

Business Connection & Permanent Establishment

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Agenda

- Introduction to the concept of Business Connection
- Introduction to the concept of PE
- Fixed Place PE
 - Place of Business
 - Fixed
 - Carrying on business
 - Illustrations of Fixed place PE prescribed vide Article-5(2)
- Installation PE
- Exclusions – Preparatory & Auxiliary
- Agency PE
 - Independent Agent
 - Dependent Agent as a PE
- Service PE
- Subsidiary as PE
- Force of Attraction Rule

What is Permanent Establishment and its importance?

Internationally, two basic principles of taxation are followed- the residence based taxation and the source based taxation.

When a resident of one country earns income from a source in another country, the possibility of double taxation arises because one country may tax that income on the source principle whereas the other country may tax it on the residence principle.

This is where the international tax concepts of PE and profit attribution come into play.

These determine the right of a country to tax the profits of a company that is the resident of another country.

Permanent establishment (PE) means having a taxable presence outside your company's state of residence.

Tax authorities are now going beyond the “bricks and mortar” definition, identifying PEs caused by overseas contractors, presence of personnel, warehouse space, digital activity and more.

Introduction to the concept of Business Connection

Section 9- Deemed Income

The following incomes shall be deemed to accrue or arise in India:—

- i. all income accruing or arising, 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 the **transfer of a capital asset situate in India**.

Section 9- Deemed Income

Explanation 1.—For the purposes of this clause—

- (a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is **reasonably attributable** to the operations carried out in India ;
- (b) in the case of a non-resident, no income shall be deemed to accrue or arise in India to him through or from operations which are **confined to the purchase of goods in India for the purpose of export** ;
- (c) in the case of a non-resident, being a person engaged in the business of running a **news agency** or of **publishing newspapers, magazines or journals**, no income shall be deemed to accrue or arise in India to him through or from activities which are confined to the **collection of news and views** in India for transmission out of India ;

Section 9- Deemed Income

(d) in the case of a non-resident, being—

- (1) an individual who is not a citizen of India ; or
- (2) a firm which does not have any partner who is a citizen of India or who is resident in India ; or
- (3) a company which does not have any shareholder who is a citizen of India or who is resident in India,

no income shall be deemed to accrue or arise in India to such individual, firm or company through or from operations which are confined to the **shooting of any cinematograph film** in India;

(e) in the case of a foreign company engaged in the business of mining of diamonds, no income shall be deemed to accrue or arise in India to it through or from the activities which are confined to the **display of uncut and unassorted diamond** in any special zone notified by the Central Government in the Official Gazette in this behalf.

Section 9- Deemed Income

Explanation 2 - For the removal of doubts, it is hereby declared that "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident,—

(a) has and **habitually exercises** in India, an **authority to conclude contracts** on behalf of the non-resident or habitually concludes contracts or **habitually plays the principal role** leading to conclusion of contracts by that non-resident and the contracts are—

(i) in the name of the non-resident; or

(ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or

(iii) for the provision of services by the non-resident; or

(b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or

Section 9- Deemed Income

(c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided that such business connection shall not include any business activity carried out through a broker, general commission agent or any other agent having an independent status, if such broker, general commission agent or any other agent having an **independent status** is acting in the ordinary course of his business :

Provided further that where such broker, general commission agent or any other agent works mainly or wholly on behalf of a non-resident (hereafter in this proviso referred to as the principal non-resident) or on behalf of such non-resident and other non-residents which are controlled by the principal non-resident or have a controlling interest in the principal non-resident or are subject to the same common control as the principal non-resident, **he shall not be deemed** to be a broker, general commission agent or an agent of an independent status.

Section 9- Deemed Income

*Explanation 2A—For the removal of doubts, it is hereby clarified that the **significant economic presence** of a non-resident in India shall constitute "business connection" in India and "significant economic presence" for this purpose, shall mean—*

- (a) transaction in respect of any goods, services or property carried out by a non-resident in India including provision of download of data or software in India, if the aggregate of payments arising from such transaction or transactions during the previous year exceeds such amount as may be prescribed; or*
- (b) systematic and continuous soliciting of business activities or engaging in interaction with such number of users as may be prescribed, in India through digital means:*

Provided *that the transactions or activities shall constitute significant economic presence in India, whether or not,—*

- (i) the agreement for such transactions or activities is entered in India; or*
- (ii) the non-resident has a residence or place of business in India; or*
- (iii) the non-resident renders services in India:*

Provided further *that only so much of income as is attributable to the transactions or activities referred to in clause (a) or clause (b) shall be deemed to accrue or arise in India.*

Section 9

Section 9 (1) specifies which income are deemed to accrue or arise in India

Section 9 (1)(i) states that:

all income accruing or arising,
whether directly or indirectly,

through or from any business connection in India

In the case of a business of which all the operations are not carried out in India,

the income of the business deemed to accrue or arise
shall be only such part of the income as is
**reasonably attributable to the operations carried
out in India**

Section 9 (contd..)

Business connection also includes any business activity carried out by a person on behalf of a foreign company, where the person:

has the authority to conclude contracts on behalf of the foreign company and exercises this authority.

habitually maintains a stock of goods in India and regularly delivers these on behalf of the foreign company

habitually secures orders for the foreign company or its group companies in India

TAKEAWAY – A view

Business activities: *There should be a real and intimate connection between the business activities of the foreign company and its activities in India, including business activities such as back office operations and support services, which do not constitute a PE in the country.*

CIT, Punjab v. R.D. Aggarwal & Co., CIT v. R.D. Aggarwal & Co [(1965) 56 ITR 20 (SC)]

- The firm carried on the business of import and export and was the commission agent of *inter alia*, for a Belgian and an Italian non-resident exporter of woollen yarn.
- Assessee later was the “sole agent” for Italian company, receiving 2.5% commission on cash amounts.
- No operation such as procuring raw materials, manufacture of goods etc. took place within India.
- The Revenue claimed that the profits that accrued or arose outside British India to the assessee by reason of business connection in British India.

