Basics of Permanent Establishment

(India Perspective)

The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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Basic Draft of this publication was prepared by CA. Sandeep Dasgupta

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Foreword to the First Edition

The Permanent Establishment (PE) is a globally recognised concept for the taxation of any business enterprise in the domain of international taxation. With changing business environment, the subject of permanent establishment has become a very dynamic subject. In the digital business environment, the virtual presence of foreign enterprise in the source country and its attribution of profit to the PE is a more complex exercise which is a subject matter of debate in the legal forum. To tackle the tax challenges in digital economy, the Finance Act, 2018 introduced the concept of Significant Economic Presence as business connection in line with the recommendation of OECD BEPS Action plan-1. The concept was further amended by Finance Act, 2020 and deferred till assessment year 2022-23. The CBDT has recently notified the threshold limit for significant economic presence which may give rise to new challenge in attribution of the profit.

Further, the synthesised texts of the Indian Multilateral Instruments-MLI have adopted Article 12 of the MLI – artificial avoidance of permanent establishment status through commissionaire arrangements and similar strategies which align the domestic law with DTAA and widened the scope of taxation under the domestic law of which India is also a signatory.

Since, the subject matter of permanent establishment keeps evolving every day, it is extremely important for budding international tax practitioners to be aware of the basic concepts of Permanent Establishment. It is only then, that the evolution of the concept could be better appreciated. Considering the scope and complexity of the topic, the Committee on International taxation of ICAI has come out with this new publication which provides greater emphasis on the basic issues and the judicial decisions around it for the knowledge enrichment of the members of the ICAI.

I congratulate CA. Pramod Jain, Chairman, and CA. Nandkishore Chidamber Hegde, Vice-Chairman and all other members of the Committee on International Taxation of ICAI for the initiative taken to bring out this publication on the topic of wide importance.

I am sure that this publication would be of immense use for our practicing members who help the business entity to provide consultancy and making factual analysis of permanent establishment exposure.

Best Wishes,

Place: New Delhi
Date : 09.06.2021

CA. Nihar N. Jambusaria
President, ICAI

Preface to the First Edition

One of the most crucial aspects in the domain of tax treaties is the study of Permanent Establishment (PE). The quest for knowledge of concepts of PE assumes greater significance since the global economy and the digital contours thereof increasingly impact the volume of cross border business and consequent physical nexus with host countries. The concept of PE is a widely deliberated topic in the domain of international taxation. International organisations like, the OECD, UN, IBFD and various authors have devoted significant efforts in bringing out work of research on the topics of Permanent Establishment.

The existence or otherwise of PE has been a subject matter of endless debate in the legal forums, due to the subjectivity associated with interpretations of relevant law. The jurisprudence has always evolved with the changing dimensions of business. Today, with technology being all pervasive in businesses, the law on PE is unable to match the pace of such business transformations. The taxation principles are increasingly becoming oriented towards taxation in the state of economic nexus or value creation. Determination of the situs of value creation is, in itself, a complex and given to subjective interpretation. In this state of flux, it is quite natural that the principles relating to Permanent Establishment would continue to evolve.

Since PE, as a concept, is a virtual extension of a foreign enterprise, it is obvious that the transactions of such PE cannot be isolated from those of the foreign enterprise. Quantification of profits of the foreign enterprise, as attributable to it's PE, is the basis for taxation of business income of such foreign enterprise. Needless to add that the profit attribution process involves robust accounting and appropriate assumption-based allocation methodologies. In summary, PE and attribution of profits to PE are two connected but distinct areas of specialisation amongst tax professionals.

Due to the subjectivity involved and also the issues of interpretation, sometimes it may be uncertain whether a foreign enterprise qua a specific activity or non-activity has constituted a PE or not. It is not unusual for taxpayers to realise about the existence of a PE years after actual constitution of PE. However, since the tax implications are likely to be quite onerous and burdensome because the taxpayer in such cases would have failed to adhere to important tax compliances or have meet tax obligations in the country where such PE is constituted. Due to the emergence of PE

situation, in certain cases involving employees or other manpower associated with the PE, there could be personnel tax and social security implications, too. Digital economy has compelled tax administrations around the globe, besides the OECD, to work on new nexus rules in the absence of physical nexus traditionally conceived to be constituting PE. Amidst these evolutions in concepts of taxation of a foreign enterprise, came in the devastating COVID-19 pandemic. This pandemic has led to apprehensions about the tax implications under extant PE norms caused by restricted mobility / forced presence in foreign states. The OECD Secretariat issued recommendations to sovereign nations to clarify about treaty interpretations in order to allay such concerns. A fundamental understanding of PE and nuances around the concept is therefore imperative.

This publication also seeks to outline the evolution of the PE concept amidst the unending research and learning associated with it. In this era of vast dynamism in business, this publication aims to provide working knowledge about determination of PE to professionals specialising in the international taxation space. This publication does not elaborate on the PE profit attribution aspect, emergence of new nexus rules or taxing right allocation rules as part of the OECD's BEPS project as that would need a separate and elaborate analysis beyond the scope of this book.

It may be useful for the readers to upfront note that greater emphasis is accorded to the fundamental concepts associated with this topic and towards easier application of the legal principles. This publication is aimed at equipping early stage international tax practitioners with the fundamental concepts of Permanent Establishment. With businesses spanning multiple geographies, it shall be incumbent for international tax practitioners to familiarise themselves with this fundamental concept of economic nexus of global businesses. Since PE is a traditional nexus concept in international taxation to fix taxable presence in a country and thereby to enable taxing rights to such country, readers should be conscious of digitalisation of the economy which has necessitated new nexus concepts beyond PE, which is not a subject matter of this publication.

I am sincerely thankful to CA. Nihar N Jambusaria, President, ICAI and CA. (Dr.) Debashis Mitra, Vice-President, ICAI for being guiding force behind all initiatives being taken by the Committee.

I also whole heartedly acknowledge the untiring efforts undertaken by CA. Sandeep Dasgupta for drafting the publication. He was actively supported by his colleagues CA. Risha Gandhi, CA Paras Modi, CA Prachi Shah and CA

Zainab Vaithy. I am also thankful to Ex-Central Council member, CA. Sanjiv Chaudhary, who spared his valuable time and took special efforts to review the publication in a timely manner. I also appreciate the efforts of CA. Sachin Sastakar who further reviewed the publication and provided his inputs.

I shall fail in my duty if I do not acknowledge the hard work done Mr. S.P. Singh, Ex-IRS in overall reviewing this publication in a timely manner. Notably, Mr. S.P. Singh being the first Director of Income Tax (International Taxation), Mumbai and earlier being part of the Foreign Tax & Tax Research Division in the Central Board of Direct Tax, has in-depth and practical knowledge of issues in International Taxation at the policy making and implementational levels. His involvement has ensured that all review comments are appropriately and duly taken care of.

I am also grateful for the unstinted support provided by Vice-Chairman CA. CA. Nandkishore C Hegde and other members (including co-opted members and special invitees) of the Committee on International Taxation; CA. Anil S Bhandari, CA. Tarun J Ghia, CA. Chandrashekhar V Chitale, CA. Aniket S Talati, CA. G Sekar, CA. Rajendra Kumar P, CA. Sushil Kumar Goyal, CA. Pramod Kumar Boob, CA. Manu Agrawal, CA. Anuj Goyal, CA. Satish Kumar Gupta, CA. Kemisha Soni, CA. Atul Kumar Gupta, CA. (Dr.) Sanjeev Kumar Singhal, CA. Charanjot Singh Nanda, Shri Manoj Pandey, Shri Sunil Kanoria, CA. T. P. Ostwal, CA. Arun Saripalli, CA. Padam Chand Khincha, CA. Ameya Kunte, CA. Rashmi Bihani, CA. Karthik Natarajan, CA. Aseem Chawla, CA. R. Sathish Kumar, CA. Baldev Raj, CA. Gaurav Singhal, CA. Prakash Sinha, CA. Manoj Kumar, CA. Nidhi Goyal, CA. Kriti Chawla, CA. Sachin Sinha, CA. Manoj Kumar, CA. Smita Patni

Last, but not the least, I appreciate the efforts made by CA. Mukta Kathuria Verma, Secretary, Committee on International Taxation and CA. Vikas Kumar, Assistant Secretary for co-ordinating the project and for rendering secretarial assistance.

I am quite hopeful that this publication will be of immense use to the members.

Place: New Delhi
Date: 09.06.2021

CA. Pramod Jain
Chairman,
Committee on International Taxation, ICAI

Glossary of Key Terms Used

AAR	Authority for Advance Rulings
BEPS	Base Erosion and Profit Shifting
COVID	Corona Virus Disease
DTAA / DTAC	Double Tax Avoidance Agreement / Double Tax Avoidance Convention
FAR	Functions, Assets and Risks
FARM	Functions, Assets, Risks and Market
HC	High Court
IBFD	International Bureau of Fiscal Documentation
IT Act / Act	Income Tax Act 1961
ITAT	Income Tax Appellate Tribunal
MC / MTC	Model Convention / Model Tax Convention
OECD	Organisation of Economic Cooperation and Development
PE	Permanent Establishment
SC	Supreme Court
SEP	Significant Economic Presence
UN	United Nations

Contents

Chapter 1
Permanent Establishment – Certain Fundamental Aspects

1.1. An introduction

Generally, two types of taxation systems are prevalent globally – Residence-based taxation and Source- based taxation. Under a residence- based taxation system, an enterprise is taxed in respect of its worldwide income by the state of its residence. Under a source- based taxation system, only income from a source inside the country is taxed. India follows a combination of residence- based and source- based taxation systems. The Income-tax Act,1961 ("the Act") provides for levy of income-tax on the income of foreign companies and non-residents, but only to the extent of their income sourced from India. Under section 5 of the Act, a foreign company or any other non-resident person is liable to tax on income, which is received or is deemed to be received in India by or on behalf of such person, or income, which accrues or arises or is deemed to accrue or arise to it in India. An income, which may be deemed to accrue or arise to a non-resident in India, is often through existence of "business connection" which such non-resident is deemed to have in India as per the provisions of the Act. The concept of business connection basically predicates an element of continuity between the business of the non-resident outside India and a connected activity carried out in India: a stray or isolated transaction is not normally regarded as business connection. While the above source based taxation rule is enshrined in the Income-tax law in India, the said rule is subject to the provisions of the applicable tax treaty, in case of eligible non-residents.

