PESHORI CONSULTANTS
Financial and Tax Advisors

Permanent Establishment (PE)

CA Prerna Peshori

Coverage

PESHORI CONSULTANTS
Financial and Tax Advisors

- Introduction
- Meaning of PE
- Types of PE
- Fixed Place PE
- Specific Issues
- Discussion on different Pes
- Implication of having PE

Introduction

- A country can tax any income either on the basis of a) residence of the person or on the basis of b) source of income in that country.
- Non-residents are taxable in a country on the basis of source of income in that country.
- As per Section 5 r.w. Section 9 of the Income-tax Act, income of a non-resident is taxable in India if it is a) received or deemed to be received in India OR b) is accrued/arising or deemed to have accrued/arises in India [Source Rule in India].
- **Doing Business in India vs Doing Business with India**

PESHORI CONSULTANTS
Financial and Tax Advisors

Introduction

- PE is a yard stick to tax the business profits of a non-resident enterprise.
  - Crucial in determining whether a non-resident enterprise must pay income tax in Source State.

- Article 7 of the tax treaties provide that business profits would be taxable in source state only if there is PE in that state (conditional right to tax)

- Income tax Act, 1961 (the Act) usually uses the term ‘Business Connection’ (except Section 44DA and section 92F)

- ‘Business connection’ has not been defined precisely under the Act but inclusively and has a much wider scope than PE

PESHORI CONSULTANTS
Financial and Tax Advisors

Definition of PE

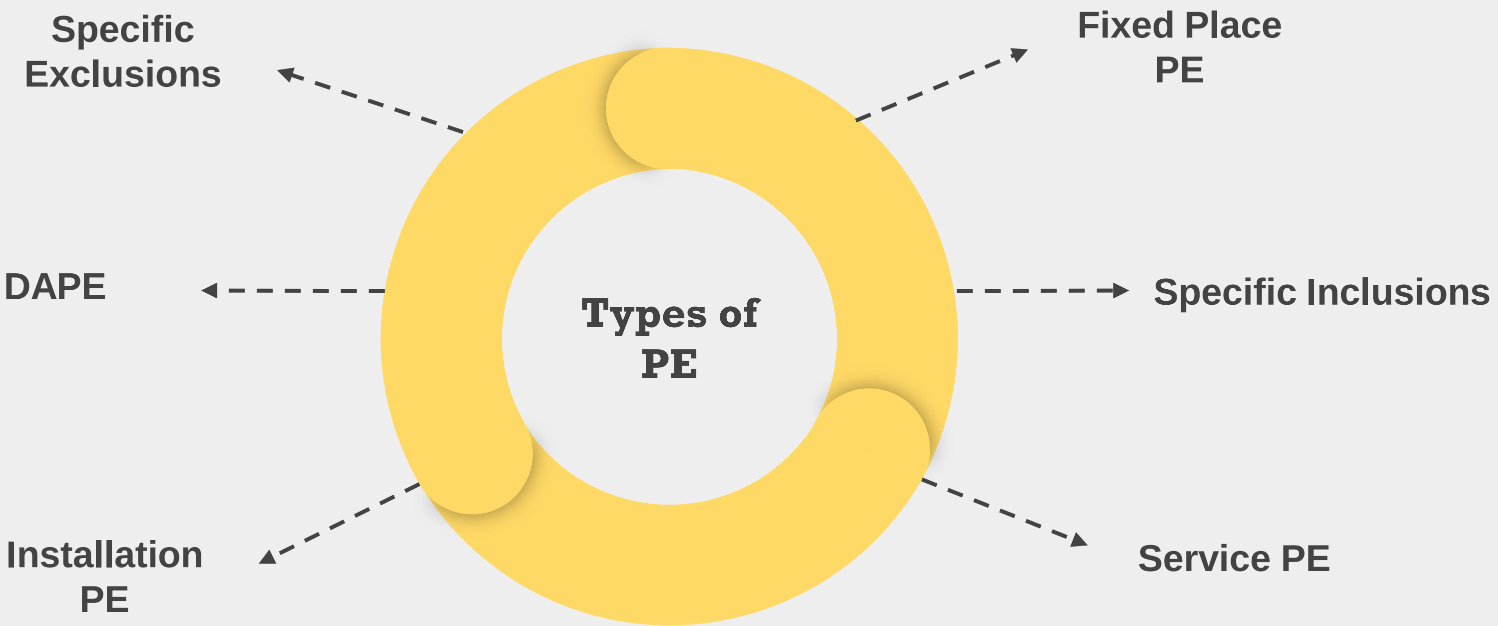
- Article 5 on Double Tax Avoidance Agreements (DTAA) defines the term PE as "A Fixed place of business through which the business of an enterprise is wholly or partly carried on.“ There are different types of PE

