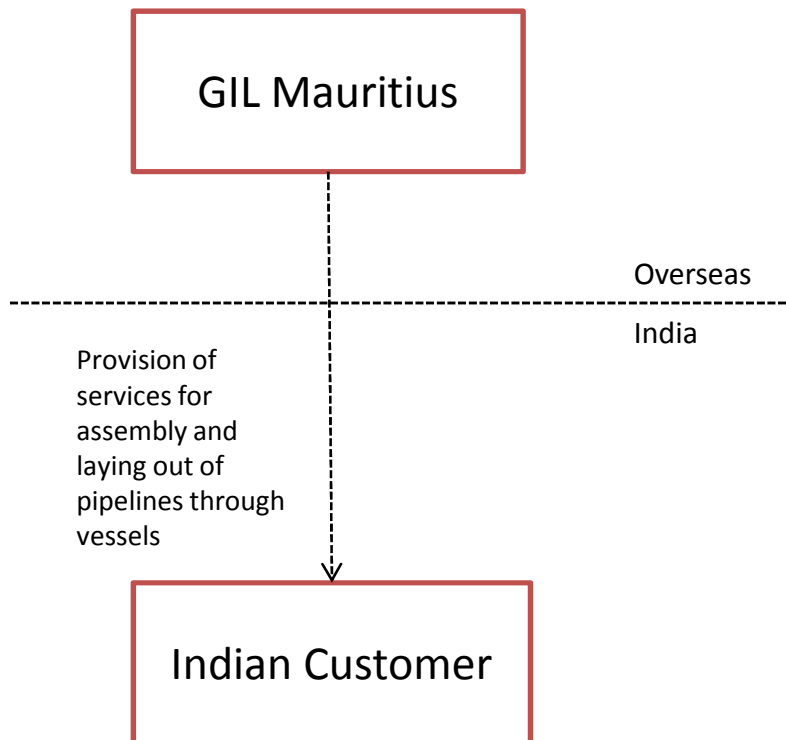
## (17 ITR 491) (Del Trib)



### Facts

- The assessee carried out certain work, in the nature of services for laying out pipelines from ‘marine vessels’ which housed personnel, machines and material. The work was claimed to be carried out for a period of less than 9 months.
- The AO, relying on the decision of ITAT in case of Fugro Engineering BV (ITA 269/DEL/2007), held that the assessee had ‘fixed place’ PE in India as it was operating through a ship.
- The AO held that provisions of Article 5(2)(i) of India-Mauritius Treaty providing for PE in case of construction or assembly project was not relevant as the assessee had a ‘fixed place PE’ in terms of Article 5(1) itself.

## (17 ITR 491) (Del Trib)



### Held – No Construction PE

- ITAT held that ‘pipeline assembly project’ carried out through ‘marine vessels’ would constitute a PE only when the period of activity exceeded 9 months as per India-Mauritius Treaty
- ITAT rejected Revenue’s contention that where a ‘construction or assembly project’ satisfies ‘fixed place of business’ test under Article 5(1), threshold period of 9 months would not be relevant
- ITAT held that such an interpretation would make the provisions of Article 5(2)(i) otiose as all ‘construction or assembly project’ would have a ‘fixed place of business’



## Specific prevails over general

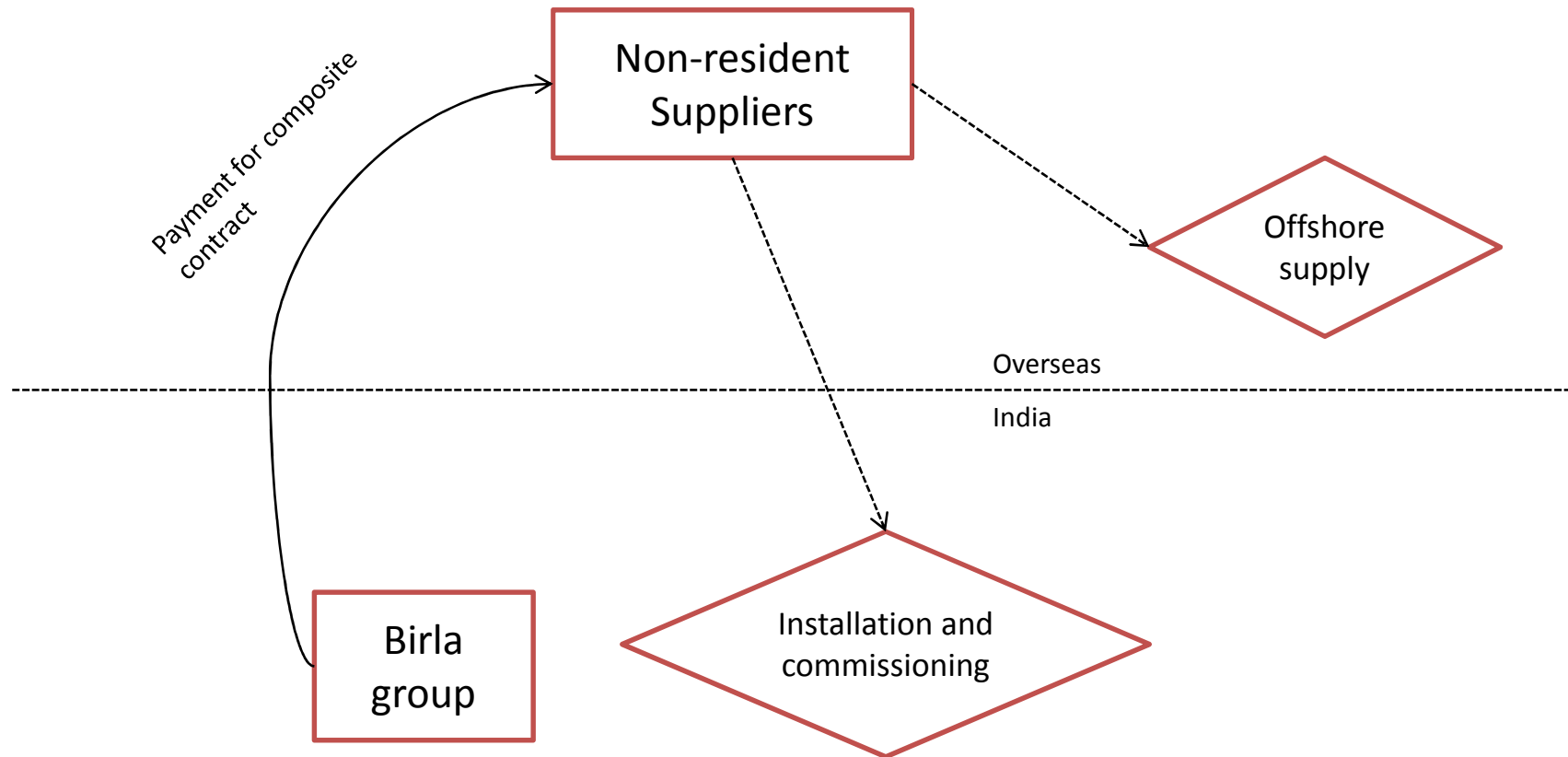
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### **Kreuz Subsea Pte. Ltd. [2015] 58 taxmann.com 371 (Mumbai Trib.)**

- Provisions of Construction PE are very specific and, therefore, such specific activities cannot be read into Service PE.
- There cannot be overlapping of activities carried out within the ambit of **Construction PE** and **Service PE**.
- Both should be read independent of each other, or else there would be no requirement of enshrining separate provisions.
- If the activities related to construction or installation are specifically covered under one article then one need not to go in for article on Service PE.
- Thus, the activity of the assessee which is purely installation services has to be scrutinized under article on **Construction PE** only and not under article on **Service PE**

## Composite Contracts

Birla Corporation Ltd. [2015] 53 taxmann.com 1 (Jabalpur - Trib.)