Normally, a tax treaty provides that business income of an enterprise may be subject to tax in the Source State of such income only if such enterprise has a PE in the source state. Very simply put, in the context of a tax treaty between a resident state and source state, a permanent establishment signifies virtual extension of an enterprise of the resident state, in the source state. Therefore, a PE serves as the basis of economic nexus between a taxpayer and a taxing state. Existence of mere presence of a foreign enterprise in the source state in not sufficient for the source state to levy tax.

The source state, may tax business income of the concerned foreign enterprise, only if such foreign enterprise carries on business in that source state through its PE therein.

Double Tax Avoidance Agreements (DTAAs) / Double Tax Avoidance Conventions (DTACs) / Tax Treaties are entered into by contracting states in order to enable residents of those contracting states to avoid double taxation of the same income and to provide certainty of taxation. Section 90(1) of the Act empowers the Union Government to enter into tax treaties with other countries following the principles of public international law. An enabling provision under the domestic income tax of contracting states allows the taxpayers to access the sovereign tax treaties. Illustratively, in India section 90(2) of the Act serves as such enabling provision to access Indian tax treaties. While the concept of "Permanent Establishment" (PE) is defined in Article 5[1] of OECD (Organisation of Economic Cooperation and Development and the United Nations) Model Tax Conventions, such concept has been borrowed into the domestic tax laws of nations over time.

It is pertinent to note that domestic tax laws in their turn also exert substantial influence on the content of bilateral tax treaties. The countries seek to preserve domestic taxing rights through certain deviations from the language of the bilateral tax treaties. Apparently, India follows the United Nations Model Tax Convention[2] which borrows significantly from the OECD Model, but differs in some major ways. While this basic publication carries references to the OECD Model convention, it also refers to and uses the commentaries on the UN Model Convention.

Article 7 mandates that existence of a PE in a jurisdiction is a pre-requisite for the purpose of taxation of business profit of an enterprise of another jurisdiction in that jurisdiction. The definition of PE in a tax treaty is also pertinent for other articles therein. The term "Fixed base in Article 14 (Independent Personal Services) can be understood by reference to the term "permanent establishment". Articles 10, 11 and 12 (dealing with dividends, interest, and royalties respectively) provide for reduced rates of tax at

[1] Articles referred are as per the Model Tax Convention, OECD, unless stated otherwise.

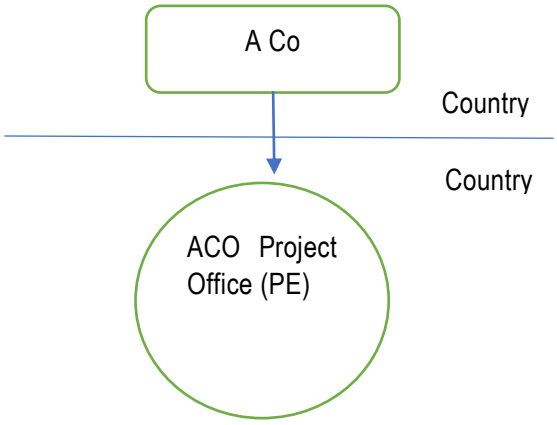
[2] In 1980, the United Nations published, as a result of the Ad Hoc Group of Experts' deliberations, the United Nations Model Double Taxation Convention between Developed and Developing Countries.

sources on payments of these items of income to a resident of another Contracting State when income is *not* effectively connected to a PE in the Source State. The concept of PE is also relevant in determining which contracting state may tax certain gains under Article 13 (Capital gains) and certain "other income" under Article 21.

As stated earlier, the objective of this publication is to enable the reader with only a conceptual clarity on PE as a basis of economic nexus and to provide a brief overview on the evolution of the concept in the post- BEPS / digital era. By intent, this publication does not delve deeper into the discussion on attribution of profits to a PE in consonance with the arm's-length principle as per the OECD Transfer Pricing Guidelines.

1.2. The Concept

The most loosely or commonly used term to describe form of taxable presence of an enterprise (of a resident state) in a foreign state (source state) could be a "branch office", "liaison office", "project office". While the branch office, project office and liaison office are fundamentally extensions of the foreign enterprise in a source contracting state, only branch office and project office of foreign enterprises are allowed to and actually carry out business activities in the source state. These forms of business presence constitute PE of a foreign enterprise in a source state, wherever they exist. A liaison office of a foreign enterprise in a source state typically acts as a mere communication / liaison channel of for such a foreign enterprise.



By virtue of PE existing in a contracting state (i.e. the Source State / say, Country S), such state has a right to tax the income of a foreign enterprise

(i.e. resident of source state, say Country R / say ACO) only if such enterprise carries on business through a PE within the Source State. A PE of a foreign enterprise does not become a resident of the source state, once constituted. It is possible for an enterprise to have PEs in two or more countries and to have more than one form of presence in the same country, viz., a subsidiary and a PE.

Assuming that there is a tax treaty between Countries R and S, the profits attributable to the business activities carried out through the permanent establishment of ACO may be taxable in Country S according to the domestic tax laws of Country S. The income of the PE may be taxable in Country R, also under the domestic law of that country. In order to reduce double taxation, normally, Country R shall grant a tax credit to ACO. If there is no tax treaty between Countries R and S, unless Country R provides for unilateral tax credit to its residents, relief from double taxation of the same income may not be possible, leading to juridical double taxation.

In the case of CIT Vs. Vishakhapatnam Port Trust [(1983), 144-ITR-146 (AP)] on the subject of "Permanent Establishment", the Hon'ble Andhra Pradesh High Court has observed as under:

"The words "Permanent Establishment" postulate the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country, which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a virtual projection of the foreign enterprise of one country onto the soil of another country."

The UN Model not only re-affirms the concept but also supplements it with the new concept of a "fixed base", to be used in the case of professional services or other activities of an independent character.

The term "Permanent Establishment" has been a treaty based term but has been adopted in the domestic tax laws of various countries including India, UK, USA, Austria, Denmark, Germany, Netherlands, Spain, etc. Tax treaties with some countries reflect variation from the definition of Permanent Establishment in those countries' domestic laws, whether judge- made or made by the Parliament. For instance, France will tax income of a foreign enterprise also on the basis of existence of a complete cycle of activity in France, even if such foreign enterprise does not have business premises or

relevant agent. A stock of merchandise is expressly treated as permanent establishment as per the domestic tax law of Belgium.

PE under Indian Income-tax Act, 1961:

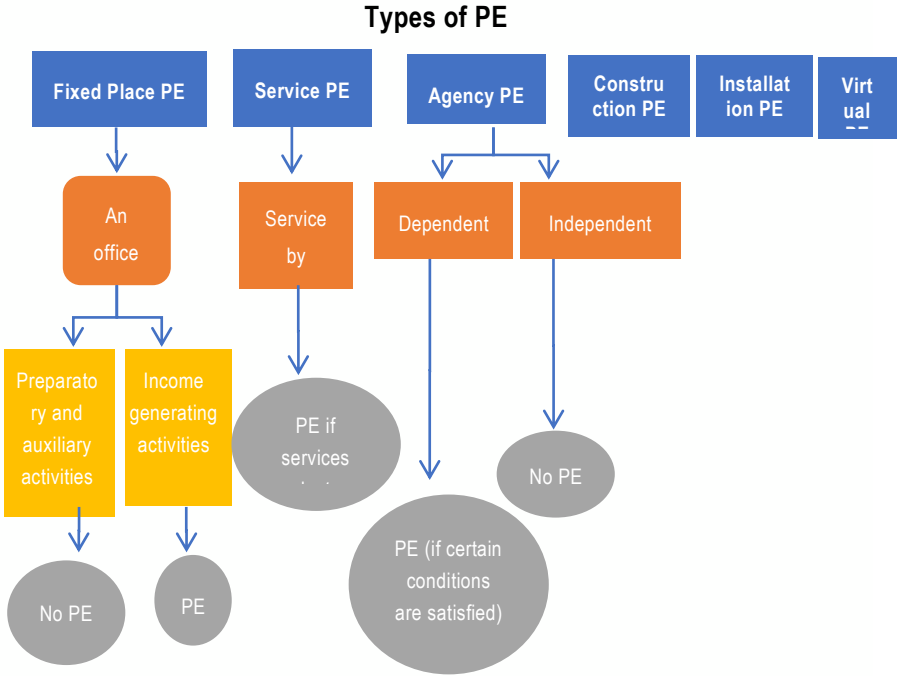
The comparable term to PE under the Indian income tax law is "business connection" [s 9(1)(i)]. There exists a distinction between a "business connection" and a PE. The concept of "business connection" is wider than PE and hence, a business connection may exist even without a PE, but the absence of a "business connection" may indicate absence of a PE as well.

While Article 5 of the OECD and UN Models defines PE in an exhaustive manner, section 92F(iiia) of the Act (in the context of Transfer Pricing Provisions)" defines PE in an inclusive manner.

If a foreign investment manager functions from outside Source state and does not get any assistance from Source state, except by way of advice from various entities in Source state, it does not have a PE in Source state. However, if the business of such investment manager is so carried out that it necessitates an office in Source state or the employment of personnel in Source state or the carrying out of systematic operations in Source state in some manner, then it may be necessary to consider, on facts, whether a PE exists in Source state or not.

