

Permanent Establishment – Concept & Landmark Rulings

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Agenda

01

Introduction

02

Landmark Rulings on
PE

03

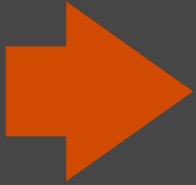
Q & A



Section 01

Introduction

Concept of PE



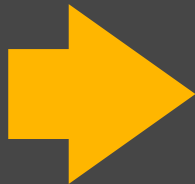
Importance of PE

The existence of a PE is necessary for a source country to tax business profits of a resident of another country



Is there a PE?

This is the most contentious and frequently confronted issue for multinational enterprises doing businesses in other countries which is being analysed more from substance perspective basis the business model



Implications of PE

- Results in taxability of resident of contracting state (foreign company) in the source state (in India) to the extent income attributable to the latter state (in India)
- Exposes the multinational companies to the compliance obligations in the source country

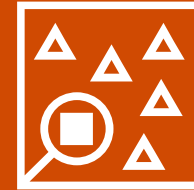
Types of PE- Overview of Article 5

Agency PE

Dependent agent carrying on specified activities

Installation/Supervisory PE

Building site, Construction, Assembly, Installation, Project



Fixed Place PE

Office, warehouse, place of management, equipment etc.

Service PE

Employees visiting India to render services

Virtual PE

In the era of digital revolution for e.g. India introduced SEP

Test of all PEs are independently applied UN and OECD MC – only for guidance, provision of Bilateral treaties to be seen

Fixed Place PE

Article 5(1)- PE means a fixed place of business through which the business of an enterprise is wholly or partly carried on

Article 5(2)- Spells out certain illustrations of PE viz. place of management, branch, office, premises used as sales outlet etc.



Essential characteristics of fixed Place PE

01

Disposal Test

There must be a 'place of business' at the disposal of foreign company (typically premises, equipment, etc.)

02

Permanence Test

The place of business must be fixed

03

Business Activity Test

The business of foreign entity must be carried on through the fixed place

Fixed Place PE



Disposal Test

- Unrestricted / discretionary access to a fixed place of business
- Foreign entity is in position to use premises as per the requirement
- Legal enforceable right not necessary
- PE can exist in business premise of another enterprise
- Disposal is the power to use the place of business directly



Business Activity Test

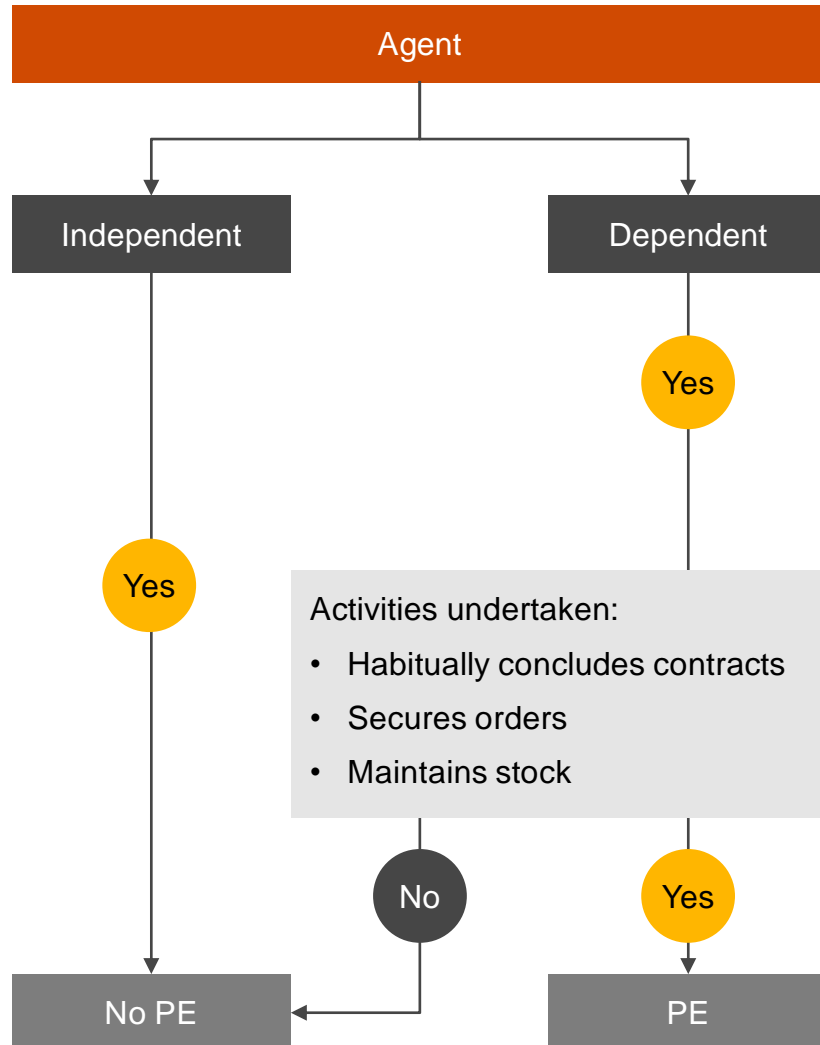
- Foreign enterprise must carry on its business at the place of business
- Activity carried out through place of business need not be of a productive character
- Activity should not be of preparatory or auxiliary character