## Composite Contracts

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### **Birla Corporation Ltd. [2015] 53 taxmann.com 1 (Jabalpur - Trib.)**

#### **Facts**

- The assessee was engaged in the business of manufacturing and selling cement.
- During previous years 2009-10 and 2010-11, it made remittances to various non-resident vendors in Austria, Belgium, China, Germany, Switzerland, the UK and the US towards import of plant, equipment and machinery, without deducting tax at source. These vendors also provided the installation and commissioning services for which no separate fees were charged
- AO was of the view that the above remittances were made with respect to composite contracts and believed that tax should have been deducted on payment for said contracts as they included provision of supervision, commissioning and installation services by the vendor
- CIT (A) analysed the contracts and noted all contracts were composite contracts for purchase of goods and related services for installation and commissioning etc and tax should have been deducted on entire amount
- Following this, the taxpayer approached the Income-tax Appellate Tribunal (ITAT)

## Composite Contracts

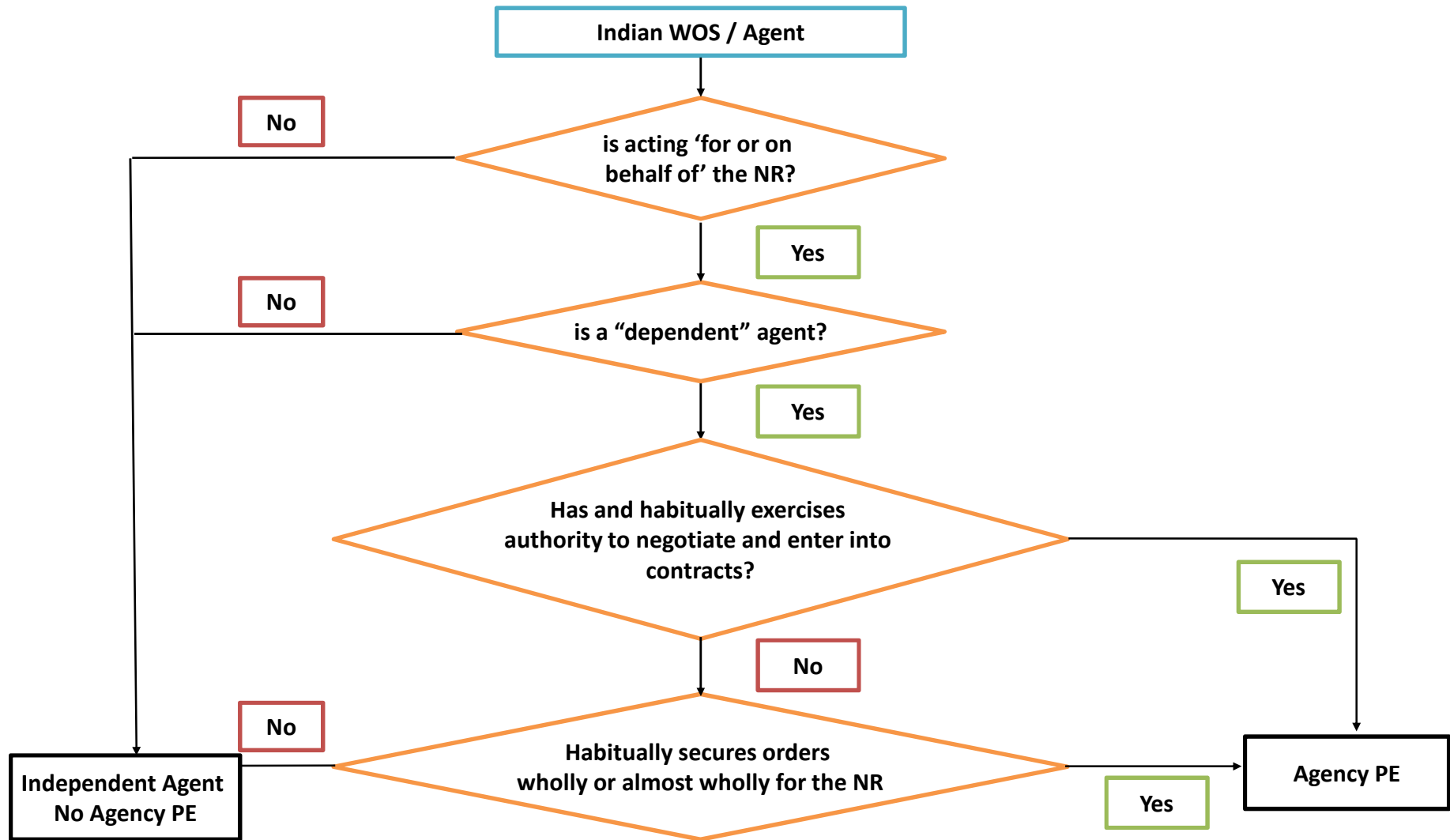
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### **Birla Corporation Ltd. [2015] 53 taxmann.com 1 (Jabalpur - Trib.)**

#### **Tribunal's ruling**

- Deeming provisions for taxing FTS income as per the ITA excludes “consideration for assembly” from its purview. The expression “installation, commissioning or erection” of the plant and equipment is same as the expression “assembly” used in the exclusion clause and hence, such activity would be out of the provision of FTS taxation
- The DTAA with vendors of all the countries mentioned above provided for the installation PE clause in Article 5 with a specified threshold time limit for triggering PE. The said threshold was not breached in any of the cases, and hence no PE was constituted.
- When the project fails to satisfy PE test by not exceeding threshold limits provided in the DTAA, the same cannot be brought to tax as FTS. Treating the said services as FTS, would render PE provisions meaningless and redundant and would be contrary to spirit of observations in UN Model Convention.-  
India Fisheries- 57 ITR 331 (SC)
- Accordingly, in the case of installation and like services, the provisions of Article 7 read with Article 5 would prevail over Article 12.

## Article 5(5) – Dependent Agency PE

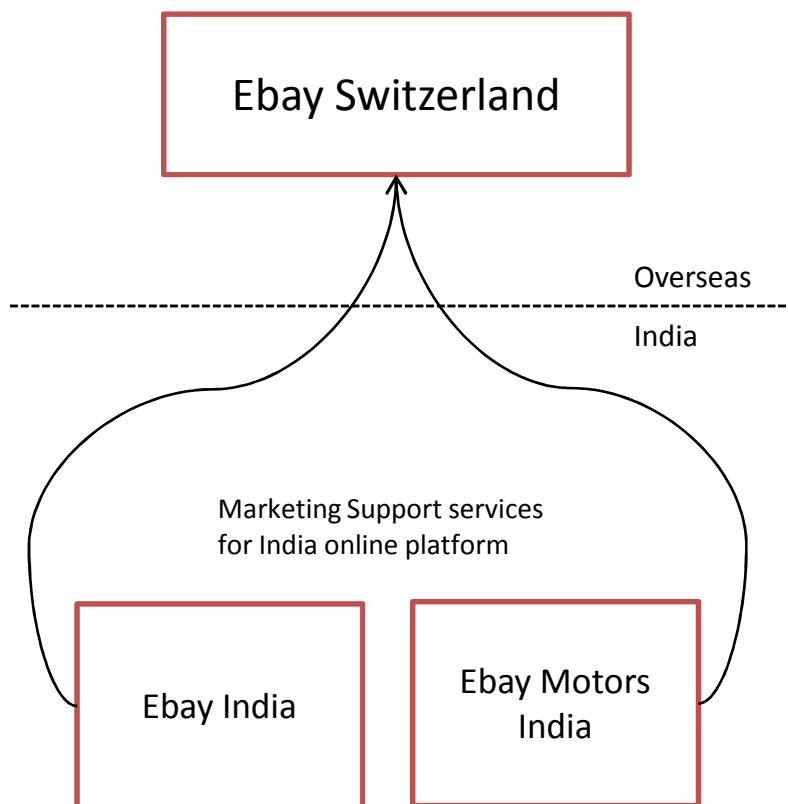


## Article 5(7) – Features of “Independent Agent”

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- Agent can be treated as “Independent Agent” only if:
  - Agent is legally & economically independent of NR
    - *Not subject to high degree of control (like employer/ employee relationship)*
    - *Not subject to detailed instructions and control in respect of conduct of business*
    - *Conduct business according to own view, expertise and method*
    - *Will the agent continue its business if principal terminates the service agreement*
    - *Agent bears the risk of loss from its own activities*
  - Agent is acting ordinary course of his business
  - Agent’s activities are not wholly, or almost wholly, on behalf of NR
- However, if one of the above conditions are not satisfied, agent can be treated as “Dependent Agent”
- If “Dependent Agent” carries out any activity on behalf of NR as mentioned in the tax treaty, triggers “Dependent Agency PE”<sub>46</sub>

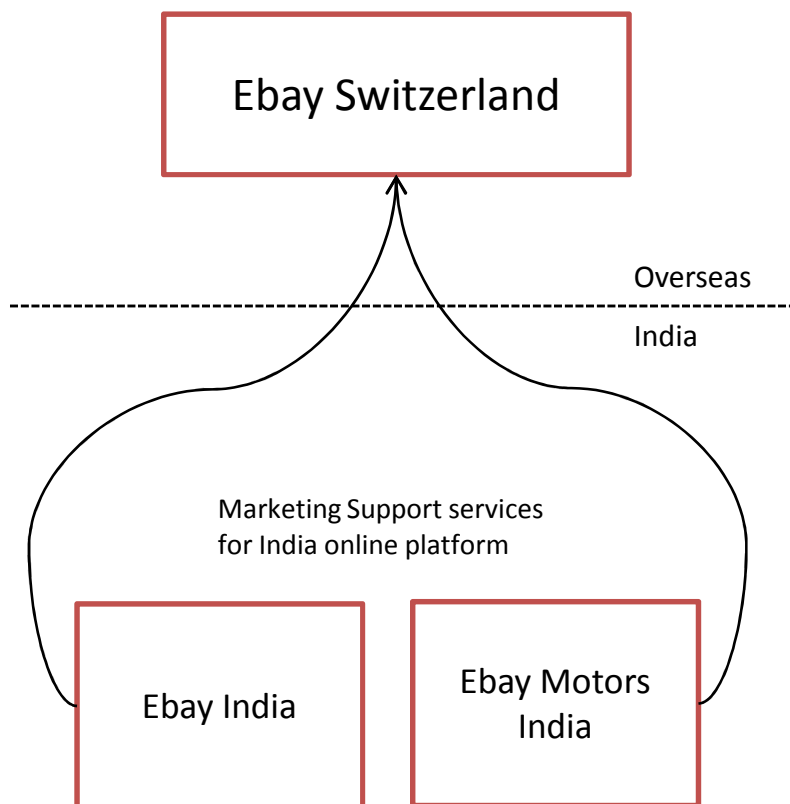
## (140 ITD 20) (Mum Trib)