1.3. Types of Permanent Establishment

As mentioned above, Article 5 of the Model Tax Conventions (OECD and UN) and the tax treaties define PE. India's bilateral tax treaties are mainly based on the UN Model Tax Convention and include certain aspects of the OECD's Model Tax Convention. While there are three relatively common types of PE in the context of Indian tax treaties, viz., the basic rule / fixed place PE, the agency PE and the service PE, a few other types of PEs are also included, viz. the construction PE and the installation PE/ supervisory PE. The concept of virtual PE is no misnomer in this era of digital revolution. The types of PE are elaborated further under point 5 below.


Types of PE
Fixed Place PE
Service PE
Agency PE
Construction PE
Installation PE
Virtual
An office
Service by
Dependent
Independent
Preparatory and auxiliary activities
Income generating activities
PE if services
No PE
No PE
PE
PE (if certain conditions are satisfied)

Chapter 2

Detailed analysis of Article 5 of the UN Model Tax Convention

The definition of PE in Article 5 does not use the qualifying words "unless the context otherwise requires". As such, the definition needs to be followed in all cases unless specifically excluded.

Briefly stated, Article 5 of the UN Model provides as follows:

- Article 5(1) contains the "basic rule" for PE. A PE is a fixed place of business through which the business of an enterprise is wholly or partly carried on.
- Article 5(2) provides a list of Specific inclusions which are understood to prima facie create a PE e.g., an office, workshop, place of management.
- Article 5(3) specifies the term PE in relation to building sites or construction or installation projects, etc.
- Article 5(4) excludes, by means of a list of exceptions, a number of fixed places of business, from the PE concept.
- Article 5(5) stipulates that an enterprise's dependent agent constitutes a PE of the enterprise it represents, if it (agent) carries on certain specified activities.
- Article 5(6) contains a special rule for agents of insurance companies and is absent in the OECD Model.
- Article 5(7) provides that the business activities of an agent of independent status do not constitute a PE of the enterprise he (agent) represents, provided the agent satisfies certain prescribed conditions.
- Article 5(8) contains a rule for associated enterprises. The mere fact that one company controls another does not make the second company a PE of the first one.

In order to determine whether a PE is constituted, one has to undertake a functional and factual analysis of each of the activities undertaken by the

enterprise. Further, while deciding whether a PE exists or not, provisions under Article 5 have to be read as a whole.

The expression "permanent establishment" has been used in relation to a "business of an enterprise" taxable under Article 7. It has not been used in relation to profits from operation of ship or aircraft in international traffic which are specifically covered under the provisions of Article 8.

The AAR[3] held that a return of income has to be filed in India (Source State) even if a non-resident contends that it does not have a PE in India and consequently, takes a position that it is not taxable for business profits earned in India (Source State). This is based on the logic that the decision about the existence or otherwise of a PE needs to be to the satisfaction of the assessing authorities, as otherwise the authorities would never get an opportunity to examine the matter. However, there are subsequent rulings[4] which have held that there is no obligation to file a return of income when there is no tax liability in India even if such nil tax liability is due to tax treaty benefit. However, in a case of a PE it would be best to file a return as the very concept of a PE is now a dynamic concept and subjective, and to avoid any penal proceedings by the revenue authorities.

The burden of proof is upon the Revenue to prove the existence of a PE and it cannot ask the taxpayer to prove that a PE did not exist. The revenue authorities may determine existence of a PE even at the stage of examining a taxpayer's request for a certificate for beneficial treatment of withholding tax under section 197 of the Act. Verification of the conditions to constitute a PE must not only be conducted from a formal standpoint, but also, and above all, from a substantial standpoint. In other words, PE determination in a source state has to be decided based on actual facts of a case.

Whether a PE exists or not under Article 5(1) has to be ascertained separately for each enterprise, that is, existence of a PE of one entity in a multinational group is irrelevant while determining whether another entity in the group has a PE.

Moreover, if the revenue authorities have consistently accepted in the earlier years that the liaison office of the taxpayer in India was not a PE, they would

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[3] XYZ/ABC Equity Fund, In re (2001) 250 ITR 194 (AAR).

[4] Vanenburg Group B.V. (2007) 289 ITR 464 (AAR), Dow Agro Sciences Agricultural Products Ltd (2016) 380 ITR 668 (AAR)

not be justified in treating them as a PE in a subsequent year without bringing any material on record pointing to any change in facts.

2.1 Article 5(1) of the UN Model: Permanent Establishment

Article 5(1) of the UN Model reads as follows:

> "For the purposes of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of an enterprise is wholly or partially carried on."

Article 5(1) states the "basic rule" for constitution of a PE and expresses the primary meaning of PE.

Paraphrasing Article 5(1) as above, a PE exists if the following conditions are satisfied cumulatively:

- There is an “enterprise”.
- Such enterprise is carrying on a "business";
- There is a "place of business" in the other contracting state / Source state;
- Such place of business is at the disposal of the enterprise;
- The place of business is "fixed" and
- The business of the enterprise is carried on wholly or partially through this fixed place of business.

A PE does not exist unless all the aforesaid conditions are satisfied. To illustrate, if a foreign doctor (other than those covered by Article 14) provides services over a long period of time in Source state, but at different locations such that the doctor does not meet some of the aforesaid conditions (e.g., the doctor does not have power of disposal of the place of business), the doctor cannot be said to have constituted a PE in Source state.

Unlike the definition of "permanent establishment" in section 92F(iiia) of the Act, the definition of PE in Article 5(1) is exhaustive.

The definition cannot be considered in abstract and the functional test is to be applied to determine whether the taxpayer has a PE, that is, permanent infrastructure including office equipment, supervisory staff, and other

features of such PE. If revenue authorities contend that there is a PE of a foreign enterprise in a source state, they have to support their findings by adequate evidence.

In a generic sense, the term "permanent establishment" has been described: (a) as a virtual projection of the foreign enterprise in Source state; or, (b) as a firm foot in the soil of Source state; and (c) as not including casual transactions not involving the presence of the foreign enterprise for a considerable period of time in Source state.

2.2. Business

Article 5(1) requires that the enterprise should be carrying on a "business". Neither the OECD Model nor the UN Convention provides a definition of "business". Hence, by virtue of Article 3(2) of the conventions, in India, the term would be construed in accordance with s 2(13) of the Act which defines "business" as "including any trade, commerce or manufacture or any adventure or concern in the nature of trade, commerce or manufacture". As held by some Courts[5] an activity carried on continuously in an organized manner with a view to earn profit is "business": The expression "affairs" may be much wider than the expression "business".

The question whether an activity constitutes a business or not is a mixed question of law and fact, which has to be decided on totality of all facts and circumstances of the case. In the context of whether a foreign institutional investor (FII)/venture capital fund (VCF) holds shares as a "capital asset" (which would involve capital gains under Article 13) or "stock in trade" (which involves a "business" and consequently falls within the purview of Article 5 and 7), the AAR[6] initially held that, inter alia, the following tests may be relevant:

- Powers in the Memorandum of Association.
- Extent to which transactions are substantial in nature (eg: shares are purchased with substantial borrowings, quantum of total holdings, etc.).

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[5] Clifford Chance Vs DCIT (2002) 82 ITD 106 (Mum) ; Western Union Financial Services Inc Vs ADIT (2006) 101 TTJ 56 (Del),); Booz & Company (Australia) (P.) Ltd., (2014) 42 taxmann.com 288 (AAR).

[6] P No 10 of 1996, In re (1997) 224 ITR 473 (AAR); XYZ/ABC Equity Fund, In re (2001) 250 ITR 194 (AAR); AAR No 566 of 2002, In re (2004) 271 ITR 1 (AAR)

[see also Morgan Stanley and Co International Ltd (2005) 272 ITR 416 (AAR)].

- Largeness of systematic activity.
- Frequency of transactions (e.g.: multiplicity of transactions).
- Entries in books of accounts.
- Magnitude of purchases and sales.
- Ratio between purchases and sales.
- Period of holding.
- Motive behind the transaction (For instance, if the motive is to derive profit from purchase and sale of shares, the profit is a "business profit"; however, where the motive is to derive dividend etc, then any profit on sale of shares would be a "capital gain").

Some important observations by Courts[7] in the context of determination of existence of business are as follows:

- For the purpose of classification of income, the terminology or the context used in the SEBI Regulations can be used to determine the nature of the transaction.
- The intention of the investors is an important factor in determining the question.
- Reference is invited to decision of the Supreme Court[8] in CIT v Holck Larsen, wherein it was highlighted that the real question is not whether the transaction of buying and selling the shares lacks the element of trading, but whether the latter stages of the whole operation show that the first step of the purchase of the shares was not taken as, or in the course of, a trading transaction.
- In order to ascertain whether the first step of the purchase of the shares was not taken as, or in the course of, a trading transaction, one has to take cognizance of the legal framework and circumstances prevailing at the time of making the investment and the facts of the case.
- The circumstances and the framework of the plethora of legislative provisions unmistakably point out that a FII is not registered for

[7] Fidelity North Star Fund, In re (2007) 288 ITR 641 (AAR), Acee Enterprises [2015] 54 taxmann.com 74 (Del HC).

[8] (1986) 160 ITR 67 (SC).

carrying on trade in securities; it can only invest in securities for the purpose of earning income by way of dividends/interest and realizing capital gains on the transfer.

- In light of the above, it will be preposterous to impute that FIIs, who responded to the offer of investment in securities following the regulatory guidelines, registered under the SEBI Regulations and undertook to abide by those regulations, would, in the very first step itself, have intended to violate all the legislative requirements which provided them the opportunity to enter the capital market in India.
- Accordingly, the transaction is only in the nature of investment in capital assets to earn "capital gains".

The following factors may not be relevant to determine existence of business:

- The nature of receipt arising from the activity (e.g., royalty, technical services, dividend or interest).
- The fact that the taxpayer has not entered contracts of a similar nature with others.