Permanence Test

- “Permanent establishment: postulate existence of a **substantial element** of an **enduring or permanent nature** or everlasting eternally in nature without interruptions of a foreign enterprise in another country which can be attributed to a fixed place of business in that country.
- OECD/ International authors – Generally **Six** months’ period necessary to satisfy the permanence test
- Exceptions to 6 month:- **Recurrent nature** activities and **Exclusivity of business** in the other country
- PE to be seen project wise - commercially & geographically coherent project to be aggregated

Agency PE



- The primary test for an agency is the legal ability of the agent to bind the principal to a third party
- Independent agent – no PE
 - Legal independence – depending on control exercised by principle
 - Economic independence – entrepreneurial risk borne by principle/ number of principle
- A person will not be considered agent of an independent status:
 - When activities are devoted wholly or almost wholly on behalf of that enterprise;
 - Conditions are made or imposed which would have been made between dependent enterprises
- Only dependent agent constitutes a PE who,
 - Acts on behalf of an enterprise
 - Habitually concludes contracts on behalf of an enterprise
 - Maintains stock of goods from which he regularly delivers goods on behalf of the enterprise

Service PE

India's tax treaties provide that the Service PEs of foreign companies shall be deemed to be constituted in India if these enterprises provide services in the country **through their employees or other personnel** for a period exceeding the threshold delineated in specific tax treaties

Stewardship Activities

Having people on ground to protect own interest –
No Service PE should constitute



Secondment Issues

- Legal vs. economic employer
- Recharge Mechanism
- Fixed PE exposure



Fee for Technical Services

Specific exclusion from Service PE in many of India's tax treaties



Other Personnel

Services provided by personnel under the control of the foreign company in India



Man Days vs. Solar Days

Representation in India irrespective of number of people



Aggregation of Days

Activities of that nature vs. same or connected project



Installation/Construction/Supervisory PE

Building site, Construction, Assembly,
Installation/ project, exceeding the specified
threshold-

Being special
provision,
Construction PE
prevails over general
provision of fixed
place PE

Generally, PE to be
determined project
wise

Period to commence
when contractor
begins his work in the
country, including
any preparatory
work; temporary
interruptions to be
ignored; time of sub-
contractor to be
included; to continue
till work is completed
or permanently
abandoned