- As per section 92F(iiia) of Income Tax Act, 1961, ‘Permanent Establishment’ includes a fixed place of business through which the business of the enterprise is wholly or partly carried on.

- PE definition has undergone several changes in line of BEPS Action Plan 7 to prevent artificial avoidance of PE status.

Permanent Establishment Concept

PESHORI CONSULTANTS
Financial and Tax Advisors



Tests of all PEs are independently applied. No hierarchy.

PESHORI CONSULTANTS
Financial and Tax Advisors

Typical Structure of Article 5 – Permanent Establishment

5(1)

Fixed Place PE

5(2)

PE inclusions - place of management, branch, office, factory, etc.

5(3)

Construction PE

Building site / Construction / Installation

5(4)

Specific activities exemption

5(5)

Agency Permanent Establishment

5(6)

Independent agent not to constitute PE

5(7)

Holding or subsidiary in other contracting state would not in itself constitute a permanent establishment.

5(8)

Closely related person or enterprise

Fixed Place PE (Article 5(1)

Place of Business

- ➔ There must be a physical place of business.
- ➔ It does not matter whether this place of business is owned or leased

Location

- ➔ The place of business must be a fixed place.
- ➔ The residence of an employee may also be treated as a PE if the same if used as an office for business.

Permanence

- ➔ The place of business must be for a fixed and reasonably longer period of time.
- ➔ There should be a reasonable degree of continuity and regularity, no short or transit.

At Disposal

- ➔ The place must be at the disposal of the foreign entity.
- ➔ If the place of business is situated in the business premises of another enterprise and the foreign enterprise has certain part thereof at its constant disposal, that premises may be considered as having a PE in India.

Business Activity

- ➔ Proper business activity must be carried out from such a fixed place.

Fixed Place PE – Place of Business Test

PESHORI CONSULTANTS
Financial and Tax Advisors

- The term 'place of business' covers any premises, facilities or installations used for carrying on the business of the enterprise whether or not they are used exclusively for that purpose.
  - Stall in exhibition
  - Office space
  - Storage space in customs depot
  - Hawkers stall
  - Painter in client premises

- Home office whether it can constitute PE?
  - Intermittent activities will not lead to PE
  - Regular business of NR carried on from employee's home office would lead to PE
  - Where the employer does not require the employee to WFH, it may not constitute PE
    - Danish Tax Council held that where employee was not in a managerial role, home office was not PE
    - However, in another case, Danish Tax Council held home office as PE as the employee was in managerial role

Fixed Place PE – Disposal Test

PESHORI CONSULTANTS
Financial and Tax Advisors

- ❑ Place should be at the disposal of the foreign enterprise for the purpose of its business activities
- ❑ The foreign enterprise should have the ability to exercise some right or dominion or control
- ❑ The place may be owned or rented or in any way available for use.
- ❑ Could be in another enterprises’ premises
- ❑ Legal right to use need not be the sole determinant; factual use or exercise of such right will have a greater bearing
- ❑ Even illegal occupation could constitute a PE

Examples (not constituting fixed place PE):

► Possession of mailing address without an office, telephone listing or bank account [Motorola Inc & Others Vs. DCIT [2005] 95 ITD 269 (Del ITAT)]

► Foreign training agency imparting training to employees of a company in their office at the behest of the said company

► Salesman visiting customers office regularly to collect orders

Fixed Place PE – Location Test

PESHORI CONSULTANTS
Financial and Tax Advisors

- ❑ Fixed location (of the person), (including equipments) through which business is wholly or partly carried on.
- ❑ Activities performed within a broader geographical area covered

Examples constituting fixed place PE:
► A diving offshore vessel functioning within a defined area
► An “office hotel” in which a consulting firm regularly rents different offices
► A pedestrian street, outdoor market or fair in different parts of which a trader regularly sets up his stand