The aforesaid tests have to be applied in totality and not in isolation. For instance, mere authority in the memorandum of association to undertake a particular transaction is not conclusive of the nature of transaction; there must be some material to show that in furtherance of the objects clause in the memorandum, steps are taken or it is given effect to for a particular transaction. Further, frequency of transactions, though an important factor, is not a decisive factor. It is well settled that a single plunge may amount to a business venture if surrounding circumstances so indicate.

It is possible for a taxpayer to have two portfolios of securities, that is, an investment portfolio consisting of capital assets and a trading portfolio comprising of stock-in-trade (trading assets)**.** With a view to reduce litigation and to maintain consistency in approach during assessments, the Central Board of Direct Taxes (CBDT) has issued Instructions/Circulars[9] providing guidelines for determination of the character of a particular investment i.e. whether the same is in the nature of a capital asset or stock-in-trade, and on taxability of income arising from transfer of listed and unlisted shares.

[9]Instruction No. 1827, dated August 31, 1989, Circular No. 4 /2007 dated 15 June 2007, Circular No.6/2016 dated 29_February 2016, Instruction F.no.225/12/2016 dated 2 May 2016

2.2.1 Illustrations of "business"

The following are certain examples of a "business":

- A VCF formed with the object of carrying on business of acquiring or investing in securities of all kinds, and ultimately selling at a profit, and carrying on the activity by acquiring large block of securities in companies pursuant to an intricate and complex system of investments, carries on a "business";
- A foreign enterprise carrying on the business of rendering money transfer services across international borders appointed agents in India for paying the monies to the beneficiaries after satisfying themselves about their identity and verifying the genuineness of the claim. The agreement of agency was initially for a period of five years which could be renewed for successive periods of one year. The agents could appoint sub-agents and had to maintain records and measure up to the standards set by the foreign principal. They received training from the foreign principal in the use of the software and communication systems. All these activities carried on systematically and continuously with a set purpose, amounted to a "business".

2.2.2 Project office

Although there is divergence in judicial thinking on whether a "project office" formed with the permission of the Reserve Bank of India (RBI) constitutes a PE under Article 5(1), presently, a business carried through the PO[10], should lead to constitution of PE in India, unless activity is auxiliary or preparatory in nature covered by the exclusion provision.

2.2.3 Supply of labour

The AAR[11] has held that an enterprise carries on a "business" when it engages skilled labour to supply them to other companies requiring such labour, gets paid on the basis of certain rates per unit of labour employed and, consequently by effecting economies in the scale of wages it offers to its employees, earns a margin of profit for itself. However, contrary views

[10] Rolls Royce Industrial Power Ltd. Vs ADIT (ITA-1410/Del/2007) ITAT, Delhi

[11] Tekniskil (Sendirian) Berhard vs Commissioner of Income-Tax (1996) 222 ITR 551

have also been expressed by other judicial authorities[12], especially in the context of secondment arrangements.

2.2.4 Profession

Merely because a person happens to be professionally qualified, it cannot be said that such a person's activity cannot be treated as carrying on of "business". It is important to see how a professional activity is carried on. A professional activity can also be characterised as an activity of carrying on "business" if it is carried on like a commercial activity".[13] Thus, where a medical practitioner does not confine himself to his conventional function of examining patients and prescribing medicines but establishes an X-ray machine, CT Scan machine and likewise other medical facilities for augmenting his professional work, it cannot be said that he has no profit motive in such adventure and that he is not carrying on a "business" activity.

2.3 "Place of business" test

This test requires that in order to constitute a PE, the foreign enterprise should have a "place of business". The term "place of business" is not defined. A "place", though normally "a particular portion of space", must be read in light of it being used to define an "establishment". A "place of business" means all the tangible assets (e.g., premises, facilities, machinery or equipment, or installations) which are used for carrying on the business, whether or not they are exclusively used for business purpose. In marginal cases, one tangible asset may be sufficient. The nature of the fixed place of business is very much that of a physical location, that is, one must be able to point to a physical location through which the business is carried on. The term "place" is wide enough to cover a large geographical area. Hence even a hawker paddling his wares on a particular street can be said to have his place of business on that street.

2.3.1 Illustrations: Place of business

- An office of 10 ft by 10 ft.
- A depot for storing imported goods.

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[12] Samsung Electronics Company Ltd vs DCIT- (2018) ITA Nos.- 65 to 70/Del/2013

[13] Clifford Chance vs Deputy Commissioner of Income Tax- (2002) 82 ITD 106 Mum

- A fully equipped diving support/fishing vessel
- A computer server.
- A place of business which is notified under s 592 of the Indian Companies Act, 1956.
- A facility for berthing at a port in Source State which is guaranteed for foreign ships provided on a time charter.
- Residential premises, if used for carrying out business activities.
- A motor racing circuit.
- Lockable space for storing tools and equipment within a stadium and lighting facilities.
- Vessels engaged in seismic surveys on the high seas in connection with the exploration of mineral oil/ natural resources.

2.3.2 Illustrations: No "place of business"

- Intangibles (e.g., a website which is a combination of software and electronic data) – as opposed to a server.14
- No services are rendered in India by an international newspaper (X) when it receives advertisement charges from its Indian client (Y) for publishing Y's advertisements in X's newspapers if such advertisements are meant for business of Y outside in India.[15]

The OECD Model Convention 2010 clarifies that, for the purpose of existence of a fixed place, the term 'place of business' covers any premises, facilities or installations used for carrying on the business of the enterprise. Thus, the place of business, generally should be in tangible form (such as an office, a factory, and equipment, etc). OECD Model Convention 2010, as well as UN Model Convention 2011, define key features for determining 'place of business' s including premises, facilities, installations, equipment, etc.; may

14 ITO vs Right Florists Private Limited- (2013) I.T.A. No.: 1336/ Kol. / 2011

15 It is important to note and distinguishably that in case of Google India (P.) Ltd. Vs Jt. DIT (IT(IT)A No.1190/Bang/2014)(2018) the payment made by the Appellant to Google Ireland Limited in relation to purchase of advertisement space for resale to the advertisers in India under the Google AdWords Reseller Agreement ('the Agreement') to be in the nature of 'Royalty' under the Act and the India-Ireland Double Taxation Avoidance Agreement ('India-Ireland Treaty')

be owned, rented or otherwise at the enterprises' disposal. The place need not be for enterprises' exclusive use and generally, human element is not relevant. In other words, such a place of business may comprise of an equipment (for instance, a computer server) and need not be manned by the enterprises' personnel. In his book "Double Taxation Conventions A Commentary to OECD-UN-and US model Convention for Avoidance of Double Taxation on Income and Capital", at page 285, renowned International Tax luminary and author Mr. Klaus Vogel defines a 'place of business' as "a place, though normally a particular portion of space, must be read in light of its being used to define 'establishment'. Therefore, according to Mr. Klaus Vogel, "a place of business would comprise of all the tangible assets used for carrying on the business".

2.4 "Power of disposition" test

The place of business should be at the disposal of the foreign enterprise for the purposes of its business activities. Some right or domain or control to use a place is required for having a PE. Such place of business may be owned or rented or may also be situated in business facility of another entity. The premise must be at the disposition of the enterprise. However, such power need not be a legal right to use a place and an illegally occupied place could also constitute a PE if the enterprise has some domain or control to use it (See example of hawker above). At the same time, no PE exists merely because an enterprise is present at a particular place if that place is not at the disposal of the enterprise, or that the presence is very limited. There should be some evidence to indicate that whenever any employee of the foreign enterprise comes to Source state, he should be able to walk into the business premises and occupy a space or a table. The onus is upon the Revenue to prove these facts to establish existence of PE.

2.4.1 Illustrations

- Mere possession of a mailing address in Source State without an office, telephone listing or bank account does not result in a PE.[16]

16 Mr. Philip Baker in his commentary on Double Taxation Conventions (Third edition) and as endorsed by the Delhi ITAT in case of Motorola Inc., Erisson Radio vs Deputy C.I.T (2005) 95 ITR 269 (Delhi ITAT)

- Occasional use of business premises of a group company (allowed gratis) in Source State to negotiate contracts does not create a PE.[17]
- A salesman who visits his customer's office in Source State to collect orders does not have the office at his disposal merely on account of his visits and hence, his employer does not have a PE. However, there could be a PE if the foreign enterprise has an office at his disposal together with telephone and telex, where its employees work.[18]
- Where a parent provides management services to its subsidiary through its (parent's) personnel sitting in its (parent's) premises, such premises are not at the disposal of the subsidiary[19].
- A website hosted on the computer server of an internet service provider does not result in the server being at the disposal of the enterprise (say "W") owning the website, even if W can choose the particular server on which its website should be hosted. If, however, W leases and operates the server on which its website is hosted, such server is at its disposal.[20]
- Whether an oil rig is at the disposal of a contractor who provides personnel for manning, operation and management of an oil rig, would necessitate reflection and conclusion whether firstly an oil rig could constitute place of business as above. Indian courts have held such oil rig to constitute a fixed place of business[21]. Once this is affirmed, conclusion on the disposal test in the context of oil rig may be academic.

2.4.2 Purpose of use of premises

Use of the premises should create an impression in the minds of the business customers of the foreign enterprise in Source State, that the office of the group company can be viewed as a projection of foreign enterprise's activities in Source state.

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[17] Motorola Inc., Erisson Radio .vs Deputy C.I.T (2005) 95 ITR 269 (Delhi ITAT)

[18] OECD commentary 2010 version on Article 5 of the OECD Model Tax Convention

[19] Motorola Inc. Erisson Radio .vs Deputy C.I.T (2005) 95 ITR 269 (Delhi ITAT Special Bench)

[20] OECD commentary 2010 version on Article 5 of the OECD Model Tax Convention

[21] ULO Systems LLC and others vs DCIT International Taxation (2019)ITA No. 5279/Del/2011

2.5 Place of business must be "fixed"

2.5.1 Definition of "fixed"

The concept of "fixed" has two aspects: that of space (location test) as well as that of time (permanence test).