### Facts

- The assessee is a tax resident of Switzerland which operates India specific websites, providing an online platform for facilitating the purchase and sale of goods and services to users based in India
- There were two websites.
- It used to charge “user fees” from the seller on successful completion of sale.
- For this purpose, it entered into a Marketing Support Agreements with Ebay India and Ebay Motors India
- Assessee claimed that revenue from Indian operations was in nature of ‘business profit’ and hence, taxable only in Switzerland under the Indo-Switzerland DTAA
- The AO however held that the amount was in the nature of ‘Fees for Technical Services’ and taxable on gross basis @ 20% u/s 115A.
- The AO also held that the assessee had a DAPE in India in the form of its two group companies, whose entire income was derived from services rendered to the assessee

## (140 ITD 20) (Mum Trib)

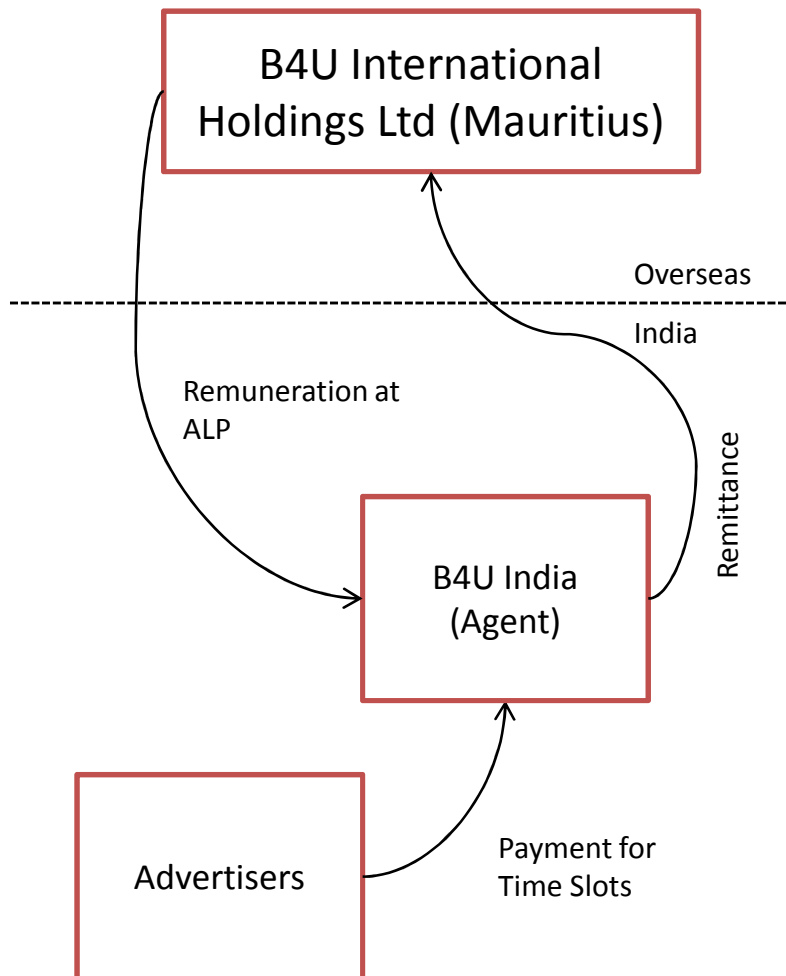


### Held – No DAPE

- Income of Assessee from India-specific websites not FTS
- Services rendered to online sellers by eBay Switzerland not 'managerial,' 'technical' or 'consultancy'
- Sale transactions carried out through websites operating outside India
- Indian group entities rendering marketing support services are 'dependent agents'
  - but not DAPes under Article 5 of Indo-Swiss DTAA as activities prescribed under tax treaties not carried out



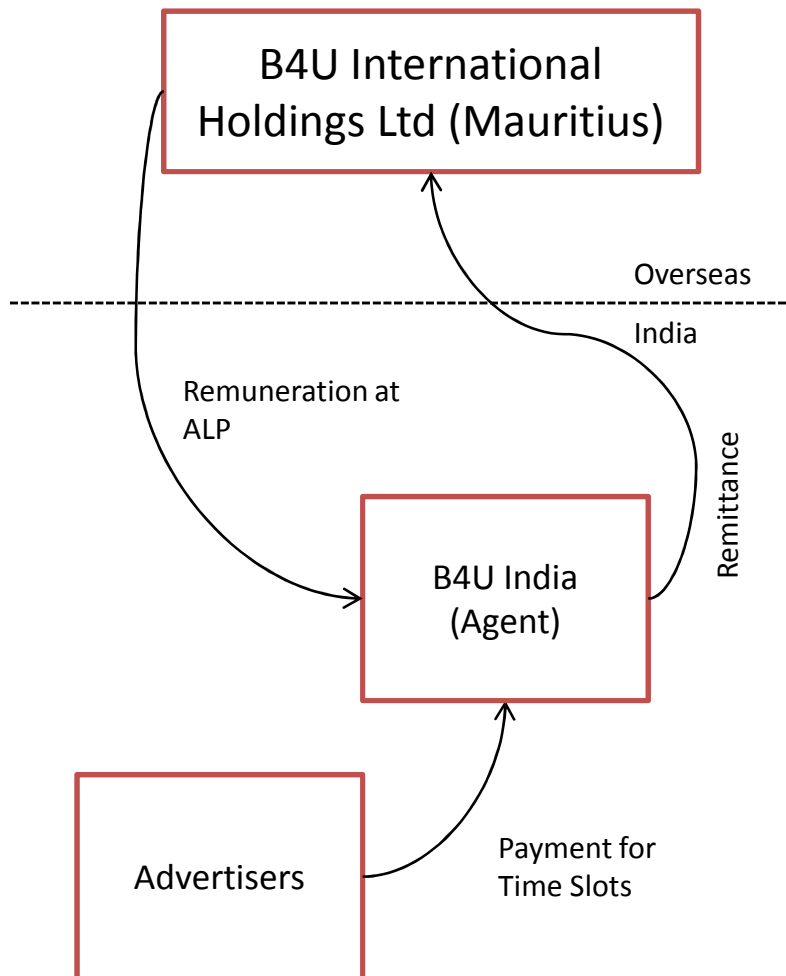
## ITA Nos. 1274 / 1557 / 1599 / 1621 of 2013 (Bombay HC)



### Facts

- The assessee's business is of telecasting of TV channels such as B4U Music, MCM etc in India.
- Income of the assessee from India consisted of collections from time slots given to advertisers from India through its agents
- The assessee claimed that the only activity which is carried out in India was incidental or auxiliary/preparatory in nature as per the direction of the principals without application of mind and hence not a DAPE.
- The Assessing Officer did not accept this contention of the assessee and held that affiliated entities of the assessee are basically an extension of assessee in India and constitute a PE