Duration of
site/project is most
important criterion
for construction PE

UN MC- 6 months;
OECD MC- 12
months

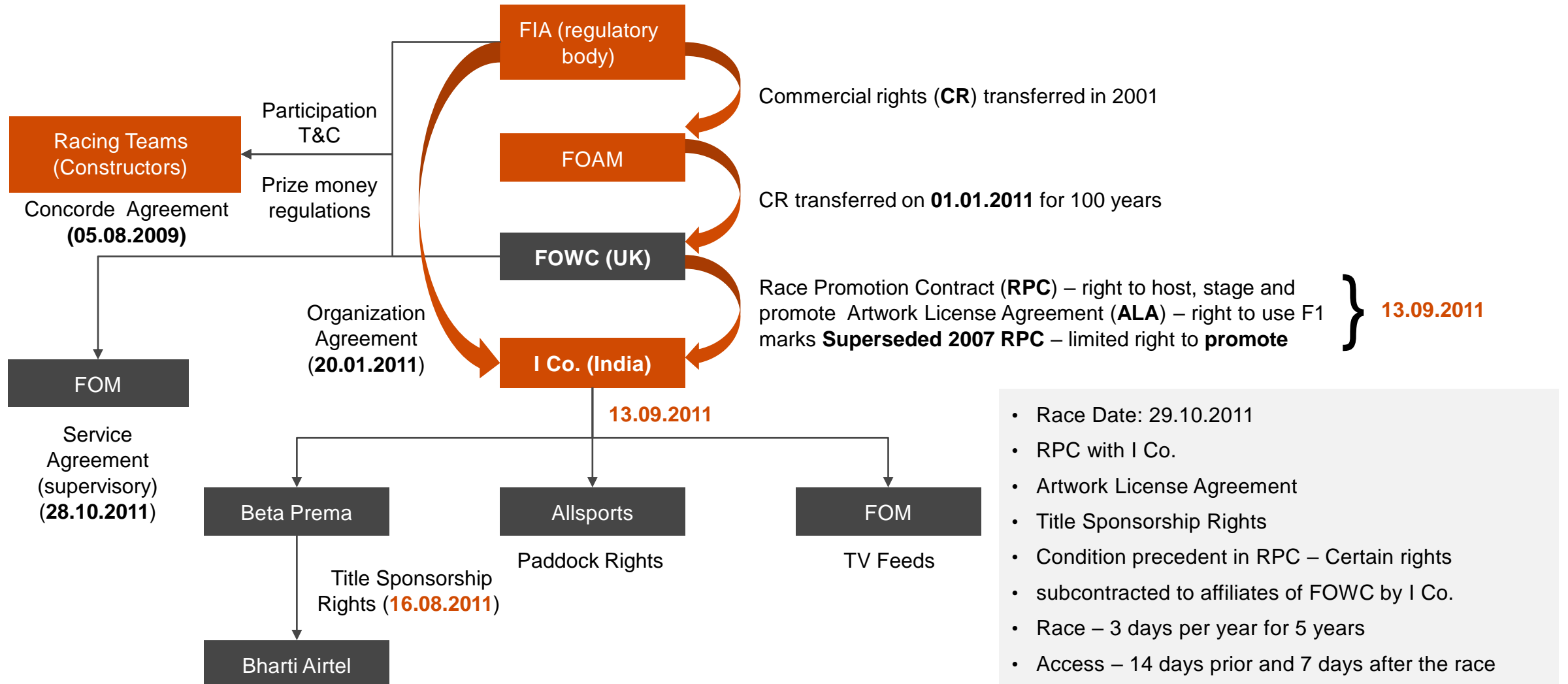
duration test
overrides
permanence test

commercially &
geographically
coherent project to be
aggregated even
though there may be
several contracts

Section 02

Landmark Rulings

Formula One World Championship Limited



Formula One World Championship Limited

Supreme Court (SC) decision based on peculiar facts of a racing event (of 3 days) involving multiple licensing/ sponsorship agreements

- Buddha International Circuit is a **fixed place**
- **Agreements to be read together** - to identify person with real and dominant control over the event
- **Physical control** of circuit with FOWC & affiliates from inception: Omnipresence of FOWC over event
- **Ownership of track or organizing other events by I Co. is immaterial.**
- **RPC Agreement leads to following inferences:**
 - FOWC is the **exclusive agency** through which circuit is introduced for an event - **exclusivity of activities**
 - Term of the RPC is **5 years - recurrent nature of activities**
 - FOWC had **access** to all material areas for 14 days prior and 7 days succeeding the event
 - I Co. to engage third party approved **by FOWC** for services of international feed
 - I Co. assigns to FOWC **all copyright and IPRs** in any image or visual footage
 - I Co. **prohibited from** causing, permitting, enabling or encouraging display of **advertisement**
 - Mere construction of the track by I Co. at its expense will be of no significance



The arrangement demonstrates that entire event was taken over & controlled by FOWC & affiliates: Disposal test fulfilled