Fixed Place PE – Duration Test

PESHORI CONSULTANTS
Financial and Tax Advisors

- The place should be available for sufficiently long period of time
- No minimum threshold
  - In general 6 month period considered
- If the nature of business is such that it is required to be carried on only for a short period of time, then the place of business where such business is carried on, may constitute a PE
- Temporary interruptions does not affect PE
- PE ceases to exist when;
  - Business is no longer carried
  - Fixed place of business is disposed off
  - All the connected activities of business are stopped (temporary interruptions in running business are not to be considered)

Fixed Place PE – Duration Test

PESHORI CONSULTANTS
Financial and Tax Advisors

- OECD regards place of business to be fixed if it is carried on for more than 6 months
  - Exception – where activities are for shorter duration but recurrent in nature
  - Exception – where activities are carried on for shorter duration but carried solely in source state

- Formula One World Championship Ltd. v. Commissioner of Income-tax, (International Taxation)-3, Delhi [2017] 394 ITR 80 (SC)
  - FOWC entered into a Race Promotion Contract” (RPC) with Jaypee Sports to grant the right to host, stage and promote the Formula One Grand Prix of India event
  - PE constituted even in case of 3 day event as FOWC has access during that 3 days and the contract was for 5 years

Fixed place PE Supreme Court in Formula One

Facts:
- The tax payer, a UK resident company ("UK Co") entered into a race promotion contract with Jaypee Sports and granted the right to stage, host and promote the Formula one Grand Prix of India event. UK Co also permitted Jaypee the use of certain IP
- The tenure of the event was for five years
- The participants on the event entered into an agreement with UK Co that they would not participate in any other similar event

Held:
- UK co had the right to access the circuit (ie place where the event was held) for the duration of the event, two weeks prior to it and for a week succeeding the event
- UK Co had right to dictate who could access the circuit and organizing any other event on the circuit was not permitted
- The circuit was at the disposal of UK Co through which the business was conducted
- Based on the exclusive nature of the access and the period of access, the circuit itself constitutes a fixed place of business within the meaning of Article 5(1) of the tax treaty

Fixed Place PE – Specific Issues

PESHORI CONSULTANTS
Financial and Tax Advisors

- Website can they be PE?
  - OECD view – Website not being a tangible property – it does not have location that can constitute place of business. However, server on which website is stored has physical location and may constitute PE
  - India's reservation – Website may be PE where it leads to significant economic presence of an enterprise.
  - An enterprise can be considered to have acquired a place of business through a website on any equipment, if opening the website on that equipment includes downloading of automated software, such as cookies, which use that equipment to collect data from that equipment, process it in any manner or share it with the enterprise.
- Computers of NR at customer's offices can be a PE
  - Amadeus Global Travel Distribution S.A. [2011] 11 taxmann.com 153
  - Galileo International Inc. [2008] 19 SOT 257
- Software not a PE
  - Western Union Financial Services Inc. [2007] 104 ITD 34

Fixed Place PE – Specific Issues

- Satellite’s footprint can be a PE?
    - OECD View – No as not at the disposal of operator of satellite
    - India’s reservation - India is of the view that in such a case, the source State not only contributes its customer base but also provides infrastructure for reception of the satellite telecast or telecommunication process. India is also of the view that a satellite's footprint falls both in the international and national space. The footprint has a fixed location, has a value and can be used for commercial purposes.

AAR ruling - MasterCard Asia Pacific Pte. Ltd.

- Applicant (Sing Co), part of Mastercard group, provided transaction processing and payment related services to its various banks in the Asia Pacific, MEA region including India for which Sing Co received:

► transaction processing fees,

► fees for building and maintaining a secure network and

► additional revenue for services ancillary to the transaction processing activities

- I Co (subsidiary of SingCo) provided support functions

exclusively to SingCo in respect of India operations.

- The transaction processing activity consisted of electronic processing of payments between banks through the use of Mastercard Network.

AAR ruling - MasterCard Asia Pacific Pte. Ltd.