## ITA Nos. 1274 / 1557 / 1599 / 1621 of 2013 (Bombay HC)



### Held – No DAPE

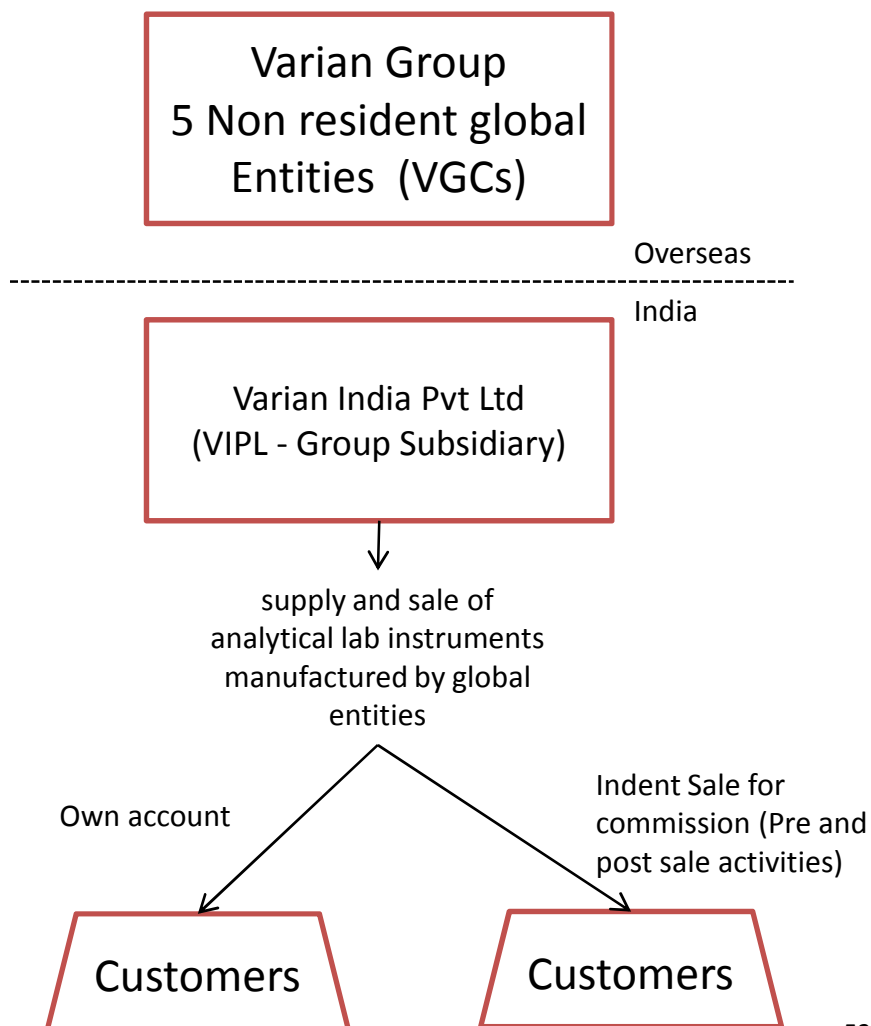
- ITAT also had agreed with contention of assessee
- The assessee was in compliance of with Central Board of Direct Taxes Circular No. 23 of 1969 and that it carried out the entire activities from Mauritius and all the contracts were concluded in Mauritius
- Only 4.69% of the total income of B4U India was commission/service income received from the assessee and, thus, it cannot be termed as an dependent agent.
- Further, assessee and B4U India were dealing with each other on arm's length basis. Hence no further, profit attribution.

## Article 5(8) – Subsidiary PE

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- Existence of Subsidiary in other state shall not by itself constitute either company a PE of the other
- Legal independence of the Subsidiary respected
- Test of disposal of premise of subsidiary / group entity to the Foreign Entity relevant
- Provisions of Article 5(1) to 5(7) relevant and mere presence / absence of subsidiary / group entity is of no relevance

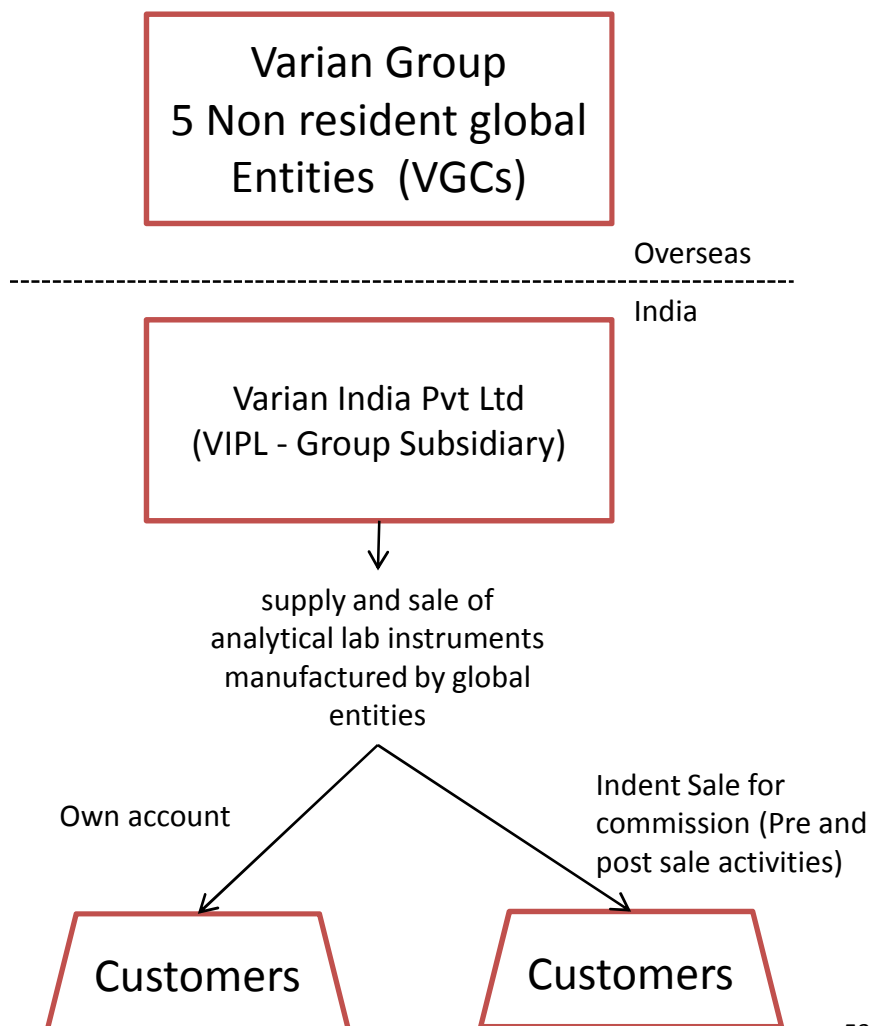
## 142 ITD 692 ITAT Mumbai



### Facts

- VGCs were 5 overseas entities in USA, Australia, Italy, Switzerland and Netherlands
- AO took a view that assessee was the dependent agent for 3 overseas companies, i.e. USA, Italy and Australia.
- Further, AO held that the "Force of attraction rule" would be applicable under India-US treaty
- The AO, therefore, applied the provisions of rule 10 of the IT Rules, 1962 to estimate the profit attributable to the PE in view of 'Force of Attraction Rule' and estimated 10 per cent of the operating profit from the business done in respect of those three companies.

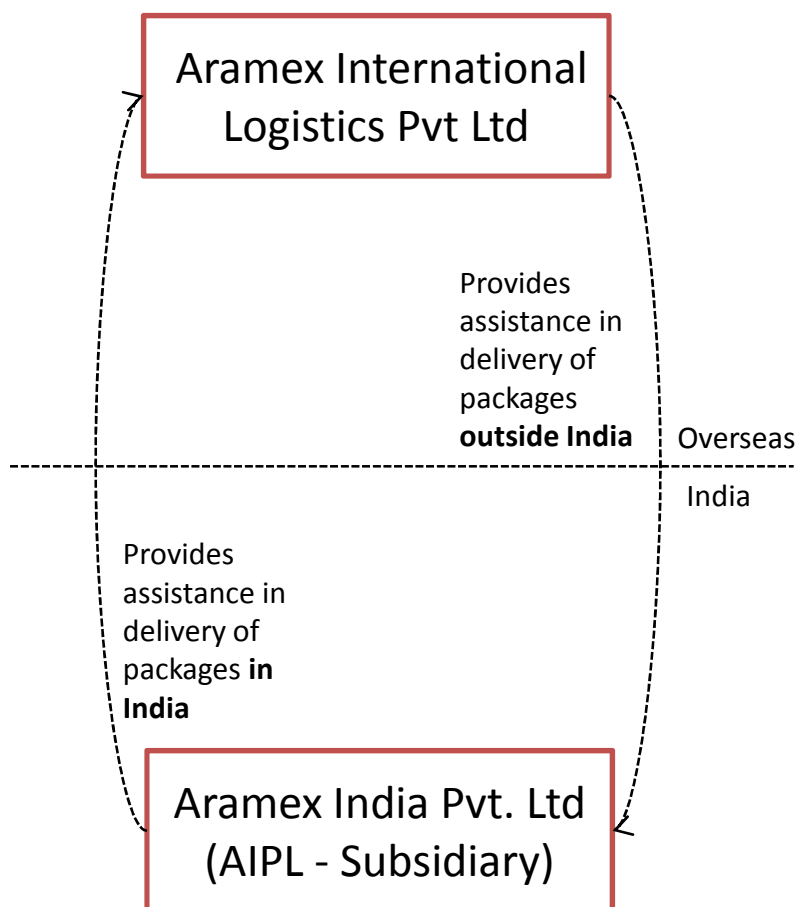
## 142 ITD 692 ITAT Mumbai



### Held – No PE

- ITAT rejected Revenue's contention that VIPL constitutes PE of US parent and overseas group companies
- Dependent agent conditions specified in Article 5 of the treaties with US, Italy and Australia not satisfied;
- No authority to negotiate or conclude contracts in India
- Assessee did not assume any risks or act wholly on behalf of the principal
- ITAT Rejected application of force of attraction rule in the absence of PE