CIT, Punjab v. R.D. Aggarwal & Co., CIT v. R.D. Aggarwal & Co [(1965) 56 ITR 20 (SC)] - DECISION

- The Supreme Court came to a conclusion that no business connection existed in that case because the contracts for the sale of yarn took place outside India, the price was received by the non-resident exporters outside India and the delivery was also given outside India.
- Some commercial activity was carried out within the territory, but “business connection” postulates a real and intimate connection between trading activity and taxable territories.
- The Supreme Court also emphasized on the requirement for continuity of business
Isolated events do not constitute a business connection

Held income not taxable.

Hind Energy & Coal Benefication (India) Ltd.

vs. ITO (IT&TP)

[2019] 179 ITD 388(Indore-ITAT)

The assessee company availed the services of an India agent to import coal from 4 different suppliers.

The ITAT held that the agent was engaged in providing similar services to various parties in and outside India.

As per sec 9(1) the agent cannot be termed as wholly and exclusively associated to any particular non-resident supplier, hence it does not constitute **business connection of the NR supplier**.

DCIT V. Vertex Customer Management Ltd.

[2016] 158 ITD 365 (Delhi-ITAT)

The assessee company is a tax resident of the UK.

It secures orders on orders on behalf of the Indian entity and then outsources the work to it.

The responsibility of the assessee is not done away with until the Indian entity has concluded the services.

The Hon'ble ITAT held that there was a real and intimate relationship between activities of assessee outside India and those inside India and, therefore, the **assessee had a business connection in India.**

ADIT(IT) V. Neo Sports Broadcast (P.) Ltd.

[2011] 133 ITD 468 (Mumbai-ITAT)

The assessee Co. entered into an agreement with Nimbus (a non-resident) to obtain a license to live broadcast of certain matches in India and a definite consideration has been paid by the assessee.

Nimbus continues to hold the rights over such broadcasts.

The Hon'ble ITAT held that the mere act of allowing the assessee by Nimbus to live broadcast the matches for a defined consideration, **would not constitute a business connection in India**, to constitute a business connection of a non-resident in India, it is imperative that **some sort of business activity must be done by the non-resident in the taxable territory of India.**

Adidas India Marketing (P.) Ltd. V. ITO

[2019] 111 taxmann.com 203 (Delhi-ITAT)

The assessee Co. was in the business of sourcing, distribution and marketing of products of brand name 'Adidas' in India.

The parent entity i.e. Adidas AG received an insurance claim from a German insurer for the decline in the value of the investments held in the Indian entity.

The decline in value was on account of the destroyed inventory situated in India.

Such claims were in respect of the intangibles in the form of financial interest in the assessee Co. and not in respect of the tangible property in the form of the stock of the assessee.

Hence, it does not constitute a business connection in India and such claims are not liable to tax in India.

Cushman & Wakefield(S) Pte. Ltd.
[2008] 305 ITR 208 (AAR)

The applicant is a tax resident of Singapore it is engaged in providing services in connection with the acquisition, sales, dealings in real estate and other services.

The applicant has an Indian subsidiary that is bound to pay referral commission to the applicant on the fees collected from the clients which were referred by the applicant.

The applicant cannot be said to have a business connection in India as per section 9(1)(i) of the Act.

Introduction to the concept of Permanent Establishment (“PE”)

Introduction to PE & Article 5 of OECD MC

- International taxation should be based on either political, residential or economic allegiance between the taxpayer and the taxing state.
- It defines the requisite level of nexus in a source country to support taxation of income at source
- A PE would amount to a virtual projection of the foreign enterprise in the other country

Article 5 of OECD MC

- Article 5(1) – Fixed place of PE / general rule PE
- Article 5(2) – illustrative list
- Construction site PE – Article 5(3)
- Excluded activities list – Article 5(4)
- Agency PE
 - Article 5(5) – dépendent agents a PE
 - Article 5(6) – independent agents not a PE
- Controlled companies – Article 5(7)
- ***Service PE & Supervisory PE***

Article 5 of the OECD and the UN Model Convention

OECD MODEL

- (1) "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
- (2) The term "permanent establishment" includes especially: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop, and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
- (3) A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

UN MODEL

- (1) "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
- (2) The term "permanent establishment" includes especially: a) a place of management; b) a branch; c) an office; d) a factory; e) a workshop, and f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.
- (3) *The term "permanent establishment" also encompasses:*
 - (a) *A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.*
 - (b) *The furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned.*

OECD MODEL

(4) The term "permanent establishment" shall be deemed not to include:

- a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character;
- f) the maintenance of a 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.

UN MODEL

(4) The term "permanent establishment" shall be deemed not to include:

- a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;
- c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity;
- f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs (a) to (e),

provided that such activity, or in the case of subparagraph (f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

Fixed Place PE

Fixed Place PE – Article 5(1) of OECD MC

- 'permanent establishment' means **a fixed place of business through which the business of an enterprise is wholly or partly carried on**
- Essential characteristics of fixed place PE
 - **Place of business** existence facilitates not only premises but a certain amount of spaces at its disposal which is used for business activities or in certain instances, machinery or equipment can constitute a place of business.
 - **Fixed** word means there should be a link between place of business and a specific geographical point to make it fixed. It doesn't mean actual fix to the soil.
 - **Carrying on** of the business through this fixed place of business.