2.5.2 "Location" Test

(a) Specific situs

The "location test" requires the place of business to be located at a "single place". Such place could be:

- a specific place or a distinct place within Source State (that is, it should have a specific situs); or
- moving within a specific geographical point or area or location".

If a foreign enterprise does not operate in Source State at a distinct place, then it does not constitute a PE, even if it operates for a long duration in the State.

(b) Specific place

The place of business should be a specific place within Source state It is not necessary that the equipment constituting the place of business has to be affixed to the ground; it is enough that the equipment remains at a particular site. The possibility of it being moved is irrelevant; what is important is whether it is, in fact, moved.

(c) Existence of "geographical" and "commercial" coherence

The expression "fixed place" does not necessitate that the place of business should be stationary and not moving. It involves identifying a "definite place" as the place from which a business is carried on. It is necessary that 'there should be both "geographical" and "commercial" coherence. Thus, an area cannot be regarded as a single place of business, if:

(i) the activities are carried on within a limited geographical area but there is no “commercial coherence'": or,

(ii) it constitutes a coherent commercial whole but lacks “geographical coherence”

2.5.3 "Permanence" Test

(a) Meaning of "permanence"

The use of the word "permanent" itself suggests that a PE can exist only if the place of business has a certain degree of permanency. The activity need not be "permanent" in the sense of everlasting eternally in nature or without interruptions. Permanence of the place has to be gauged only for as much time as the business requires. In the context of motor sports, when a race was to be conducted only for three days in a year and for the entire period of race, the place (being the racing track) was at the disposal of the assessee, the permanence test was met.[22]

At the same time, the expression "fixed" contains, in itself, the indication of a reasonable period for the existence of the place of business and in order to constitute a PE, the presence in Source State must be more than merely temporary or transitory.

For instance, an overseas supplier, who merely sells equipment to an Indian buyer and sends its expert engineer to India to supervise erection of the equipment for a short period, does not have a fixed place of business since it does not give rise to any establishment in India of a permanent or enduring nature either wholly or substantially which would amount to a virtual projection of the supplier in India.

(b) Intended permanence/actual conduct

The term "fixed" and the condition of "permanence" implicit therein should be construed by intent as well as conduct.

(c) Duration

Article 5(1) does not make reference to any minimum period for which a PE should be in existence in Source State. Article 5(3) suggests that the duration of a "basic rule PE" under Article 5(1) need not be for years but may be for a few months as well. PE may emerge even if place of business exists for a short period of time in certain circumstances e.g. in case of recurrent activities. However, an isolated activity cannot result in a fixed PE as the

[22] Formula One World Championship Limited vs Commissioner of Income Tax CIVIL APPEAL NO. 3849 OF 2017 (SC)

ingredients of regularity, continuity and repetitiveness are essentially missing in such cases.

(d) Calculation of time threshold

(i) Commencement of a PE : A PE comes into existence as soon as a foreign enterprise begins to carry on its business through a fixed place of business. For this purpose:

- The business is regarded to have commenced once the foreign enterprise is "prepared" at the place of business for its activities in the State.
- The period of time during which the place of business is being set up in Source State should not be considered, if this activity is substantially different from the activity which is intended to be carried on from the place of business in the Source State.

(ii) Cessation of PE : A PE ceases to exist when the business is no longer "carried on through a fixed place of business or the fixed place is disposed of. It is important to note, however, that since a PE of the non-resident is essential for only taxation of attributable business profits of such non-resident, if any, non-business income say capital gains income resulting from disposal of assets by the PE, may continue to be taxed in India, even after cessation of the PE.

2.6 "Business activity"/"Business connection" tests

The business of a foreign enterprise must be carried on ("business activity test") wholly or partially through a fixed place of business ("business connection test"). It may be carried on in Source State:

- pursuant to the physical presence of the entrepreneur himself, or his personnel (e.g., employees, dependent agents'", etc); or
- through automatic equipment (e.g., vending machines, computer, etc) when the foreign enterprise operates and maintains such equipment'. Human intervention may not be necessary for existence of a PE.

2.6.1 "Through which"

The word "through" has a wide meaning. It includes: (a) a situation where business activities are carried on "in" a fixed place of business; or (b) a place where business is not literally carried on "in" a place (e.g., a road construction site). The word "through" is used to be consistent with the language of Article 7(1) which refers to a foreign enterprise carrying on a business and making profits through a PE in Source State.

The fact that a foreign entity (A) derives economic benefit on account of activities of another entity (B) at a place of business in Source State, does not mean that A carries on its business "through" that location. To illustrate, if A procures management services from B, A does not have a PE if B is carrying on its business in Source State by using its own personnel. An exception could be a case where the management services and the relations between A and B are such that A can be construed to be carrying on its own business through the medium of such services rendered by B.

2.6.2 Agent

In certain situations, the business of a foreign principal may be carried on by its agent in Source State. Having regard to this, if the agent works at a fixed place of business and carries on the business of the foreign enterprise in Source State, a PE could be constituted under Article 5(1) although no "agency" PE is constituted under Article 5(5). However, it may be noted that whether a PE may be constituted in a situation where the premises of such agent are not at disposal of the foreign enterprise, is a debatable aspect. For instance, a legally independent agent, whose place of business may not be at the disposal of the foreign enterprise, might still constitute a PE of the foreign enterprise, if the courts conclude such agent to be economically dependent on such foreign enterprise.

The business of an enterprise is carried on mainly by the entrepreneur or persons who are in a paid-employment relationship with the enterprise (personnel). These personnel include employees and other persons receiving instructions from the enterprise (e.g., d*ependent agents*).

2.6.3 Business "carried on"

The expression" carries" denotes “actual carrying on of business” and does not cover a "would have carried on" situation.

If the fixed place of business is leased to another enterprise, normally it will only serve the activities of the lessee's enterprise instead of the lessors; in general, the lessor's permanent establishment ceases to exist, except where he continues to carry on a business activity of his own through the fixed place of business.

2.7 Article 5(2) of the UN Model

Article 5(2) of the UN Model reads as follows:

"The term 'permanent establishment' includes especially:

(a) A place of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

(f) A mine,

(g) An oil or gas well, a quarry or any other place of extraction of natural resources." Article 5(2) is inclusive and it contains an illustrative list of places which, *prima facie*, constitute a PE. The common thread in all these examples is that an enterprise can carry on business in Source State through these establishments. What is not included in Article 5(2) is not automatically excluded from Article 5(1), as is discussed below:

- (i) A warehouse, (ii) a farm, and (iii) a store or other sales outlet, constitutes a PE even though not specifically provided for in Article 5(2).
- A "simple depot" or "depot agency" or "inspection or repair depots", owned and operated by a container leasing enterprise (CLE), could be regarded as a PE although, no PE may exist if such depots are owned and operated by independent enterprises.

2.7.1 Article 5(2) in relation to Article 5(1)/5(4)

There are divergent views on the relationship between Article 5(2) and 5(1). As per one view, a place of business enumerated in Article 5(2) constitutes a

PE only if it satisfies the tests of Article 5(1) i.e. paras 1 and 2 of Article 5 complement each other. Thus, a project office specifically illustrated under Article 5(2)(c), does not result in a PE if it does not satisfy the "business activity" test under Article 5(1). However, as per the other view, Article 5(2) is independent of Article 5(1). This view is based on the well-established principle of statutory interpretation that an inclusive definition in Article 5(2) intends to add to the primary meaning in Article 5(1) so as to bring within its scope, items which may or may not fall within the scope of the primary definition. The Supreme Court observed that Article 5(1) defines a PE in an exhaustive manner and it is for this reason that Article 5(2) illustrates instances which may constitute PE of the foreign enterprise[23].

2.8 Components of PE under Article 5(2)

2.8.1 Place of management

The expression "management" in Article 5(2)(a) refers to the management of the foreign enterprise itself, and not of another entity and hence, a foreign entity/ enterprise does not have a PE under Article 5(2)(a) when it seconds an employee to its subsidiary in Source State in order to manage the subsidiary.

A "place of management" could be situated in residential premises. The term has to be interpreted widely.

2.8.2 Branch

A "branch" is "a division; a sub-division; department; a component portion of an organisation. It is a projection of an entity and depicts management and control of the entity over it. By itself, on account of its ("branch") meaning and statutory definitions, one associate company of a group of companies cannot be regarded as a "branch" of another company. Branch is the simplest example of a PE, and most foreign banks operate in India using the branch model.

2.8.3 Office

An "office" is mentioned, as such, for correspondence purposes. Unless defined otherwise in the domestic law, the term "office" would include a "place of management.

[23] DIT Mumbai vs Morgan Stanley & Co. Inc (2007) 292 ITR 416 (SC)

"Office" means a room, a set of rooms or building where the business of a commercial or industrial organisation or a professional person is conducted-". Thus, the term would include all types of offices including:

- A "management office" performing supervisory and coordinating functions.
- Depending upon the facts, a project office" or liaison office or even a recruitment office of a labour contractor for recruiting labourers"; could also constitute an "office".

2.8.4 Factory

A factory would obviously be a permanent establishment of the foreign enterprise in the Source State.

2.8.5 Workshop

A contractor does not have a "workshop" on an oil rig when it merely provides personnel for manning, operation management of such rig.

2.8.6 Oil or gas well

This clause covers only those foreign enterprises which own or operate an oil or gas well in Source State.