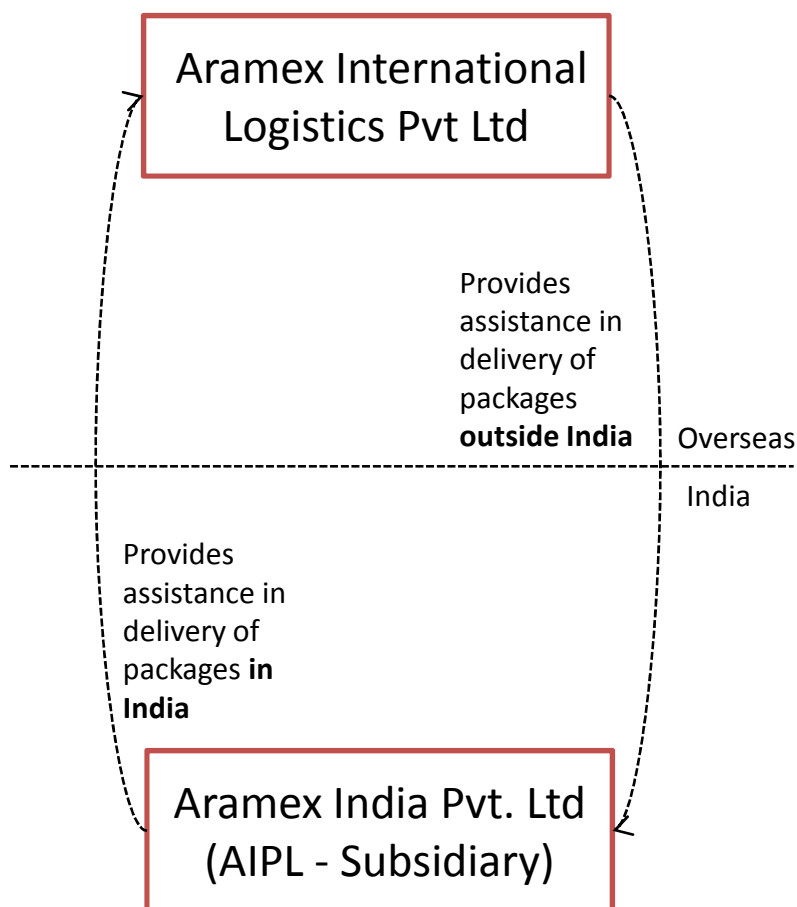
## 348 ITR 159 – AAR



### Facts

- The applicant, Singapore resident a part of Aramex group of companies.
- The applicant had to assist AIPL in delivery of packages outside India. Correspondingly, AIPL had to assist applicant in delivery of packages in India
- Applicant charged fees to AIPL in connection with invoicing and payment functions performed by it
- Applicant approached AAR for a ruling on whether payments received by it on account of activities conducted outside India in connection with the international express business, and fees received from AIPL in connection with invoicing and payment functions for carrying out obligations outside India were chargeable to tax in India

## 348 ITR 159 – AAR



### Held – Fixed Place and Subsidiary PE in India

- Business of the applicant and Aramex group in India is only carried on by AIPL
- AIPL obtains orders, collects articles, transports them to a specified destination so as to be taken over by the group and then delivered to the addressees in various countries through its entities in those countries
- 100% subsidiary created for purpose of attending to the business of the group in India creates PE for Aramex Group under India-Singapore DTAA
  - AIPL is fixed place of business through which the business of group is carried out
  - AIPL is mere "camouflage" for Group in India
- Receipts from outbound & inbound consignments attributable to PE in India held taxable



# Attribution of Profits





# Approach

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- Computation / Attribution of profits to PE - very difficult
  - Applying the provisions of the Act [Sec. 92F(iiiia) / 44DA]
  - Separate entity approach, Transfer Pricing Rules, CBDT Circulars, etc
- Specific provisions made in double taxation avoidance agreement would prevail over general provisions contained in Income-tax Act. Where there is no specific provision in the agreement, it is basic law, i.e., the Income-tax Act, that will govern the taxation of income. Circular No. 333 [F. No. 506/42/81-FTD] dated 2-4-1982

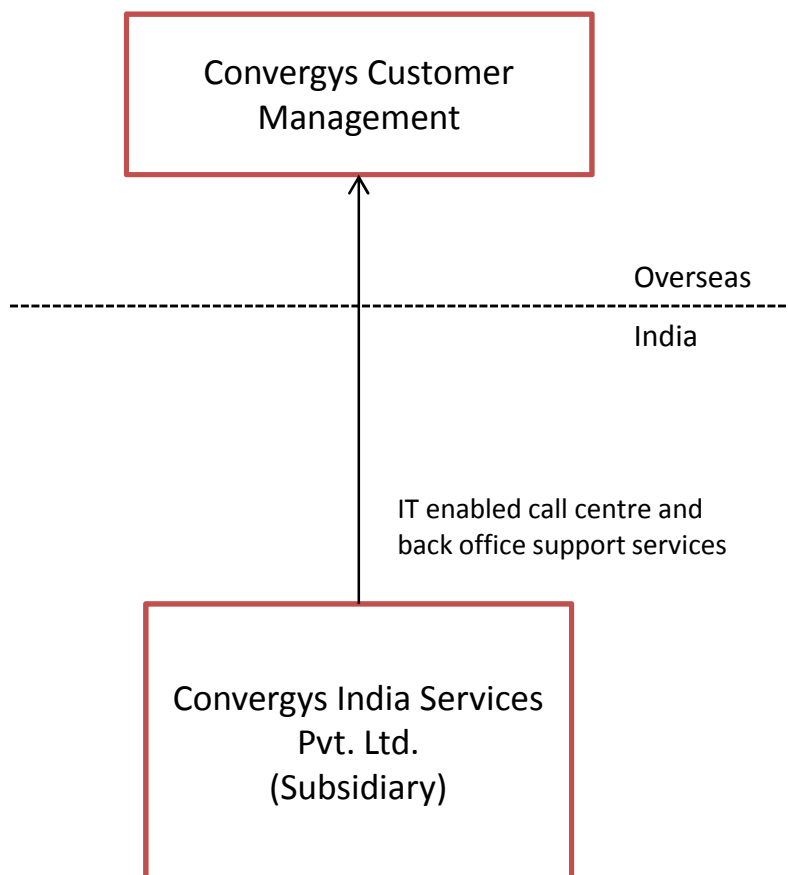
## Rule 10 - Determination of income in case of non-residents

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*10. In any case in which the Assessing Officer is of opinion that the actual amount of the income accruing or arising to any non-resident person whether directly or indirectly, through or from any business connection in India or through or from any property in India or through or from any asset or source of income in India or through or from any money lent at interest and brought into India in cash or in kind **cannot be definitely ascertained**, the amount of such income for the purposes of assessment to income-tax may be calculated :—*

- (i) at such **percentage of the turnover** so accruing or arising as the Assessing Officer may consider to be reasonable, or*
- (ii) on any amount which bears the same **proportion to the total profits and gains of the business** of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or*
- (iii) in such other manner as the Assessing Officer may deem suitable.*

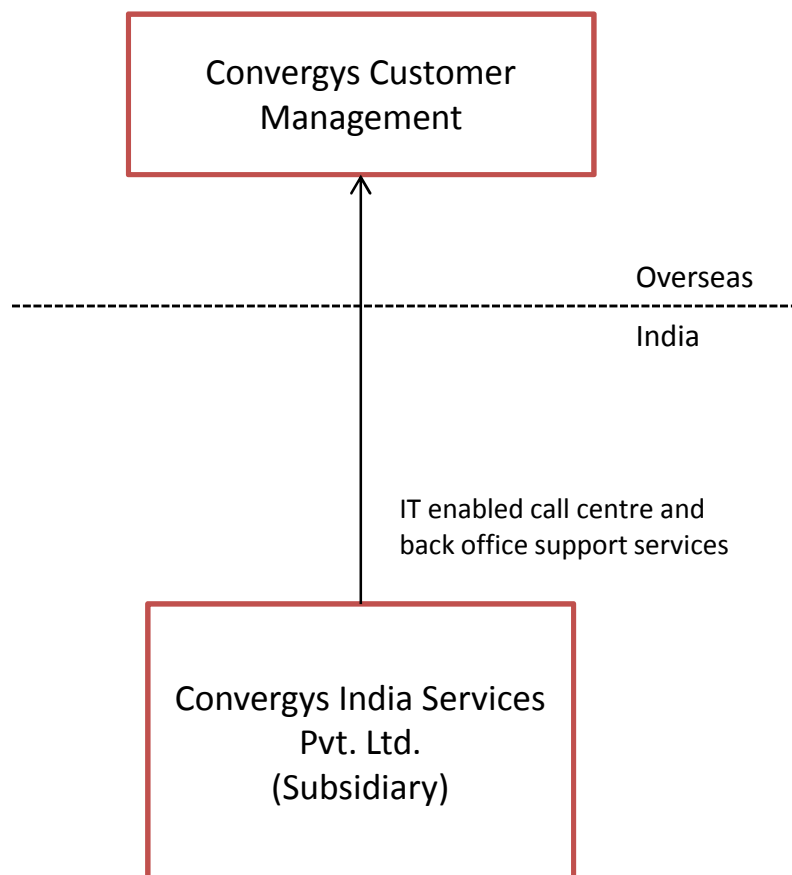
## 26 ITR 443 - Delhi Tribunal



### Facts

- The assessee is a US tax resident. Assessee has a subsidiary in India viz. Convergys India Services Pvt. Ltd. (“CIS”) which provides IT enabled call centre/back office support services to assessee
- AO held that the assessee created fixed place PE, Service PE and Dependent Agent PE in India
- AO stated that the premises of CIS were at the disposal of Convergys US and the business of Convergys US was carried on from such place.
- Further, CIT(A) held that CIS did not have either economic independence or functional independence in relation to functions. CIT(A) also confirmed existence of Service PE but held that there was no DAPE in India.