The presence of Permanent Establishment is determined by applying the following test called BASIC RULE PE

- The Place of business test
- The Location test
- The Permanence test
- Disposal test
- The Business activity test

Place of business

Place of business

- Generally covers any premises, facilities or installations used for carrying on the business
- Should be at the **disposal** of the enterprise
- In some cases, even machinery, equipment or certain amount of space at disposal – but should be tangible equipment
- No formal legal right to use the place is required
- Need not be 'owned' by the enterprise
- Need not be used 'exclusively' by the enterprise
- May be situated in the business facilities of another enterprise. But it must be at the disposal of the enterprise

Fixed - Location Test

Location Test

- Place of business must be 'fixed'
- **Place of business may be treated as fixed due to:**
 - **Geographical location; or**
 - **Duration / time**
- Existence of a **link** between the place of business and a **specific geographical location** would be sufficient
- **Certain** degree of '**permanency**' or '**regularity**' required
- Something **more than casual** or occasional
- **Duration** of the place of business gives some indication but not conclusive
- Whether a place of business is 'fixed' or not - has to be judged against the background of all the circumstances

Geographical and Commercial Coherence

- **Both** geographical and commercial coherence are necessary, the fact that activities may be carried on within a limited geographical area should not result in that area being considered as a single place of business
- Painter works successively for series of unrelated contracts for a number of unrelated clients in a large building – geographic coherence but no commercial coherence – result is No PE (OECD MCC)
- Painter working on a single contract undertakes work throughout a building for single client – geographic and commercial coherence – result is PE (OECD MCC)
- A consultant working at different branches in separate locations pursuant to a single project for training the employees of a Bank – commercial coherence but no geographic coherence – result is no PE (OECD MCC)
- A consultant moves from one office to another within the same branch location pursuant to a single project for training the employees of a Bank – both commercial coherence and geographic coherence – result is PE (OECD MCC)

Carrying on business

Carrying on business

- For a place of business to constitute a PE the enterprise using it must carry on its business wholly or partly through it
- The **activity need not be of a productive character**
- Furthermore, the activity need not be permanent in the sense that there is no interruptions of operations, but operations must be carried out on a regular basis
- Human intervention required? - automatic vending machine
- Whether a website can constitute a PE

Article 5(2)

Article 5(2) – Illustrative list of PE"s

- Article 5(2) provides a illustrative list of examples, each of which can, prima facie be regarded as PE.
- permanent establishment" includes especially
 - a place of management
 - a branch
 - an office
 - a factory
 - a workshop
 - a mine, an oil or gas well, a quarry or any other place of extraction of natural resources
- **But even the examples provided above should meet the requirements of Article 5(1) in order to qualify as PE**
- **Activities in connection with exploration of natural resources are not included in extraction of natural resources. Hence it is governed by Paragraph 1 of Article 5.**

Few instances under OECD MTC

- **Own residential apartment** used by person to conduct its business activities at times can be considered as permanent establishment.
- **Services** like technical in nature, training, inspection, audit, painting, repair or maintenance are generally provided at premises of service recipient. Such provisions of services at recipient's premises is at times viewed as a place of business' of service provider on premises that service provider is under an obligation to provide the services.
- **Hotel rooms** using for undertaking business activities would considered as a place of business.
- **Maintenance of stock** or use of facilities for storage of goods is treated as 'preparatory or auxiliary in nature' and cannot be considered as place of business.
- The **golf course** can be regarded as a 'place of business' because the centre of income earning activities was at that particular place.

Installation PE

Article 5(3) of OECD MC – Installation PE

- A building site or construction or installation project constitutes a permanent establishment only if it lasts for more than twelve months.
- A building site or construction or installation project includes:
 - construction of roads, bridges or canals
 - renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals
 - Laying of pipelines
 - excavating and dredging
 - installation of new equipment in an existing building or outdoors
 - onsite planning and supervision of the construction of a building
- **An office or workshop, if part of a single project covered under Article 5(3), will not by itself constitute a PE under Article 5(1) but will be considered as part of the project**

Article 5(3) – UN MC and US MC

UN MC

- Article 5(3)(a) provides that the term „permanent establishment“ encompasses a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than **six months**

US MC

- Article 5(3) provides that a building site or construction or installation project, or an installation or drilling rig or ship used for the exploration of natural resources, constitutes a permanent establishment only if it lasts, or the exploration activity continues for more than **twelve months**

Supervisory Activities

- UN MC provides that supervisory activities in connection with a building site, a construction, assembly or installation project shall also be covered under Article 5(3)
 - OECD MC & US MC do not provide the same
- The pre-requisite for supervisory activity constituting a PE is that such activity should be carried out only in connection with a building site, a construction, assembly or installation project and not otherwise
- A PE is constituted if the supervisory activities exceed the time limit
 - It is immaterial whether the individual building site, a construction, assembly or installation project (in respect of which the supervisory services are rendered) meets the time test
 - Minimum threshold in case of supervisory activities covered under a separate and independent contract for the supervisory services must be considered from the date when such activities start and not from the date of commencement of the entire project

Assembly projects and Supervisory activities

- UN Model Tax Convention includes assembly projects and supervisory activities constitute as Construction PE. Assembly word was replaced by 'installation' in 1977 OECD Model Tax Convention.
- Putting together the pieces of pipelines in a desired manner would amount to assembly – **GIL Mauritius Holding Ltd v. ADIT [2011] (ITAT Mumbai)**
- Carrying out equipment to work site to safeguard from damage is only carrying out contractual obligations incidental to offshore supplies of goods - not supervisory activity.- **Hyosung Corporation v. DIT [2009]**
- Supervisory activities must be in connection with a building, construction or assembly activity. - **GFA Anlagenbau GmbH v. ADIT [2014] (ITAT Hyderabad)**
- The relevant clause of India's DTAA read as installation or assembly project or supervisory activities in connection therewith exceeding for a period of six months constitute construction PE regardless of person who performs such activity – held in **Steel Authority of India Ltd v. ACIT [2007] (ITAT Delhi)**

Installation PE – India’s tax treaties – An Overview of time threshold

Time threshold	Country(ies)
> 3 months	Norway
> 6 months	Australia, Belgium, Brazil, France, Germany, Italy, Japan, Ireland, Netherlands, Sweden, UK, Spain
> 120 days in any 12 months	USA, Canada
183 days in any fiscal year	China, Denmark, Singapore, Thailand
> 9 months	Korea, Hungary
> 12 months	Cyprus

Installation PE

Measurement of time period

- **A site exists from the date on which the contractor begins his work, including any preparatory work**, in the country where the construction is to be established (eg. a planning office is installed)
- It continues until the work is complete or permanently abandoned.
- A site should not be regarded as ceasing to exist when work is temporarily discontinued. Seasonal and temporary interruptions should be included in determining the life of a site – for example, due to bad weather, shortage of material, labour difficulties - OECD, Skaar, Klaus Vogel
- In some projects, due to its nature, contractor's activity has to be relocated continuously or at least from time to time, as the project progresses. For example –this would be the case for instance where roads or canals were being constructed, waterways dredged, or pipe-lines laid.