- Fixed place test MIPs are housed at a particular site i.e. at the Customer banks' premises
  - Being fixed to the ground is not a pre requisite

- Permanence test MIPs are placed at the site of the Customer banks throughout the year
- Disposal test
  - Ownership of MIP is not a determinant factor of disposal test.
  - I Co is rendering only a support function role as per its FAR profile MIPs are carrying on authorization activities for the Applicant and not ICo
  - Sing Co charges " Mastercard one time license fee" from its Customer banks to cover the cost of installation of MIP
  - All the decisions related to MIPs, viz. when to repair or buy a new MIP, whom to engage for repairs and at what cost, agreeing to the terms of repairs etc. are taken by the Sing Co and not by the I Co
  - I Co is a cost plus entity and has neither financial nor the technical ability to undertake maintenance and upgradation activities.
  - All risk mitigation functions are performed by the Sing Co and all decisions with respect to MIPs are taken by Sing Co and not I Co

Specific inclusions

PESHORI CONSULTANTS
Financial and Tax Advisors

- Specific inclusions in the definition of PE in Article 5(2) of treaties:

Place of Management

where 'control and management' of an enterprise reside.

Branch

When a non-resident enterprise has a branch in India, then it is usually regarded as a PE of the non-resident enterprise.

Office

fixed place, room, building from where the business is carried on.

Factory

processing and manufacturing of goods is carried out.

en

Workshop

Industrial process is carried on and any place in which collective manual labour, under an employer is done by way of trade, making, repairing etc.

Mines

A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

Exclusions from PE

PESHORI CONSULTANTS
Financial and Tax Advisors

- ❑ Preparatory & Auxiliary activities are exempt from PE

- ➔ The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise

- ➔ Maintenance of stock of goods solely for the purpose of storage or display of goods belonging to the enterprise.

- ➔ Maintenance of stock of goods belonging to the enterprise solely for the purpose of processing by another enterprise.

- ➔ Maintenance of fixed place of business solely for the purpose of purchasing goods or for collection of information for the enterprise.

Exclusions from PE

PESHORI CONSULTANTS
Financial and Tax Advisors

- 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.

- Combination of activities mentioned above provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

Exclusions from PE

- Paragraph 4 shall not apply to a fixed place of business that is used or maintained by an enterprise if the same enterprise or a closely related enterprise carries on business activities at the same place or at another place in the same Contracting State and
- *a)* that place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise under the provisions of this Article, or

b) the overall activity resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character, provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute complementary functions that are part of a cohesive business operation.

PESHORI CONSULTANTS
Financial and Tax Advisors

Can liaison office be construed as PE in India

- Liaison office acts as a communication channel between the foreign enterprise and the Indian customers

- Typically, liaison offices are excluded from the definition of PE as their activities are limited to:
  1. Collecting information for the foreign enterprise;
  2. Dissemination of information about their products & services
  3. Assisting Head Office in purchasing goods or merchandise from India.

- The revenue authorities have held PE in the following situations:
  1.Liaison offices are negotiating, concluding contracts for and on behalf of its head office
  2.Activities of the liaison office are similar to that of the overseas head office

- However, in case where the activities fall within the "preparatory and auxiliary activities" exclusion, in such case no PE shall be constituted.

PESHORI CONSULTANTS
Financial and Tax Advisors

Can liaison office be construed as PE in India

Union of India v. U.A.E. Exchange Center [2020] 116 taxmann.com 379 (SC)]

➔ Indian LO of a foreign enterprise engaged in offering remittance services performs essential activity of downloading information, prints cheques / draft and dispatches them through courier it falls outside Article 5(4)(e) exception.

Jebon Corporation India [2012] 19 taxmann.com 119 (Karnataka HC)

➔ Indian LO of a foreign enterprise engaged in performing functions such as identifying new customers, pursuit and follow up of customer, price negotiation, etc. constitutes a PE of the Head office under India -Korea tax treaty.

Columbia Sportswear Company [2011] 337 ITR 407 (AAR)

➔ Activities of LO were not confined to the purchase of goods in India and therefore there is Business Connection and PE in India.

PESHORI CONSULTANTS
Financial and Tax Advisors

Construction / Installation PE

- As per paragraph 3 of Article 5 of OECD Model Convention a building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.
  - UN Model – 6 months
- Meaning of a “project”?
  - Coherent whole commercially and geographically.
- Seasonal or other temporary interruptions should be included in determining the life of a site.
- Considered as Construction PE:
  - Renovation
  - Demolition
  - Assembly of machines/aircraft
- Not Considered as Construction PE:
  - Maintenance of building
  - Redecoration

PESHORI CONSULTANTS
Financial and Tax Advisors

Construction / Installation PE

- India has negotiated difference thresholds for the purpose of construction/installation PE with different countries.