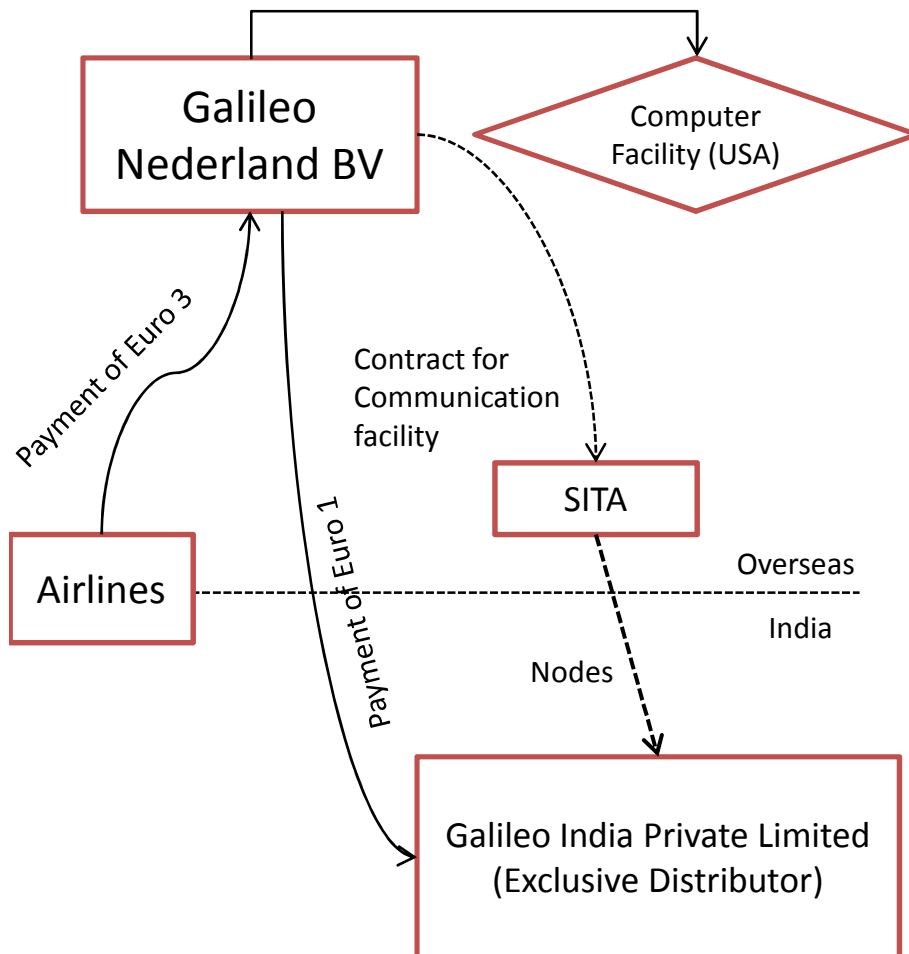
## 26 ITR 443 - Delhi Tribunal



### Held – Fixed Place PE in India

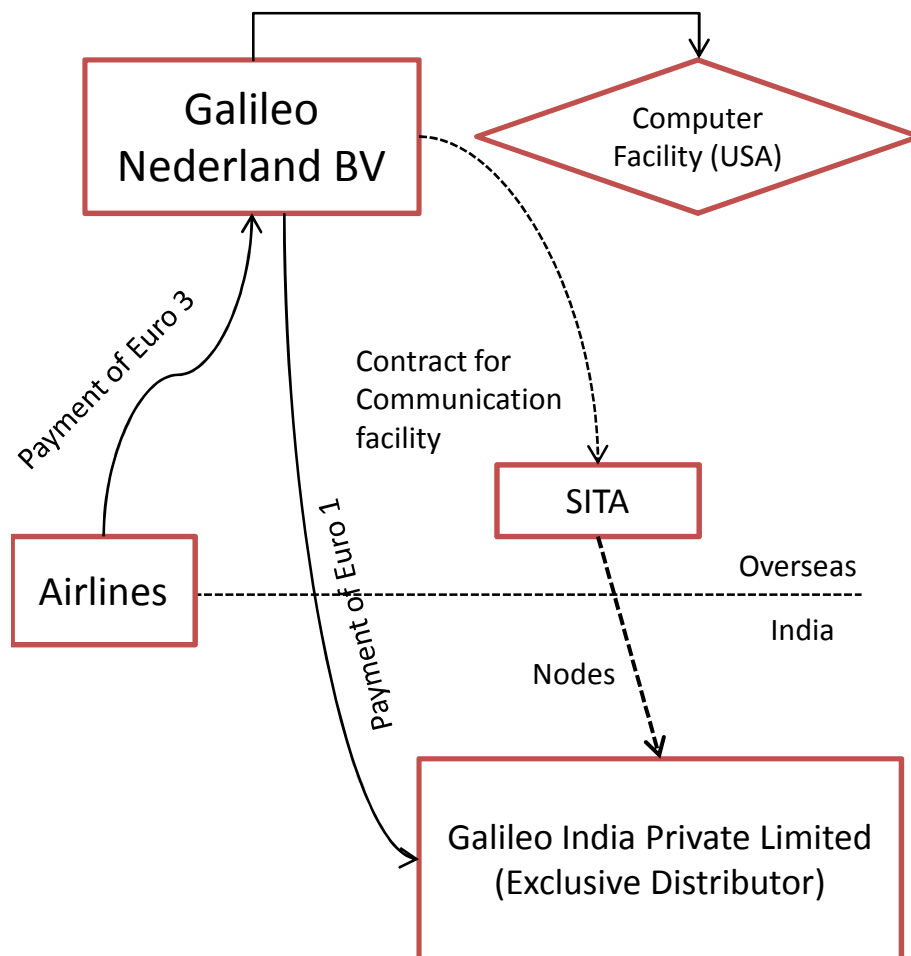
- CIS was a projection of Convergys US's business in India. Therefore, CIS is a fixed place PE.
- Revenue's profit attribution to PE by adopting global revenue of Convergys US in proportion of number of employees rejected;
- Adopted a 4 step process to arrive at profit attribution, starting with applying global profit percentage to end customer revenue from Indian operations.
- ITAT Concludes PE profit attribution by applying 15% of "residual profits" from Indian operations relying on earlier SC rulings and held that higher figure of 15% will meet the ends of justice