Installation PE

Measurement of time period – Some Issues

Multiple Sites / Projects

- **OECD Commentary** provides that the threshold time limit has to be determined separately for each individual site or project
 - Time spent previously on other sites or project (which are unconnected) should not be counted
- **The threshold limit applies to each site or project except where such sites or projects form a coherent whole commercially or geographically**
- No aggregation of duration if projects were separate (Even for same party)
- JDIT v Krupp Uhde Gnbh [2010] 41 SOT 240 [ITAT Mumbai]
- No aggregation of duration if projects were separate – Tiong Woon Project and Contracting Pte. Ltd. In re [2011](AAR)

Presence of sub-contractor

“If an enterprise (general contractor) **which has undertaken the performance of a comprehensive project** subcontracts parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.”

- OECD says to include such period
- What if entire contract is sub-contracted?
- Main contractor only does planning and supervision?

*OECD commentary suggested taking sub-contractors period into account for computing time threshold will be apply only in a situation where a building site has been set up by the contractor and the services of sub-contractor are also deployed in **aiding the execution of the building project** i.e., it applies to a situation where there is **conjoint effort** of both the contractor & sub-contractor at the building site. Thus, held no construction PE in invoked – [Pintsch Bamag, In re, [2009] 184 Taxmann 122(AAR)]*

Installation PE – Some Issues

- Activities may extend over more than one Calendar year or Assessment year
- Legal acts are excluded in calculating the time limit
- Trial run is included in the minimum period
- After sales services is either sufficiently connected with the building, installation or assembly work – PE
- Auxiliary services subsequent to a fully completed assembly or installation project – No PE

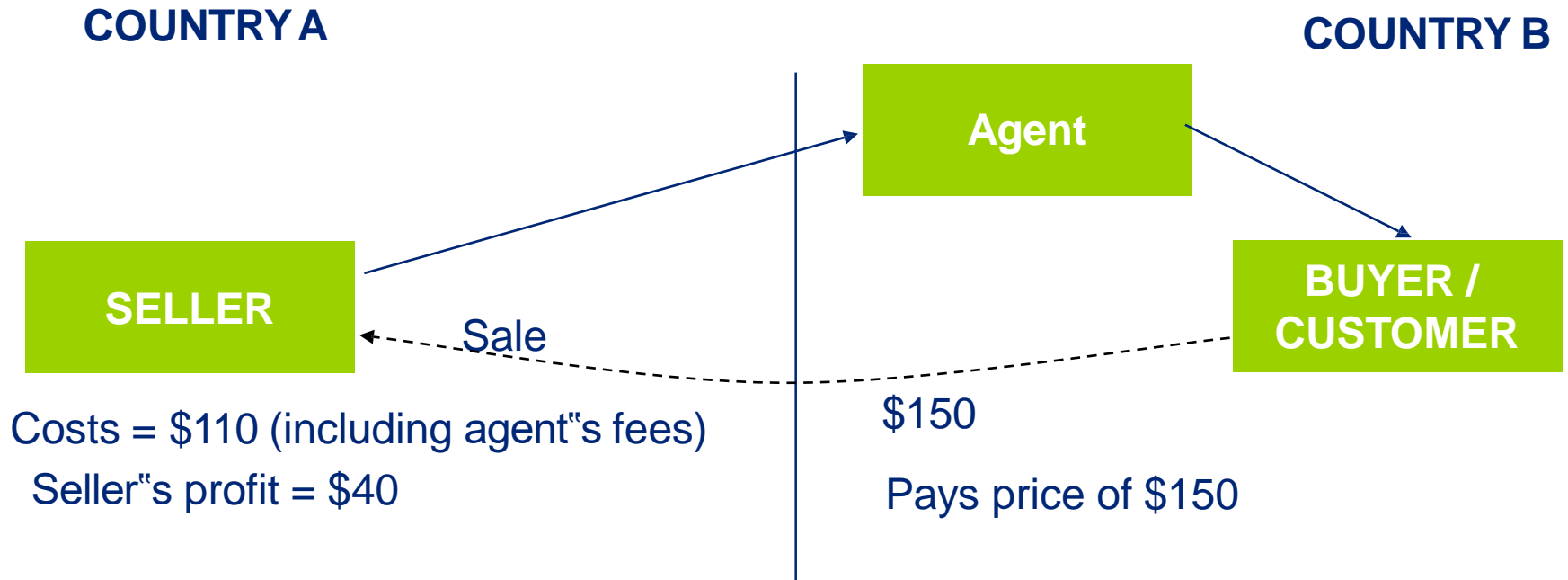
Exclusions

Article 5(4) – Exclusions

- An enterprise shall not be deemed to have a permanent establishment merely by reason of:
 - the **use of facilities solely** for the purpose of storage or display of goods or merchandise belonging to the enterprise;
 - the **maintenance of a stock** of goods or merchandise belonging to the enterprise **solely for the purpose of storage or display**;
 - the **maintenance of a stock** of goods or merchandise belonging to the enterprise **solely for the purpose of processing by another enterprise**;
 - the **maintenance of a fixed place** of business **solely for the purpose of purchasing goods** or merchandise, **or of collecting information**, for the enterprise; or
 - the **maintenance of a fixed place** of business **solely for the purpose of advertising**, for the **supply of information**, for **scientific research**, or for **similar activities which have a preparatory or auxiliary character**, for the enterprise

Agency PE

Agency PE –Basic concept



Question: Can country B tax part of seller's profit
→ Has seller an agency PE in country B

An enterprise should be treated as having a permanent establishment in a State if there is under certain conditions a person acting for it, even though the enterprise may not have a fixed place of business

Agency PE - OECD Model Convention

Article 5(5)