- Form Example with Australia, Belgium, Germany, Hong Kong, Netherlands, UK threshold is More than 6 months for construction PE. Canada, USA More than 120 days in any twelve months period.

Service PE

PESHORI CONSULTANTS
Financial and Tax Advisors

- Service PE is an international tax concept under which services(other than services covered under Royalties or Fees for Technical Services) provided by a non-resident may give rise to a PE in source country if services are provided beyond a certain period of time in source country irrespective of a fixed presence.

- Service PE article can be found only in UN Model Convention, as it is not included in OECD Model Convention.

- As per paragraph (b) of Article 5(3) of UN Model, the term permanent establishment includes furnishing of services including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, if such 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.

Service PE

- Some of the service PE thresholds that India agreed are as provided below: Australia, Hong Kong More than 183 days in any twelve-month period. Canada, USA More than 90 days within any twelve-month period Or In case services are performed to related enterprise: No specific time limited therefore even for 1 day of service.

Dependent Agency PE (DAPE)

PESHORI CONSULTANTS
Financial and Tax Advisors

- Article 5(5) of OECD Model Convention , where person is acting in a contracting state on behalf of an enterprise and in doing so habitually concludes contracts, or habitually plays the principle role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and such contracts binds the enterprise then such activities of the person constitutes permanent establishment in that contracting state.

- Example: Dependent Agency PE (DAPE) person resident in India represents or acts on behalf of the foreign enterprise, his presence in India may be regarded as presence of foreign enterprise in India and could establishment of a PE in India of that foreign enterprise

- The term "habitually" refers to a systematic course of conduct on the part of the employee or agent.

- No PE if independent agent acts in ordinary course of business

Agent of an Independent status

PESHORI CONSULTANTS
Financial and Tax Advisors

Conditions need to be satisfied

- Agent represents multiple business,
- Acts in the ordinary course of business for Foreign co,
- Legally,Economically,he is independent of the foreign enterprise on whose behalf he acts.
- Agent bears "Entrepreneurial risk".
- Extent of control and direction from the foreign enterprise.

Independent agent

PESHORI CONSULTANTS
Financial and Tax Advisors

- Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.
- Exclusively – 90% of sales

Subsidiary PE

PESHORI CONSULTANTS
Financial and Tax Advisors

- ❑ Business of the parent Company carried on through the subsidiary Company considered as Subsidiary PE.

- ❑ Generally a subsidiary company is excluded from being considered as a PE in the DTAAs. This is because the subsidiary is a separate legal entity. A subsidiary company may constitute PE for its foreign parent, only in case the conditions of constituting a Fixed place PE, Service PE or Agency PE is satisfied.

Supreme Court in E Funds IT Solutions

E Funds India performed back office operations in respect of ATM management, electronic payments, decision support, etc to two of its group companies

- ➔ E Funds India does not constitute PE of the group companies in India
- ➔ Where assesse does not have a branch/ workshop/ factory in India and has a subsidiary, that by itself will not create a PE in India unless it satisfies the tests under Article 5 of the tax treaty
- ➔ Indian subsidiary will not become location PE under Article 5(1) merely because there is interaction or cross transactions between Indian subsidiary and foreign principal

PESHORI CONSULTANTS
Financial and Tax Advisors

Implications of PE in India

- Business income is taxable at 40% on net profits.
- Books of accounts & audit may be required.
- Interest, Royalty and FTS may be taxed as business income.
- TDS obligation on payer
- Company law; FEMA
- Establishment of PE in India leads to Foreign enterprise profits in India being taxed as "Business Income '' in accordance with the rules laid down in Article 7 of Treaties.
- Delhi Tribunal in the case of Galileo International Inc observed no guidelines are available as to how much should be the income reasonably attributable to the operations carried out in India; the same has to be determined on functions performed, assets used and risk undertaken.

PESHORI CONSULTANTS
Financial and Tax Advisors

THANK YOU

Reach out on:

prernapeshori@peshoriconsultants.com

+919730166366