## (ITA No. 654/2012) dated 25 August 2014 (Del HC)

**Facts**

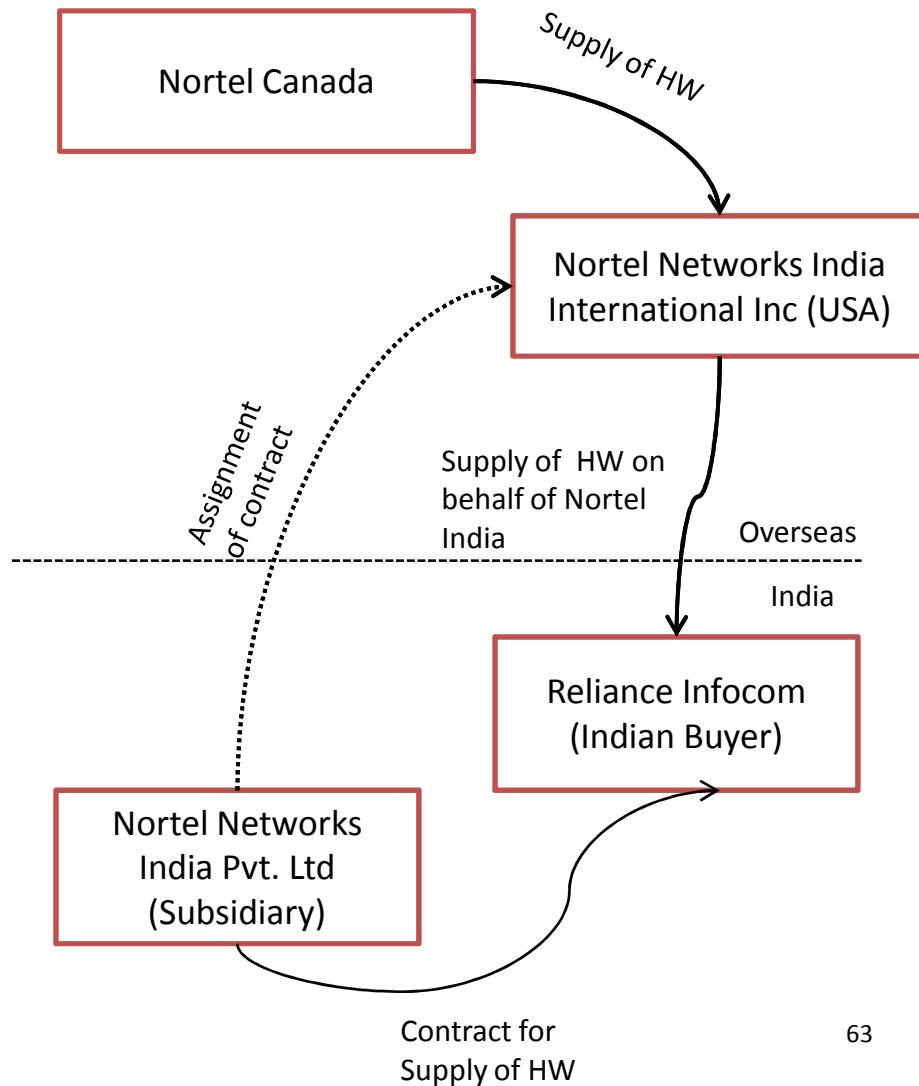
- Assessee, resident in Netherlands, was engaged in providing services to travel industry through Computerised Reservation System (CRS)
- Assessee did not physically carry any operations in India & did not engage or had employees in India
- Assessee had been paid by the airlines for worldwide booking services @ Euro 3 per booking and the same were received outside India Assessee had to pay @Euro 1 on each booking to the distributor in India
- AO held that major part of business activity of assessee leading to generation of profits was carried out in India.
  - AO held that 3/4<sup>th</sup> of profit generated from Indian operations was taxable in India

## (ITA No. 654/2012) dated 25 August 2014 (Del HC)

**Held – HC allowed assessee’s appeal**

- Rationale for decision:
  - Major functioning took place outside India.
  - Role performed in India was to merely get connected for booking function
  - Computers in India were not capable of processing data, which was processed abroad
  - Required huge investment and capacity, which was installed and available in USA.
  - Looking at nature and character of Indian functions, 15% was attributed to India
  - This worked out to Euro 0.45 which was less than the commission earned of Euro 1.
- Since AO failed to bring out new facts / data on record, co-ordinate bench rulings in assessee’s own case for earlier years followed
- HC quashed ITAT’s remand citing globalisation and directing AO to reconsider 15% attribution ratio, estimated 10 years back

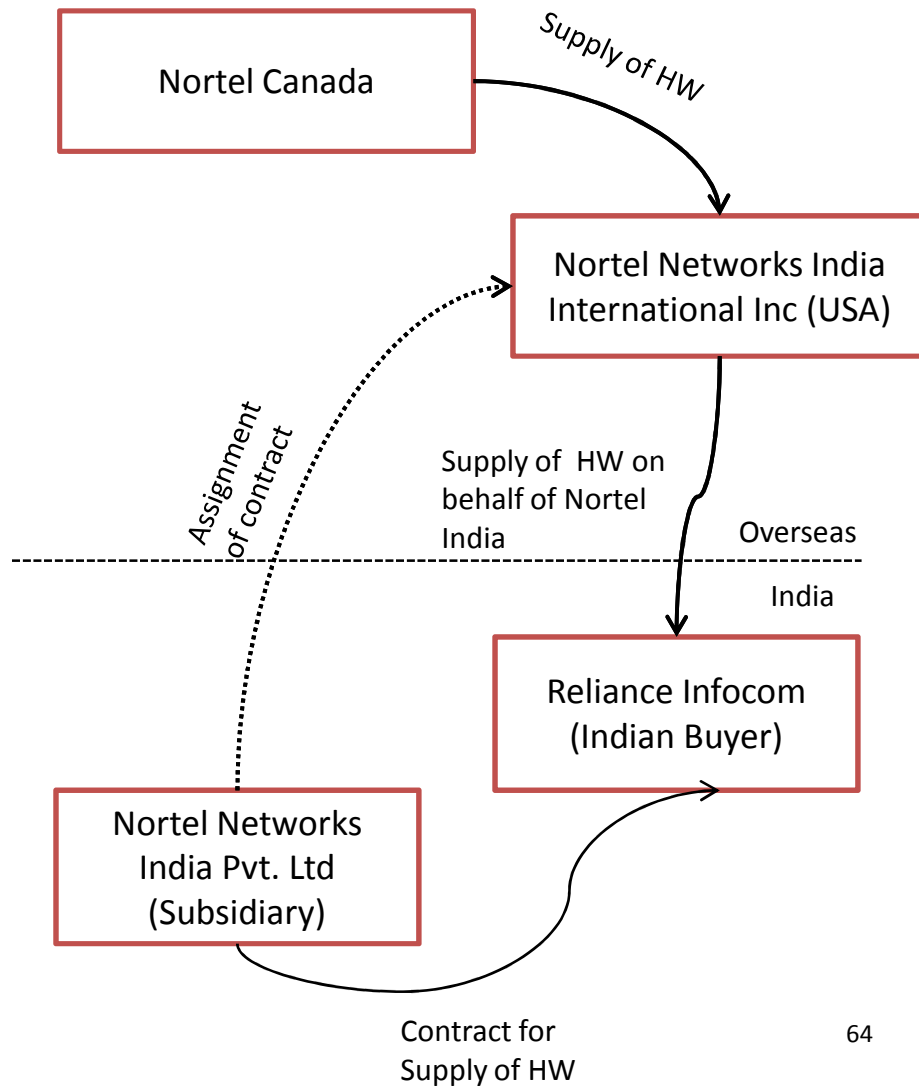
## (33 ITR 097) (Del Trib)



### Facts

- Indian subsidiary entered into contract with Indian buyer and immediately assigned contract to assessee without any consideration
  - Though hardware equipment supplied by assessee to Indian buyer (through purchase from Nortel Canada), its installation and commissioning was undertaken by India;
- Because assessee did not have manufacturing or trading infrastructure couple with the fact that it had shown a huge losses led AO to conclude that assessee was only a paper company incorporated for the sole purpose of evading taxes in India accruing to the Indian company from the supply
- AO held that Nortel India constituted assessee's PE in India (both Fixed place and DAPE) on the finding that consideration for equipment represent payment for work contract carried out in india by Nortel India