- A person
 - other than an agent of independent status;
 - acting on behalf of an enterprise;
 - habitually exercises an authority to conclude contracts in the name of the enterprise; and
 - such activities are not limited to preparatory or auxiliary nature

Article 5(6)

- Following persons acting in the ordinary course of their business shall not be regarded as constituting a PE of the foreign enterprise
 - a broker;
 - a general commission agent; or
 - any other agent of an independent status

Agency PE –Basic concept

- A person acting as a *dependent agent* will constitute a PE of the principal under certain conditions
 - Such person may be either individual or company and need not be residents of the source state
 - Deeming fiction: Contains non-obstante clause and will apply even if the enterprise does not have fixed place of business in the source state
 - To factor in a situation where business is done in the source state without personal presence but through some one representing (agent)
 - **Conditions precedent - All required to be satisfied:**
 1. There is a person;
 2. Such person is other than an agent of independent status as per Article 5(7) of UN MC
 3. He is acting on behalf of an enterprise;
 4. He is acting in the source State;
 5. He has an authority to conclude the contracts in the source state
 - He is habitually exercising such authority in the source state
 - In the name of the enterprise represented
 - The activities carried out are not of preparatory or auxiliary character
- OR**
5. Habitually maintains in State S the stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise

Judicial Pronouncements

- **Lubrizol Corporation, USA v. ADIT [2013] 33 taxmann.com424 (iTAT Mumbai)** wherein it was held that where Indian subsidiary only assisted in sale of products in India and did not have any authority to negotiate terms of sales or conclude contract on behalf of foreign company, it could not be considered as an Agency PE
- The **Delhi High Court in case of DIT v. E Funds IT Solution [2014] 42 taxmann.com 50** held that E-Funds India had provided necessary inputs to E Funds Corporation or E Funds Inc. to enable them to enter in to contracts which were later assigned to E Funds India, without any authority to conclude contract will not make F Funds India as Agency PE of taxpayer.

Judicial Pronouncements

- Taxpayer was engaged in supply & sale of analytical lab instruments directly to Indian customer manufactured by its parent. Taxpayer carried out pre and post-sale activities, like liasoning etc and entitled to commission. However, taxpayer had no authority to conclude or negotiate contracts, thus, did not constitute an Agency PE- held in **Variant India (P) Ltd v. ADIT [2014] 51taxmann.com404(ITAT, Mumbai)**
- OECD commentary provides that if a person who is authorized to negotiate all element & details of contract in a way binding on the enterprises can be said to exercise this authority 'in that state', even if the contract is signed by another person in the state in which the enterprise is situated or if first person has not formally been given a power of representation. Held in case of **Galileo International Inc v. DCIT [2008] 19 SOT 257 (ITAT Delhi)** and **Amadeus Global Travel Distribution SA v. DCIT [2008] 113 TTJ 767 (ITAT Delhi)**

Independent vs Dependent Agent

Factors to determine independent or dependent agent

- Economic / legal independence
- Ordinary course of business
- Activities - wholly or almost wholly on behalf of that enterprise
- Transactions on arm's length basis

The condition for existence of Agency PE needs to be ascertained from perspective of agent & not from principal's perspective because the agent is required to be dependent upon the principal & not vice versa. Held in case of **DIT v. B4U International Holdings Ltd [2015] 57 Taxmann.com 146(Bombay HC)**

‘Securing of Order’ constitute Agency PE

There is no guidance available either in OECD or UN in this regard but the same is generally found in DTAA / Protocol signed by developing countries like India or domestic laws [**Explanation 2 to section 9(1)(i) of the Income Tax Act 1961.**]

The Technical explanation to India-US DTAA mentions the following criteria to be fulfilled to satisfy the ‘securing of order’ clause:

Diplomatic notes exchanged at the time of signing of DTAA explains that in order for an agent to be treated as habitually securing orders wholly or almost wholly for the enterprise all of the following tests must be met:

- 1. The agent frequently accepts orders for goods or merchandise on behalf of the enterprise.*
- 2. Substantially all of the agent’s sales-related activities in the other Contracting state consist of activities for the enterprise.*

‘Securing of Order’ constitute Agency PE

- 3. The agent habitually represents to persons offering to buy goods or merchandise that acceptance of an order by the agent constitute the agreement of the enterprise to supply goods or merchandise under the terms & conditions specified in the order.*
- 4. The Enterprise takes actions that give purchasers the basis for a reasonable belief that such person has authority to bind the enterprise.*

In the case of **Rolls Royce Plc v. DIT [2011] 339 ITR 147 (Delhi HC)**, the taxpayer was having office of UK incorporated subsidiary in India who procure orders, organising event, conference in India etc. & as a practice no customers in India send their orders directly to taxpayer but has to be routed only through subsidiary. Accordingly, it was held that an Agency PE is created.

KnowerX Education (India) Pvt Ltd, In re [2008] 170 Taxman 98 (AAR)

Service PE

Concept of Service PE

- A Service PE could be constituted in India where any enterprise:
 - Renders / furnishes / provision of services in India (other than fees for technical/ included services)
 - to third party/ associated enterprises
 - through employees or other personnel
 - for a specified period

Checklist for determining existence of Service PE

Criteria	Check
Furnishing services other than Royalty / FTS	√
Services through employees or other personnel within state	√
No. of days the employees or other personnel furnishing services in India	√
Test of employment whether of the foreign company or Indian company	√
Service PE vis-à-vis Activities falling within Negative List of PE [i.e. preparatory and Auxiliary activities – Article 5(4) or combination thereof]	√

Comparison

Requisite period or Revenue Test to constitute service PE	UN Model	OECD Model	US treaty	UK treaty
Services rendered to Unrelated Enterprise	183 days	183 days	90 days	90 days
Services rendered to Associated Enterprise	183 days	183 days	1 day	30 days
Revenue test	No	More than 50% of gross revenue attributable to active business activities of the enterprise during the period	No	No

Number of days presence in different treaties

India's treaty with	No. of days	
	AE	Non-AE
Australia, Canada	One day	90 days
Singapore, Swiss Confederation, UK	30 days	90 days
USA	One day	90 days
China	183 days	
Namibia	Six months	
Sri Lanka, Syrian Arab Republic, Thailand, Botswana	183 days	
Saudi Arabia	182 days	
Iceland, Nepal	90 days	
Norway	6 months	
UAE	9 months	

* FTS clause is absent in India's tax treaties with Belgium, Brazil Malaysia, Mauritius, etc.