2.8.7 Any other place of extraction of natural resources

Article 5(2)(f) refers to "extraction" and not "exploitation" or "exploration". The words "any other place" are without any limitation and hence, include onshore as well as offshore places. "Natural Resources" has been defined in Black's Law Dictionary as "any material from nature having potential economic value or providing for substance of life, such as, timber, minerals, oil, water and wildlife". However, in the context of Article 5(2)(f), it can include only those natural resources which are capable of "extraction". Thus by intent, the term would include hydrocarbons or minerals.

The foreign enterprise should be engaged in extraction of natural resources. Mere provision of personnel for assisting in extraction is excluded from Article 5(2)(f).

2.8.8 Installation for extraction or exploitation of natural resources

Article 5(2)(j) of the India-US Tax Treaty provides that an installation or structure used for the exploration or exploitation of natural resources could result in a PE if used for a period of more than 120 days in any 12 month period. The India-Australia Tax Treaty provides that the term PE includes" an installation or structure, or plant or equipment, used for the exploration for or exploitation of natural resources". The installation or structure should be owned or operated and hence this clause does not cover a contractor merely engaged in the business of burial of pipelines, which does not own or operate such installation or Structure[24]. The provision does not cover all installations but only those used for exploration or exploitation of natural resources.

2.8.9 Warehouse

Certain Indian tax treaties include “a warehouse" in Article 5(2). Further, some tax treaties include warehouse in connection with providing storage facilities for others under Article 5(2), viz. India-Cyprus tax treaty, India-South Korea tax treaty.

2.8.10 Sales outlet

Article 5(2)(h) of the India-Netherlands Tax Treaty/Article 5(2)(f) of the India-UK Tax Treaty includes "a premises used as a sales outlet" in the definition of PE. The provision does not cover a place used for effecting delivery of courier packages. A "sales outlet" receives or solicits orders.

By itself, an associate company of a group of companies cannot be regarded as a "sales outlet".

Article 5(2) of the OECD Model is identical to Article 5(2) of the UN Model.

2.8.11 Substantial equipment

It is important to note the following extract of Article 5(3) of the India-Australia tax treaty, which reads as follows:

(b) carries on activities (including the operation of substantial equipment) in the other State in the exploration for or exploitation of natural

[24] P No 11 of 1995 (1997) (228ITR55) (AAR)

resources situated in that other State for a period or periods exceeding in the aggregate 90 days in any 12 month period; or

(c) operates substantial equipment in the other State [including as provided in sub-paragraph (b)] for a period or periods exceeding in the aggregate 183 days in any 12 month period;

such activities shall be deemed to be carried on through a permanent establishment of the enterprise situated in that other State, unless the activities are limited to those mentioned in paragraph 4 of Article 5 of the treaty, which, if exercised through a fixed place of business, would not make this place of business a permanent establishment under the provisions of that "paragraph."

2.9 Article 5(3) of the UN Model

Article 5(3) of the UN Model reads as follows:

"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;

In certain treaties, a PE may exist where such project or activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or activities exceed 10 per cent of the sale price of the machinery or equipment

(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 (for the same or a connected project) within a Contracting State for a period or periods aggregating more than six months within any twelve-month period."

Paraphrasing sub-paragraph (a), a PE exists if the following conditions are satisfied:

- There is a building site, a construction, assembly or installation project or supervisory activities in connection therewith; and
- Such site, project or activities last more than six months.

Paraphrasing sub-paragraph (b), a PE exists if the following conditions are satisfied:

- Services, including consulting services, are furnished by an enterprise;
- Services are furnished through employees or other personnel engaged by the enterprise for such purpose;
- Activities of that nature continue (for the same or a connected project) within the Source State; and
- Such activities continue for a period or periods aggregating more than six months within any 12-month period. There is no PE if the prescribed time limits are not exceeded and hence, a construction, installation or assembly project in Source State cannot be treated as a PE unless it continues for a period of more than six months, although it might otherwise fulfil the definition under Article 5(1).

If the prescribed time threshold is exceeded, the site or project constitutes a PE from the first day of the activity. There is no standard deduction of the period prior to the crossing of the threshold time limit.

Article 5(3) is not subject to Article 5(1); for example, the foreign enterprise need not have the power of disposition (control and domain) over the place where activities specified in Article 5(3) are performed.

2.9.1 Building site, a construction, assembly or installation project

The words "building site, a construction, assembly or installation project or supervisory activities" have to be read in their plain meaning. The exact nature of activities of the foreign enterprise is a matter of fact and evidence.

2.9.2 Project

The expressions "site" and "project" are not synonyms. The word "project" has been defined as "a large or major undertaking, especially one involving considerable money, personnel and equipment". A "project" may be carried on at more than one "site" or "location" and the fact that the work force is not present in Source state. for more than six months in one particular "site" or "location" is immaterial; the activities performed at each "spot" or "site" are part of a single "project" and such "project" must be regarded as a PE if, as a whole, it lasts for more than six months in Source state.

2.9.3 Article 5(3) in relation to Article 5(2): Office, workshop, place of management, etc

If a building site or a project does not last for more than six months, then it does not constitute a PE, and if there exists within it an office or other places that are illustrated under Article 5(2), such places also do not constitute a PE.

At the same time, where an office or workshop is used for a number of construction projects, then, even if none of these projects continues for more than six months, it (office/workshop) may still be considered as a PE under Article 5(2) if the office satisfies the conditions of Article 5. Likewise, in case of a foreign enterprise engaged in construction activity, its office used for storage, advertising activities, answering telephone calls and maintaining books of accounts, could constitute a PE even if no specific construction activity takes place and the place of management continues to remain in State of Residence. Therefore, it is imperative to clearly analyse the facts of each case to determine existence of PE in a contracting state.

2.9.4 "Threshold time limit" applies to each individual site or project

The "six-month test" applies to each site or project except where such sites or projects form a coherent whole commercially and geographically. Hence, time spent on unconnected sites or projects is to be ignored. Specific language of the tax treaty under consideration needs to be examined.

2.9.5 Commercial and geographic coherence

A series of contracts undertaken by a contractor that are interdependent both commercially and geographically are to be treated as a single unit for the purpose of applying the threshold test of "six months". Thus, a building site based on several contracts should be regarded as a "single unit" if it forms a "coherent whole" commercially and geographically. To illustrate, the construction of a housing colony is a "single unit" even if each house is constructed for different customers".

2.9.6 Abuse of "threshold time limit"

Domestic anti-avoidance legislative or judicial rules may be applied to prevent schemes for artificially avoiding the six months threshold.

2.9.7 Determination of "six-month threshold"

(a) Tenure

Tenure of a contract can be ascertained from the contract, invoice etc. for determining the date of commencement or completion of a contract. Besides, independent confirmation/certificate by the contractor, terms of contract, audited financial statements, correspondence with contractor, no-objection certificate granted by income-tax department to facilitate remittance, date of closure of project office etc. may be relevant. The onus is upon the Revenue to prove that the "time threshold" in Article 5(3)(a) is exceeded.

(b) Month

In the context of installation project, the AAR[25] observed, that "six months" means a period of "183 days", while analysing the connotation of the six-month time threshold.

(c) Commencement of PE

According to one view, a site in Source State exists from the date on which a contractor begins his preparatory work e.g., when he begins a planning office, etc. However, according to the other view, the "six-month threshold" commences from the date when the work physically begins in the Source State.

(d) Cessation of PE

A PE continues as long as the site, project or supervisory activities continue and it ceases to exist when: (a) the work at a site or of a project or the supervisory activity is completed or permanently abandoned; or, (b) the foreign enterprise ends its business activities in the Source State. A PE for a dredging contract ceases only when the dredger is completely demobilised; it does not cease from the date of completion of the dredging activity or on closure of "project office". Seasonal or temporary interruptions of operations (e.g., on account of bad weather, lack of raw materials or labour problems) cannot be regarded as a closure and such period should be included in determining the life of a site, although the concept of "temporary" may often be vague.

[25] In Re: P. No. 24 (1999) 237 ITR 798 (AAR)

(e) Time spent by sub-contractor

The expression "permanent establishment" in Article 5(3)(a) is defined with reference to an enterprise in relation to such enterprise's presence in site or involvement in project or supervisory activities. Hence, if a foreign enterprise (main contractor) sub-contracts to a sub-contractor all or part of its work in a Source state in relation to such site or project or activities, the time spent by the subcontractor must be considered as time spent by the main enterprise in Source state; further, if a sub-contractor is on a site intermittently, time is measured from the first day the sub-contractor is on the site until the last day (i.e., intervening days when the sub-contractor is not on the site, are counted).

In this regard, it is important to note that the commentary to the UN Model Tax Convention of 2017, specifically clarifies that if a main contractor subcontracts all parts of the main contract to another subcontractor, it does not imply that the main contractor could never constitute a PE in the Source state.

2.10 Article 5(3) of the OECD Model

Article 5(3) of the OECD Model reads as follows: "A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months." Article 5(3) of the OECD Model differs from Article 5(3)(a) of the UN Model as follows:

- the OECD Model excludes assembly and supervisory activities; and
- the OECD Model prescribes the time threshold for the building site or construction or installation project as twelve months instead of six months. To this extent, the UN Model narrows down the scope of relevant source rule

The UN Model incorporates sub-paragraph (b) with a view to allowing Source State to tax management and consultancy services provided therein.

2.10.1 Services

Article 5(3)(b) of the UN Model applies only to "services" and hence, it does not apply to other type of activities that do not constitute "services" such as manufacturing.

2.10.2 Services in Source State

Article 5(3)(b) applies only if services are performed by a foreign enterprise within Source state. Hence, where a foreign enterprise provides telecommunication services to its customers located in Source State through a satellite located outside Source State, the question is whether such services are outside the purview of Article 5(3)(b) and also whether such services can be said to have been rendered through employees or other personnel. 'Other personnel' can be understood as persons who work as per the instructions of the foreign enterprise not as employees of such foreign enterprise. Services cannot be said to have been rendered in Source State merely because invoice has been furnished in Source State or payment has been made in Source state.