## (33 ITR 097) (Del Trib)

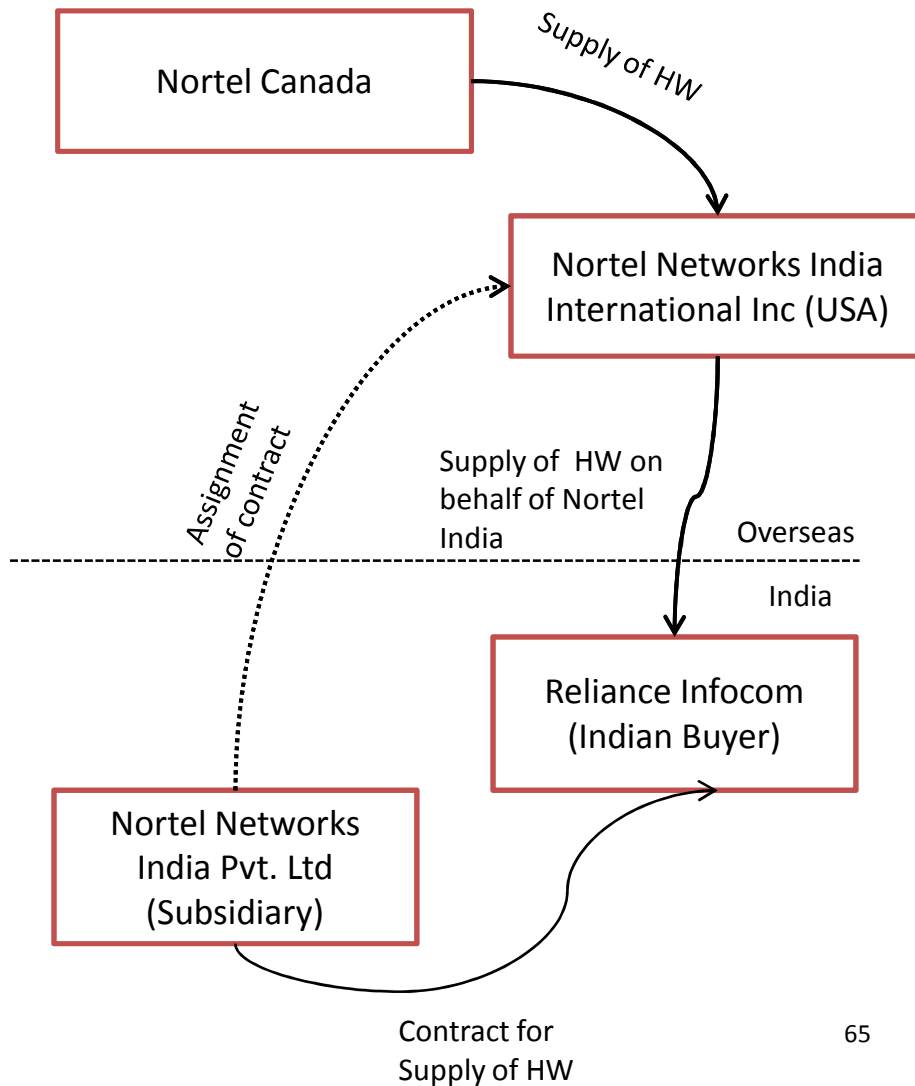


### Held – Indian Subsidiary is PE of Assessee

- Entire 'business enterprise' activities of assessee was managed by India PE and only requisite supply was made from abroad;
- Assessee was a mere shadow company, who gets its work executed through India PE
- Rejected assessee's contention that sales were completed overseas and installation was done under a separate contract, thereby no PE in India;
- As activities carried by India PE constitutes core activities resulting in income generation to assessee, rejected assessee's plea of carrying only preparatory/ auxiliary activities in India



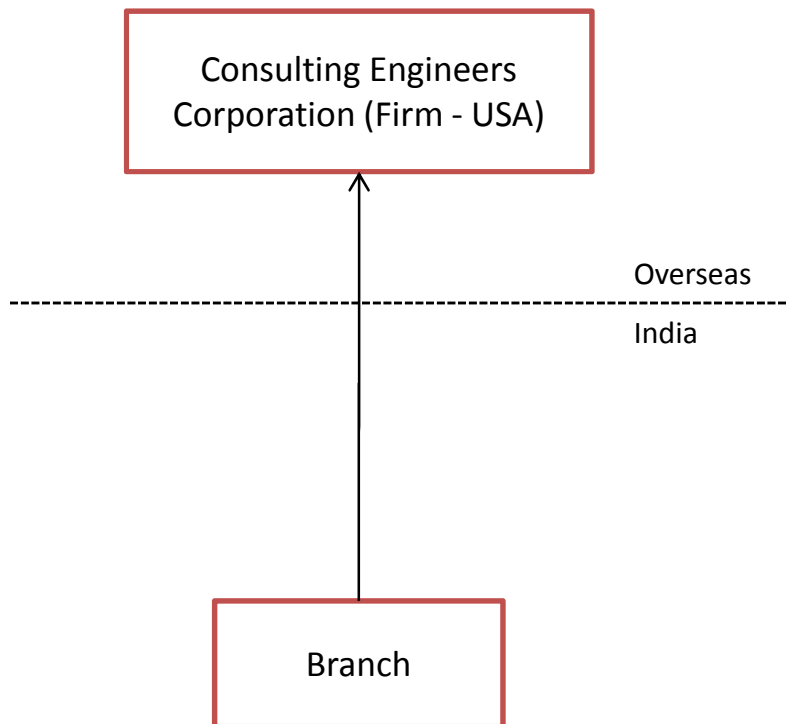
## (33 ITR 097) (Del Trib)



### Method of attribution of profits

- Global accounts of Nortel Group relied on
- AO's reference to GP margin of 42.6% accepted
- When profits are computed under rule 10 after applying the profit rate, the expenses pertaining to the PE have to be allowed as deduction.
- In this case, hardware supply contract was a part of the turnkey contract which involved supply, installation, testing and commissioning etc.
- Activities of Nortel India and that of LO of Nortel Canada and services of expatriate workers have also been taken as part of execution of work by the PE.
- Thus, from the gross profit computed by reference to the rate applicable to the global accounts of the assessee, further substantial deduction has been allowed for selling general and marketing expenses and also R&D expenses.
- Thereafter, 50% of the resultant figure has been attributed to PE. This meets the ends of justice.

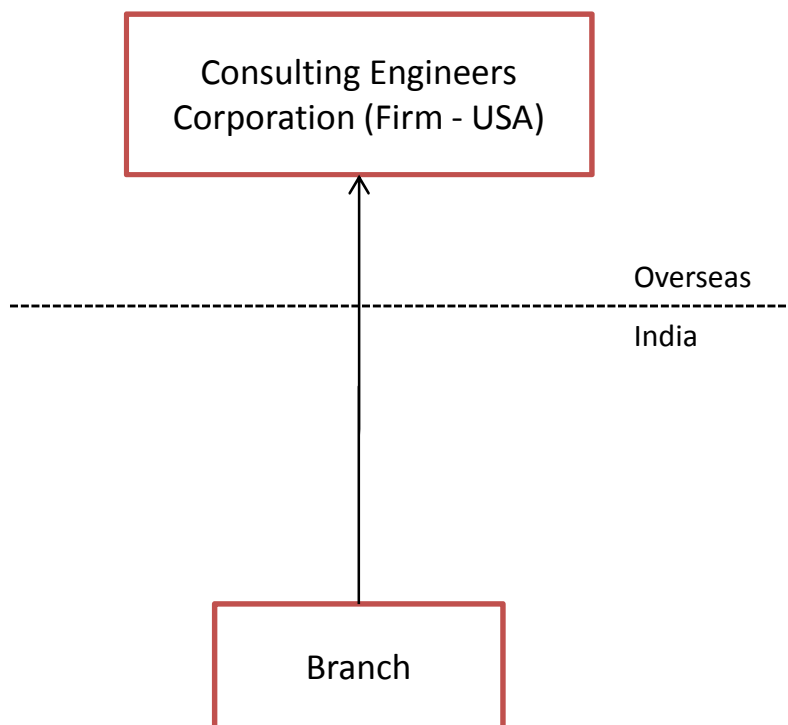
## (ITA No. 1597/Del/2009) dated 31 October 2014 (Del Trib)



### Facts

- Assessee was a non resident company and was subjected to reassessment proceedings u/s 147/148 of the Act.
- Assessee had a branch office in India. It claimed that no income is taxable in India as it was involved in preparatory and auxiliary activities.
- It had deployed 95 employees of high technical and managerial skills.
- AO held that assessee had a fixed place of business in India as PE, in the form of the said branch office.
- AO was of the opinion that assessee's business was carried out from its branch office and accordingly it constitutes PE and therefore, the income attributable to the operation carried out by the PE were taxable in terms of Article 7 of the Indo US DTAA.

## (ITA No. 1597/Del/2009) dated 31 October 2014 (Del Trib)



### Held

- BO formed 'fixed place' PE of its US HO
- Assessee carried preparation of drawing, designs and structural calculations by engaging highly technical and skilled professional and rejects assessee's stand that it merely carried preparatory / auxiliary services
- PE discharged main function of HO at low cost
- Accordingly it was a Fixed place PE.
- As regard to attribution, PE assumed some risk by providing development activities at cheaper cost;
- Upheld attribution of 50% of the profits determined by AO, by virtue of applying Rule 10, to the operations carried out by India PE

# Delhi HC ruling in case of Rolls Royce - [2011] 202 Taxman 309

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- Appellant, a UK company, was engaged in offshore supply of aircrafts engines & components to Indian customers and was having a subsidiary in India
- During survey operations at the premises of Indian Subsidiary in India, AO held that appellant had a PE in India and attributed 75 to 100 percent of the profits arising from offshore sale of goods to Indian customers to such PE
  - CIT(A) as such upheld the order passed by the AO
- ITAT upheld the order passed by the CIT(A) but reduced the attribution of profits to 35 percent as explained below:
  - Manufacturing operations for the offshore equipments supplied by the Appellant to Indian customers were undertaken outside India and 50 percent of the profits should be attributed to the territory in which such operations were carried out (i.e in UK).
  - Further, 15 percent of the profits were attributable to research and development activities undertaken by the Appellant outside India.
  - Balance 35 percent of the profits were attributable to marketing and selling activities undertaken by Indian subsidiary for the Appellant
- High Court upheld order of the ITAT

### Far from simple!

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- Determination of PE / No PE - complex proposition
- Computation / Attribution of profits to PE - very difficult
- Maintenance and Audit of Accounts for PE's operation
- Withholding of Taxes on payments for deductibility
- Overseas Employees liable to tax in Source State
- Payer liable for disallowance for payments to Foreign Company if
  - No withholding tax application made to Tax Officer
  - Many payers threaten 40% + SC + EC gross withholding
- Branch Office / Project Office more manageable scenarios as generally planned in advance

## Points to consider

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➤ **Issues which require special consideration**

- PE of e-commerce business – Right Florists Pvt Ltd (25 ITR 639) (Kol Tribunal)
- India's reservations and views on OECD Commentary on PE

Questions?

THANK YOU!