Service PE – Some Issues

Computation of No. of days, month etc.

- Computation of number of months - Calendar month or 30 days period?
 - Definition of “a month” – Section 3(35) of General Clauses Act, 1897 – as per British Calendar
 - Most DTAA's provide exact number of days
 - More appropriate to interpret month as a period of 30 days
- Multiple counting
 - Multiple counting of common days should be avoided
- Period of stay spread over 2 financial years - PE in which year?
 - Period exceeding the threshold but falling under two financial years would not prevent a PE from coming into existence
- Rendering of Service Vs Furnishing of services - **Linklaters LLP v. ITO [2010] 40 SOT 51 (ITAT Mumbai) & Linklaters Paines v. DCIT, [2014] (ITAT Mumbai)**

Secondment/Deputation of employees or other personnel

Key aspects

Whether Service PE?

- Nature of Services
- Employment Contract
- Economic Employer
- Meaning of “other personnel”
- Computation of number of days

Typical features of a Secondment

- An employee of enterprise X in State R is deputed to enterprise Y in State S
- Employee continues on the payroll of enterprise X
- Employee resides and renders services in State S
- Employee reports to enterprise Y
- Supervision, control and management of employee is with enterprise Y
- The employee may continue to be paid by enterprise X who in turn is reimbursed by enterprise Y
- Right of lien is on enterprise X

Subsidiary as PE

Subsidiary & PE

Principle

- The existence of a subsidiary company does not of itself, constitute that subsidiary company a PE of its parent company
- Mere existence or possibility of existence of close relationships is not sufficient to constitute PE

However,

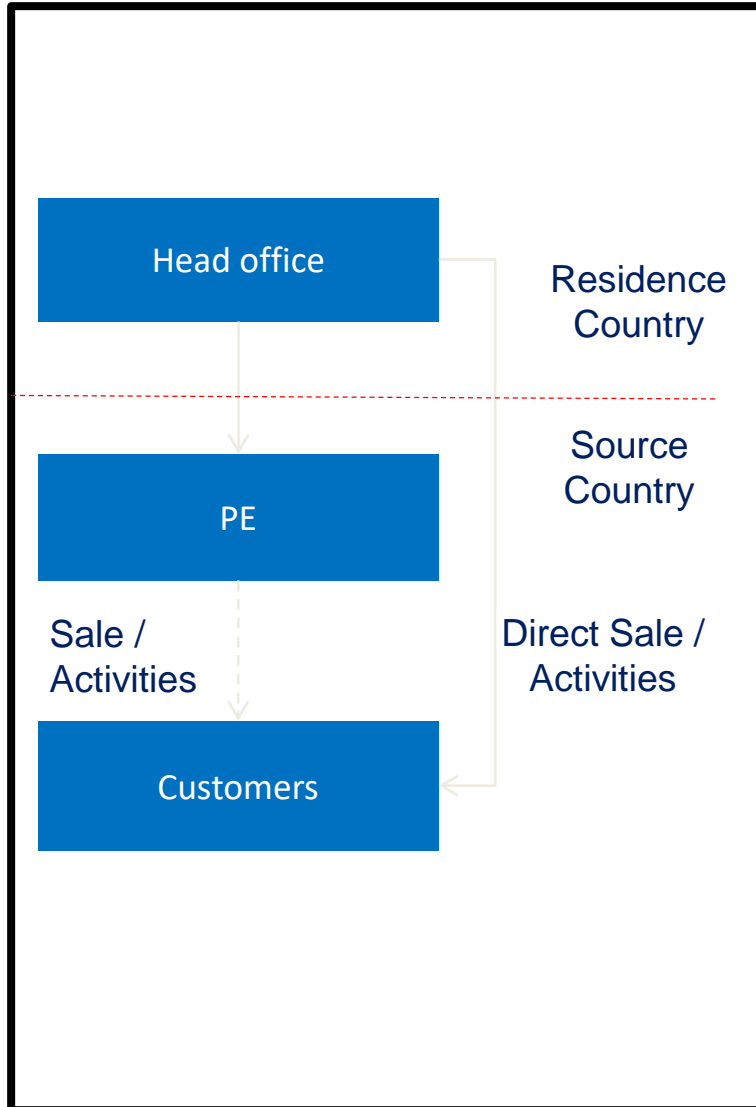
- A subsidiary company will constitute a PE for its parent company under conditions of paragraph 5 (contract concluding agent)

Whether a subsidiary becomes an Agency PE on account of parent's ownership of the share capital?

- In relation to the test of legal dependence, the control which a parent company exercises over its subsidiary as a shareholder is not a relevant consideration for determining the dependency of the subsidiary.

Force of Attraction

Force of Attraction - Concept



Principle of Force of Attraction primarily concerned with taxation of business profits in Source country

Rationale:

- Prevent tax evasion / avoidance through artificial contracts / business arrangements
- Identification of business transactions - source based taxation