2.10.3 Article 5(3)(b) applies to a "service provider"

On a plain reading, it appears that Article 5(3)(b) applies if a foreign enterprise ("service provider") furnishes services in Source state. The Supreme Court[26] has held that support services rendered by an Indian subsidiary, which enables the foreign company to onward 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

In this regard it is pertinent to note that the verb "furnishes" is a synonym for the terms provides / supplies / renders. The said article does not explicitly provide for any exceptions in terms of which services may not be provided / rendered / furnished but rather specifically includes consultancy services. Additionally and importantly, it may also be noted that services may be furnished both through individuals and non-living objects viz. computers, machines etc. Therefore, it needs to be evaluated whether article 5(3)(b) of the UN Model, requires physical presence of the employees or other personnel of the foreign enterprise (service provider) in the source state or whether services furnished in the source state without such service provider in sufficient to trigger PE implications in the source state. While the commentary to the UN Model Convention does not address this issue, it may be fairly arguable that article 5(3)(b) pre-supposes performance of business activities measured by time threshold of physical presence of service provider in the source state. There seems to be no other alternative logical

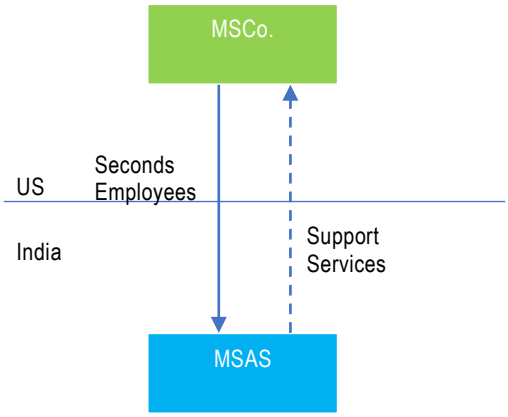
[26] ADIT vs E Funds IT Solutions Inc. 1 Civil Appeal No. 6082 of 2015 Dated October 24, 2017

way to determine physical presence. While the UN Tax Committee supported this view initially in 2014, however, a year later, it concluded that physical presence of service provider is not presupposed for the scope of Article 5(3)(b). It is imperative to note India considers the physical presence requirement to be irrelevant for application of the Service PE provisions.

2.10.4 Hiring of labour/secondments

In this regard, it's important to reflect on the Supreme Court decision in case of DIT v Morgan Stanley and Co Inc.[27].

In this case an Indian company "MSAS" provided BPO services (on a cost plus basis) to "M", its US group company. M's staff was also sent on deputation on request of MSAS to work under MSAS' direction and control. The staff continued to be on M's payroll and MSAS was to reimburse the compensation cost of M without profit element. Performance appraisal, promotion, discipline etc was to be carried out in consultation with M. M also sent its staff to India for stewardship and other similar activities to ensure high standards of quality by MSAS [which provided BPO services (on a cost plus basis) to M] and to protect business interests of its (M's) shareholders. The Supreme Court applied Article 5(2)(l) of the India-US Tax Treaty [equivalent to Article 5(3)(b) of the UN Model] in relation to the presence of the deputationists. The SC laid down the twin conditions for establishing a Service PE under Article 5(2)(1) of the India-US Tax Treaty i.e.



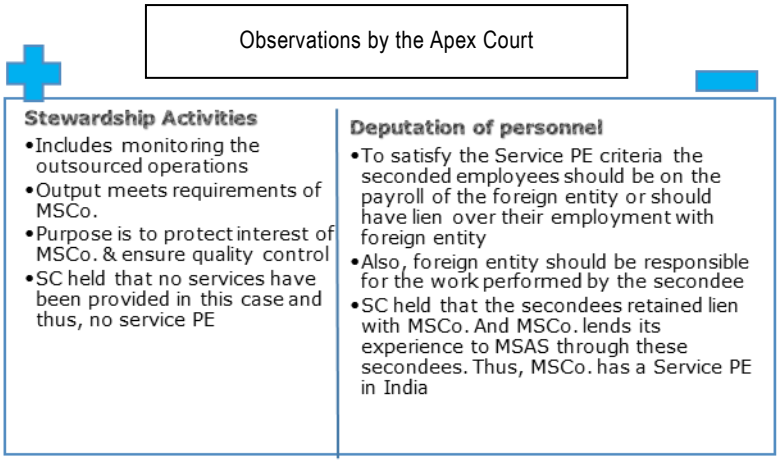
- where the activities of the foreign enterprise entail it being responsible for the work of the deputed personnel, and

[27] DIT Vs Morgan Stanley and Co Inc (2007) 292 ITR 416 (SC)

- the employees continue to be on the payroll of the foreign enterprise, or they continue to have their lien on their jobs with the foreign enterprise.

The Supreme Court was of the view that an employee of M, when deputed to MSAS, did not become an employee of MSAS. He had a lien on his employment with M and as long as the lien remained with M, the said company retained control over the deputationist's terms of employment. It observed that M deputed its staff on a request from MSAS depending upon its (M's) requirement and on completion of his tenure, the deputee was to be repatriated to his parent job. He lent his experience to MSAS as an employee of M since he retained his lien and in that sense there is a service PE under Article5(2)(1) of the India-US Tax Treaty.

Further, in a later ruling in Centrica India Offshore (P) Ltd[28], it was observed that there was no clear obligation on the Indian entity to bear the cost of the seconded employees and further that such employees continued to enjoy entitlement to their overseas social security and retirement benefits. The creation of a Service PE was thus upheld on the basis that though the Indian entity may have had operational control over the secondees, these limited and sparse factors cannot displace the larger and established context of employment abroad.



[28](2014)(227 Taxman 368)(SC)

However, in the Morgan Stanley case (supra), the Supreme Court did accept M's contention that it did not have a Service PE on account of its stewardship activities in India. It observed as follows:

- A customer is entitled to insist on quality control and confidentiality from the service provider.
- Stewardship activities involve briefing of MSAS' staff to ensure that the output meets the requirements of M and include monitoring of the outsourcing operations of MSAS.
- The stewards were not involved in the day-to-day management of MSAS or in any specific services to be undertaken by MSAS and that M was not providing any services to MSAS.
- The stewardship activity was basically to protect the interest of the customer (M) by ensuring quality and confidentiality of services and in such circumstances, stewardship activities would not fall under Article 5(2)(1) of the India-US Tax Treaty.

Based thereon, a similar view was expressed by the Delhi High Court in DIT v E-Funds IT Solution[29]. However, in Centrica India Offshore (P) Ltd(supra), the Court observed that the outsourced back office support functions in the case before it, cannot be characterized as mere stewardship activities.

Further, in another interesting decision in the case of ABB FZ LLC[30], the Bengaluru ITAT held that furnishing of consultancy services by the assessee through its employees pursuant to a regional headquarter service agreement, fell within the ambit of service PE under Article 5(2)(i) of the India – UAE DTAA. The ITAT rejected the assessee's stand that since the employees remained in India for 25 days only, service PE was not triggered. It observed that in the present age of technology where services, information, consultancy, etc., can be provided through various virtual modes like email, internet, video conference, etc., services can be rendered without the physical presence of employees of the assessee. It thus held that it is not the stay of the employees for more than 9 months which is required to be there, but what is required is the rendering of services or activities for more than 9 months within 12 months period.

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[29](2014) 364 ITR 256 (Del HC)

[30] (2017) 83 taxmann.com 86 (Bng ITAT)

2.10.5 Same or a connected project

The words "same or a connected project", do not cover unrelated projects. The reference to “connected project” is intended to cover cases where, even though the services are provided in the context of separate projects, those projects are carried on by a single enterprise and are commercially and intricately connected. This phrase “connected project” addresses that in particular abusive situations under which the supplying enterprise may artificially divide its activities into separate projects in order to avoid meeting the 183-day threshold. The determination of whether projects are connected will depend on the facts and circumstances of each case. Factors that may be especially relevant for that purpose include whether:

a. the projects are covered by a single master contract;

b. the projects would have been covered by a single contract in absence of tax planning considerations;

c. the contracts covering the different projects were concluded with the same person or related persons;

d. the conclusion of additional contracts with a person is a logical consequence of a previous contract concluded with that person or related persons;

e. the nature of the services provided under the different projects is the same or similar;

Generally, if the above aspects are not met in the context of separate, projects although by a single enterprise, such projects may be treated as unrelated or unconnected projects.

2.10.6. Connotation of the term "furnishing”"

Article 5(3)(b) refers to the furnishing of services … by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days …” There may be head room for interpretation in the current evolving business landscape, whether the term “furnishing” in this context signifies mere delivery of service in the source state or physical performance of the service in the source state.

The term "furnishing" used in Article 5(3)(b) may imply that, where employees or other personnel are present in the source country during the specified period of time, all the profits attributable to the services are furnished in the context of a same project or connected projects. While this requirement of physical performance of employees or personnel to render services in the source country to trigger PE implications may be relevant in the traditional forms of business conduct, the same requirement may have much less significance, perhaps obsolete in the context of digital forms of business, without need of physical presence of employees / personnel in the source country for service delivery. In the context of digital economy where services may be rendered remotely in the source country, it may be different aspect of analysis and interpretation whether such services may be covered within the definition of technical services for the purpose of the article on Fees for Technical Services.

2.10.7 Determination of "time threshold"

The period of six months referred to in Article 5(3)(b) applies in relation to furnishing of services by an enterprise and hence, applies to the enterprise and not to specific employees or other personnel. Thus, the same employees need not be present in Source State throughout the specified period. To the extent the foreign enterprise is performing its services in Source state on a particular day through at least one employee, that day would be considered while determining the period of presence in Source State.