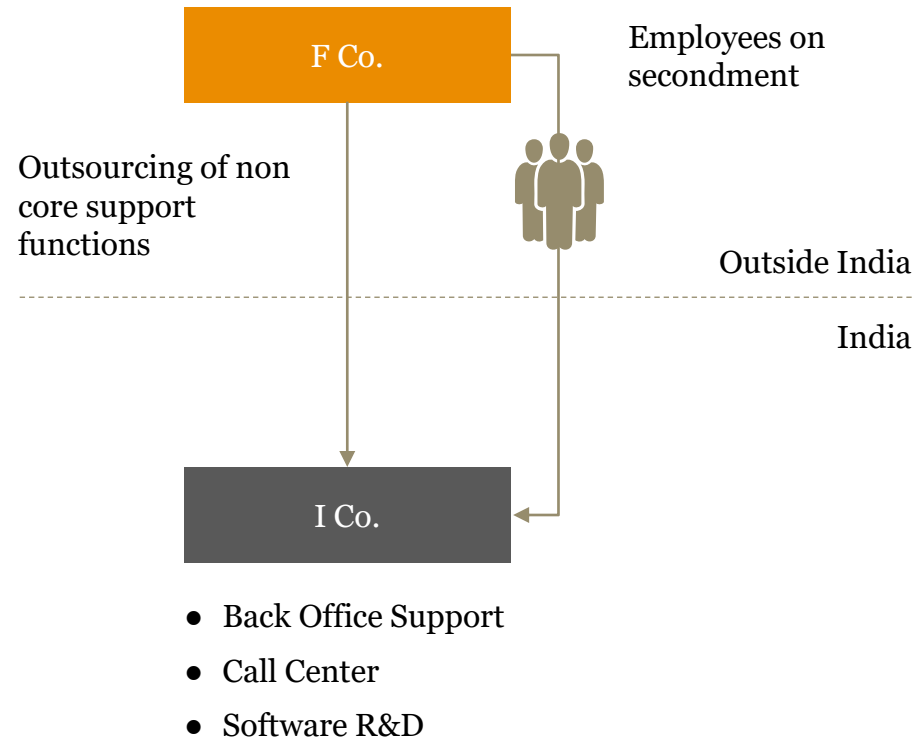
Formula One World Championship Limited

- **Permanence under Article 5(1) is to be tested vis a vis nature of business**
- Overall conduct of main entity and related parties to be considered – to see how business is carried on
- Teams competed in a race in the given place and after its completion moved to another locale where similar race is conducted
- The nature of activity is of **moving presence**
- Race by very nature is for limited time and **for entire duration, FOWC had full control over circuit.**
- **Period of the agreement being 5 years indicates repetition (conforms to HC view)**
- The **number of days** for which access is provided would not make any difference
- Referred HC ruling that: Per OECD & Klaus Vogel's commentary, as long as the presence is in a **physically defined geographical area**, permanence in such fixed place could be relative and having regard to the nature of the business, it is hereby held that the circuit itself constituted a fixed place of business (Para 70)



The nature of access and the period, although not exclusive is of a kind contemplated in Article 5(1)

E-Funds IT Solution Inc.



Brief Facts

- E-Funds Corp. and E-Funds IT Solution Inc. (F Co.) are US companies
- E-Funds Corp. indirectly holds E-Funds India (I Co.), its step down subsidiary
- F Co. carries out **4 types of business** outside India namely ATM management services, electronic payment management, decision support and risk management and global outsourcing and professional services
- Core services to the US customers were rendered by F Co.. However, F Co. outsourced certain auxiliary / support services to the I Co. These services were rendered by I Co through its employees in India
- Certain intangible software were also supplied free of cost to the I Co
- F Co. had also seconded a couple of employees to I Co only in one of the years


E-Funds IT Solution Inc.

Apex Court held that

- The support services performed by an Indian subsidiary, which enables the foreign company to render information technology (IT) and IT-enabled services to its client abroad, will not create a permanent establishment (PE) of the foreign company in India.
- The SC held that an Indian subsidiary did not create a **fixed place PE** of its foreign company in India unless the premises of the subsidiary were at the disposal of the foreign company.
- The SC also negated the possibility of **service PE** in India on the ground that none of the customers of the foreign company received any services in India.
- In relation to **agency PE**, the SC held that it has never been the case of the revenue that an Indian subsidiary was authorised to or exercised any authority to conclude contracts on behalf of the foreign company.
- The SC further held that even if the foreign company is held to have a PE in India, the transaction between the foreign company and its Indian subsidiary being at **arm's length, no further profits can be attributed in India.**
- Further, that the Mutual Agreement Procedures (MAP) agreement for an earlier year could not be considered as precedent for subsequent years.



Key takeaways

- 
- 01 PE issue ever evolving – divergent rulings
 - 02 Besides legal principles, focus on facts of the case and conduct of parties
 - 03 Updates like BEPS/ MLI to be kept in mind while analysing PE
 - 04 India's reservation on OECD



Section 03

Q & A

Thank you

Disclaimer

The views are personal and should not be considered as views of the organisation. Further, the discussion above should not be considered as professional advice on any matter.