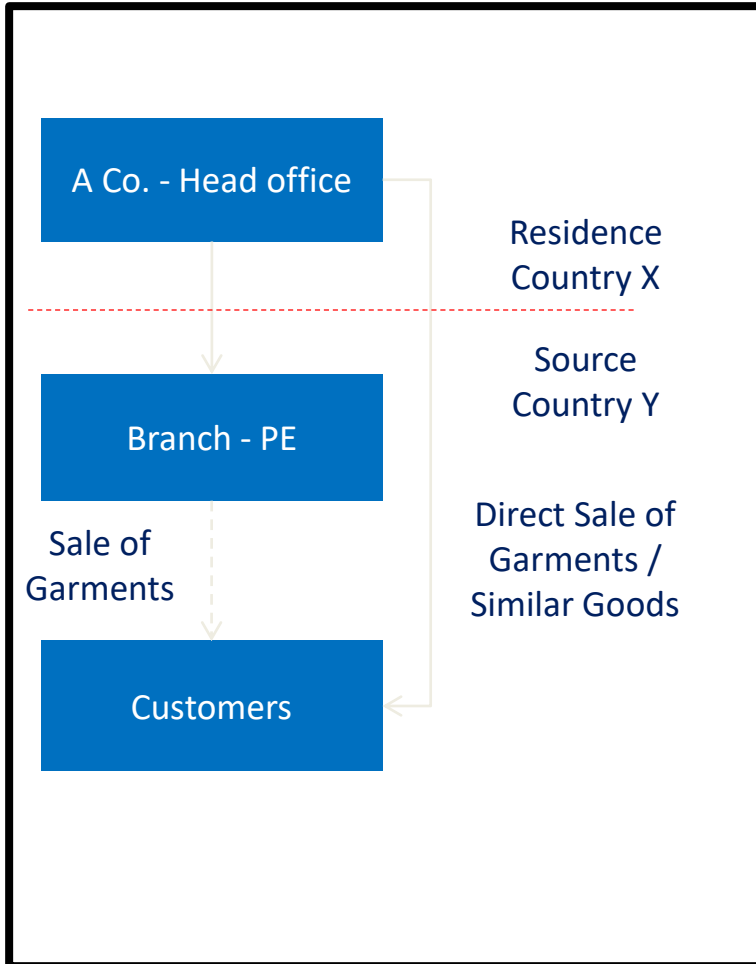
Types of Force of Attraction

Full force of Attraction: All profits derived in Source State taxable as profits of the PE whether or not through PE

Limited Force of Attraction: Profits derived through PE as well as profits from sale of goods / activities same or similar to that of PE directly carried out by the HO in the Source country taxable as profits of PE

No Force of Attraction: Only profits derived through PE taxable

Case Study (1/4)



ACo., resident of Country X, has Branch in Country Y

Branch sells garments to customers in Country Y

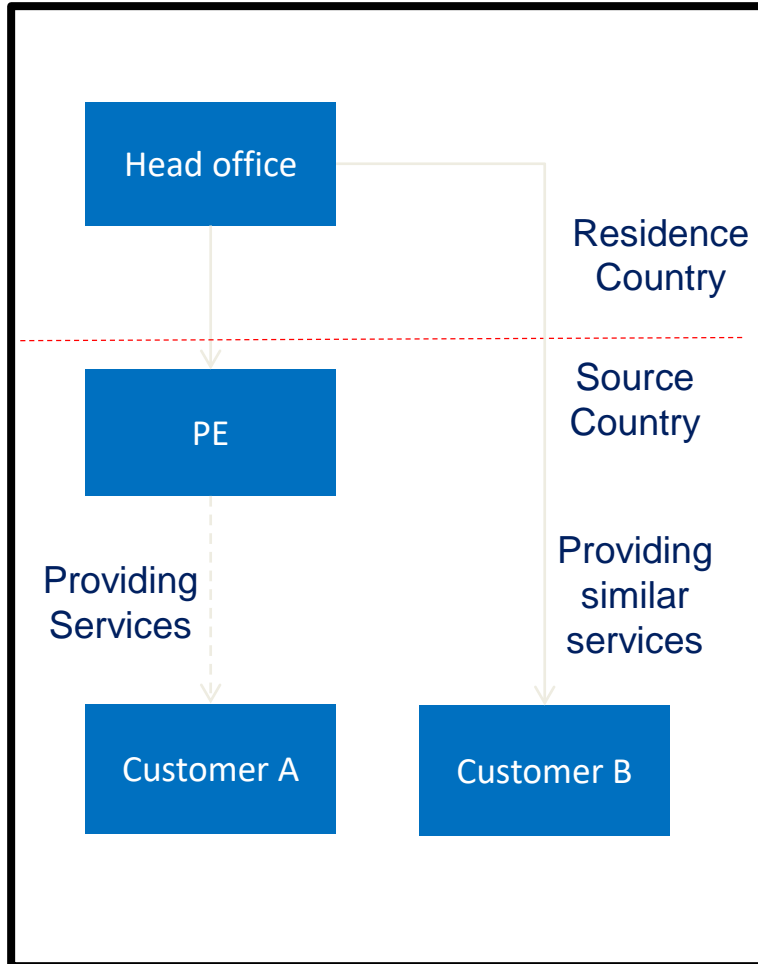
A Co. also sells garments directly to customers in Country Y

Possible that Business is being passed from Branch to A Co. thereby reducing profits of the Branch

'Force of Attraction' rule seeks to tax such profits derived by A Co.

FOA applies when profits are derived from sale of same / similar goods / activities akin to that of PE

Case Study (2/4)



Services provided by PE to the Customer A taxable as per Article 7

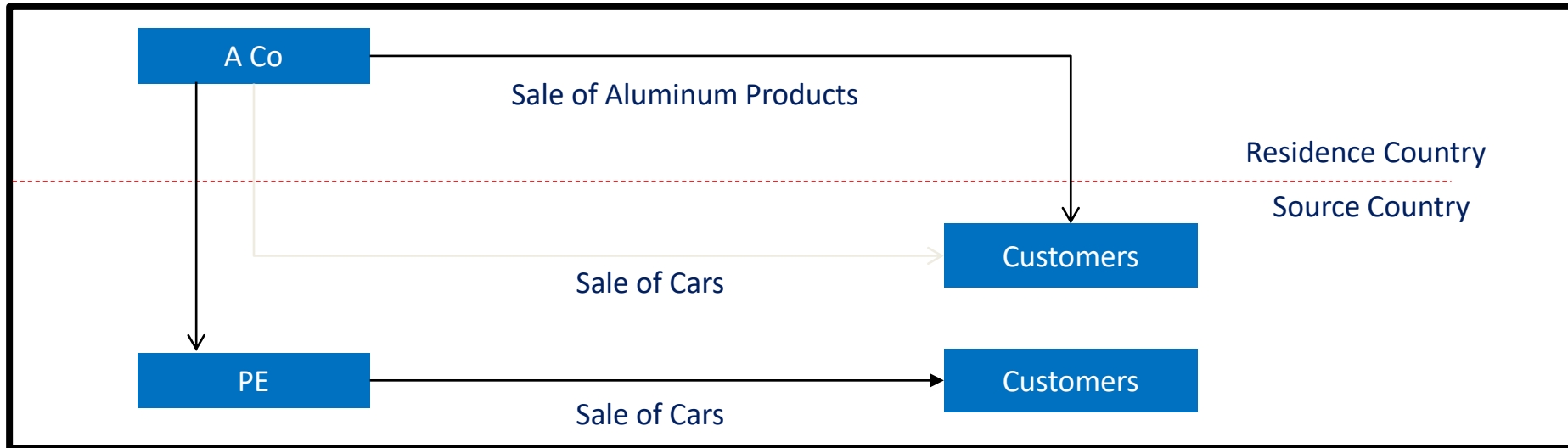
Services provided by HO to Customer B ideally taxable under Article 13

As per Article 13(6) - even in the presence of PE - only the services effectively connected to the PE taxable as per Article 7

As per Force of Attraction rule – Profits from same or similar sales / activities taxable as per Article 7 even if not connected / provided through PE

FOA applies when profits are derived from sale of same / similar goods / activities akin to that of PE

Case Study (3/4)



A Co, resident of host country, is a MNC engaged in several business sectors

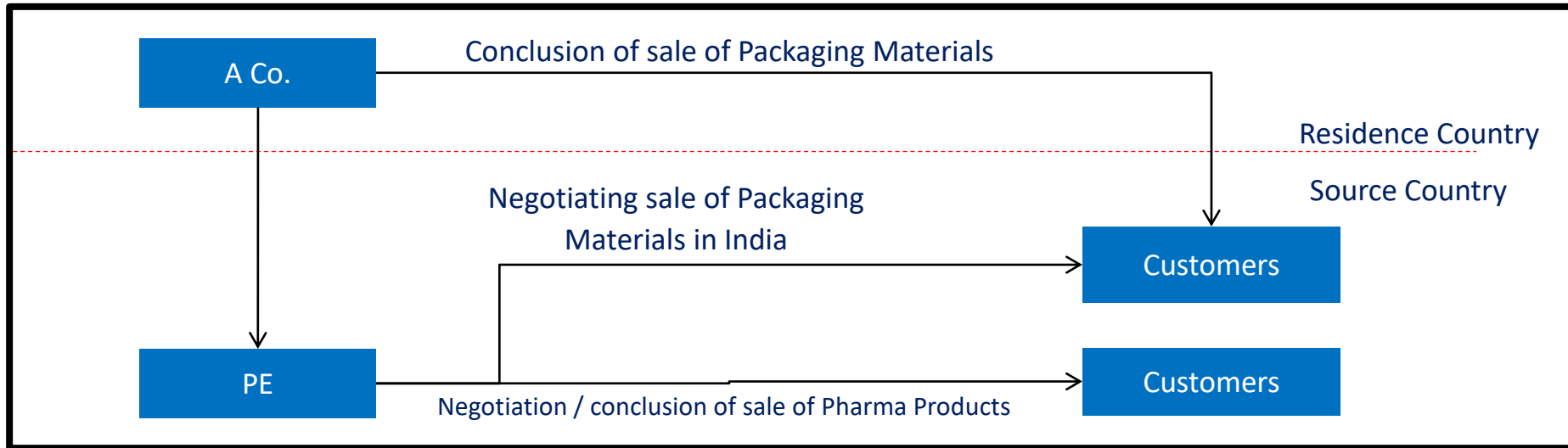
ACo has a PE in Source Country for sale of Cars

ACo also directly sells cars and Aluminum Products in Source Country

Limited FOA – Only profits with respect to direct sale of Cars by ACo taxable in Source State

Full FOA – Entire profits with respect to direct sale of Aluminum Products and Cars by ACo taxable in Source State

Case Study (4/4)



A Co. is engaged in the manufacturing of Packaging Materials and Pharma Products in Residence country

A Co. has PE in India for sale of Pharma Products. This PE also negotiates sale of Packaging Materials.

A Co. directly sells the Packaging Materials to the Customers in Source country

Limited FOA – Only profits as attributable to the extent of activity of negotiation of Packaging Materials

OECD v. UN Model v. US Model

Particulars	OECD Model	UN Model	US Model
Type	No Force of Attraction	Limited Force of Attraction	Full Force of Attraction under US domestic tax law
Methodology	Adopts economic connection principle in attribution of profits	<ul style="list-style-type: none"> Adopts Restricted Force of Attraction principle FAR Analysis 	<ul style="list-style-type: none"> Adopts concept of “effectively connected” with trade or business in USA
Taxation of Business profits in Source Country	Attributable to : <ul style="list-style-type: none"> PE 	Attributable to: <ul style="list-style-type: none"> PE Direct sale of same / similar goods as those sold through PE Other same / similar business activities carried on through PE 	Per India-USA tax treaty Article 7(1) on lines of UN Model – Limited Force of Attraction

In determining same or similar - Nature, functions, purpose and utility of goods or merchandise

FoA in Indian DTAA's

Generally Article 7(1) of Indian DTAA's are in line with OECD model or the UN Model

Protocols to be examined

Around 30 of 85 Indian DTAA's contain FoA rule

Many Indian DTAA's adopt the Article 7(1) as per the UN Model convention i.e. Limited FoA

Canada, Belgium, Denmark, Italy, USA

Some DTAA's adopt only part of the Article 7(1) of the UN Model (sale of similar goods)

New Zealand, Indonesia

Some DTAA's adopt the provisions of UN Model with a "Right to Prove Otherwise"

- Enterprise can prove that profit from sale of same or similar goods / activities are not attributable to PE

Sri Lanka, Cyprus, Germany

Some DTAA's adopt OECD model with a variation

- Phrase "directly or indirectly attributable to that PE"

Japan, Singapore, United Kingdom, Malta, Oman

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