2.10.8 Interplay between implications under Service PE /Installation PE and Fees for Technical Services (FTS) Articles

At times, taxpayers may encounter a confusion between taxability of an income as services income under Article 7 (read with Article 5) of a tax treaty vis-à-vis the fees for technical services under Article 12 / 13 of the tax treaty. This could be because of overlapping scope of such services as per these articles. For the benefit of understanding, the discussion could be in two parts, as follows:

(a) ***Service PE and FTS articles:***

The service PE articles in tax treaties, viz,. India UK tax treaty or the India USA tax treaty, etc. specifically exclude the services qualifying as fees for

technical services / fees for included services as evident from the following verbiage of the relevant articles therein – *…….“the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel but only if”……*

Therefore, in these cases, generally the overlapping effect is negated under the tax treaty.

(b) Construction / Installation PE and FTS articles:

Generally, in the definition of 'fees for technical services' as given in tax treaties, viz., those with Austria, Belgium, China, Germany, Switzerland, UK and the USA, the expression 'fees for technical services' describes these services in a general manner whereas the expression 'construction, installation or assembly project or supervisory activities in connection therewith' finds a specific mention in the PE clauses in other treaties. In the PE article dealing with construction, installation and assembly activities, including supervision activities relating to such construction, installation and assembly activities; there is no exclusion clause for services qualifying as fees for technical services. Therefore, it may be observed that unlike in the case of the provisions relating to Service PE, there is an overlapping effect of Article 5 and Article 12 or Article 13, so far as such construction / assembly / installation services are concerned. In a situation in which there are specific PE clauses in relation to a particular type of services, which are covered in the scope of services covered by the scope of the 'fees for technical services' or 'fees for included services', the taxability of consideration for such services must remain confined to taxability of profits under the relevant specific PE clause.

It may be fair to say that based on the Supreme Court ruling in case of Union Of India vs. India Fisheries (P) Ltd[31]. wherein it was held that a special provision should be given effect to the extent its scope whereas a general provision controls the cases where specific provisions do not apply.

[31] [57 ITR 331 (1965)]

2.11 Article 5(4) of the UN Model

Article 5(4) of the UN Model reads as follows:

"Notwithstanding the preceding provisions of this Article, 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 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."

Model Commentaries state that the purpose of Article 5(4) is to prevent a foreign enterprise from being taxed in Source State, if it carries on activities of a purely preparatory or auxiliary character in Source State; such activities in Source State may be productive, but are so remote from the actual realisation of profits that it is difficult to allocate any profit to Source State, or that it is only possible to attribute insubstantial profits to Source state.

2.11.1 Co-relation with Article 5(1)

Article 5(4) lists a number of business activities which are exceptions to the general definition laid down in Article 5(1); such exceptions are absolute notwithstanding that a particular activity otherwise satisfies the tests of a PE under Article 5(1).

2.11.2 Article 5(5) in relation to 5(4)

Article 5(4) starts with the words "Notwithstanding the preceding provisions of this Article" and consequently, overrides only Article 5(1) to Article 5(3). However, in view of the specific exclusion in Article 5(5)(a), provision under Article 5(5)(a) is subject to provision under Article 5(4).

2.11.3 Activities only "for the enterprise"

Article 5(4) uses the expressions "belonging to the enterprise" or "for the enterprise". Hence, a fixed place of business mentioned in Article 5(4) does not constitute a PE only if its activities in Source State are performed "on behalf of" or for the enterprise to which it belongs. However, a PE exists if such activities are also carried on behalf of other enterprises or if the activities are aimed at directly benefitting a third party as well.

2.11.4 Only exempted activities should be carried on

Having regard to the use of the word "solely" in Article 5(4), a fixed place of business mentioned in Article 5(4) does not constitute a PE if its activities in Source State are only restricted to activities specified therein. However, if a fixed place of business is used for "exception activities" (e.g. for storage or display of goods or merchandise) and also for other activities (eg, sales), it would not be eligible for the exemption and would be regarded as a "single PE" taxable in respect of both types of activities.

2.11.5 Disposal of movable property

Once a fixed place of business is deemed not to be a PE under Article 5(4), then the profits arising out of such activity as stated in Article 5(4) is also exempt. Thus, profit on the disposal of the stock-in-trade on termination of the enterprise's preparatory or auxiliary activity in Source State is also covered by the exception in Article 5(4) and, profits on the sale of products displayed in a fair or exhibition in Source State and sold at the termination of the fair, are not taxable in Source State.

2.12 Article 5(4)(a) of the UN Model

Article 5(4)(a) applies to the use of facilities by an enterprise for storage or display of goods or merchandise belonging to it.

2.12.1 Exclusion of the term "delivery"

Unlike the OECD Model, Article 5(4)(a) of the UN Model does not include" delivery" and restricts para (a) to "storage or display". The word" delivery" is deleted in the UN Model since stocking of goods in Source State for ensuring quick delivery to the customers facilitates sales of the products and thereby earning of profit in Source state. Consequently, a warehouse in Source State used for delivery of goods would be a PE. In the tax treaty with Singapore, only “occasional delivery” is exempted from PE constituting activity.

2.13. Article 5(4)(b) of the UN Model

Article 5(4)(b) relates to the stock of goods or merchandise and provides that such stock shall not be treated as a PE if it is maintained solely for the purpose of storage or display for the enterprise.

2.14. Article 5(4)(c) of the UN Model

Article 5(4)(c) provides that a PE is not constituted when a stock of goods or merchandise belonging to a foreign enterprise is maintained solely for processing by another enterprise in Source State.

2.15. Article 5(4)(d) of the UN Model

Article 5(4)(d) is wide enough to cover all enterprises including an enterprise in the form of a newspaper bureau.

2.16. Article 5(4)(e) of the UN Model

Article 5(4)(e) provides a generalised exception to the definition of PE in Article 5(1).

2.16.1 "Preparatory or Auxiliary"

The terms "preparatory" and "auxiliary" have not been defined in the Convention. It is often difficult to distinguish between the activities which are "preparatory or auxiliary" in character and those which are not. The facts of each case have to be individually examined to ascertain whether the activities have a "preparatory" or "auxiliary" character. "Preparatory" is generally "something that prepares or serves to prepare for the core activity.” "Auxiliary" generally connotes "ancillary" or "subsidiary". An "auxiliary" activity involves helping, assisting or supporting the main activity-". Having

regard to this, a fixed place of business does not exercise a "preparatory or auxiliary" activity when the activity of the fixed place of business in Source State forms an essential, indispensable and significant part (as opposed to only a small part) of the activity of the whole enterprise, this being the decisive criterion. In the context of determination of existence of PE in a source state, the phrase “preparatory and auxiliary” assumes special significance. The Supreme Court rendered one of its most awaited decisions in the case of Union of India v. United Arab Emirates[32], while dealing with the conundrum related to ‘preparatory and auxiliary’ exclusion. The Supreme Court of India, laid down that a mere right to provide service vested with the liaison office of a foreign enterprise without such liaison office having the permission to perform business activities cannot constitute a PE.

2.17 Project office, liaison office and other forms of business presence

Project office, branch office and liaison offices are prevalent forms of business presence of non-residents, other than subsidiary companies, joint ventures, in the Indian context

2.17.1 Project Office

There is a view that a project office set up by a non-resident in India primarily acts as a support office for the purpose of facilitating the performance of a project, The determination whether a project office of a foreign enterprise in the source state could constitute a permanent establishment in such source state depends on the overall facts of each case, specially the nature of activities carried out by the project office. As may be noted in the ensuing pages, very interestingly and importantly, the Supreme Court, in case of Samsung Heavy Industries Co. Ltd. (DCIT vs. Samsung Heavy Industries Co. Ltd. (Civil Appeal No 12183 of 2016), held that since the Project office under consideration never carried on any core activities of business of the taxpayer but merely acted as a Liaison office between the Head office and the client (ONGC), such non-core activities are preparatory and auxiliary in nature and therefore the impugned project office shall not constitute permanent establishment in India. Prior to this ruling the Delhi High Court in case of

[32] Civil Appeal No. 9775 of 2011 (24th April 2020)

National Power Construction Company vs DIT (International Taxation)[33] held that a project office of a foreign company acting merely as a communication channel would fall within the ambit of Article 5(4)(e) and thereby not result into a PE in India.

2.17.2 Liaison office

There had been divergence of views regarding liaison offices constituting a PE:

In UAE Exchange Centre LLC[34], the AAR held that an Indian liaison office of a foreign enterprise engaged in remittance services, performs an essential activity and thus, falls outside Article 5(4)(e) when such liaison office downloads information (such as names and addresses of beneficiaries, amount to be remitted, etc.), prints cheques/ draft and dispatches them to the addresses of beneficiaries through courier. As may be noted in the ensuing pages, this ruling was eventually overruled by the Delhi High Court. Upon further appeal by the revenue authorities, the Supreme Court upheld the decision of the Delhi High Court by ruling that since the nature of activities performed by the liaison office in the instant case partake the character of preparatory / auxiliary, such activities qualify under the exception under Article 5(3)(e) and therefore, do not constitute PE of the UAE Exchange Centre LLC. The Supreme Court upheld this principle in case of UAE Exchange Centre LLC[35]. As may be noted in the ensuing pages, in its judgment, the Supreme Court upheld the view that even if the activities of the liaison office were regarded as business activity, the preparatory or auxiliary character of such activities excludes the liaison office from being treated as a PE by virtue of Article 5(3)(e) of the India-UAE tax treaty.

In certain other cases, it was held that the liaison/ representative office was not a PE. Where no violation was reported by the RBI, the activities of the liaison office were presumed of preparatory and auxiliary character.

- Identifying new customers, marketing activities, price negotiation, discussion of commercial issues, securing and processing orders have led to the liaison office forming a PE. Courts have observed that

33 ITA No. 143/2013 (Del)(2016)

34 2004 268 ITR 9 AAR

35 116 taxmann.com 379

merely because the Head Office received orders and payments directly from the buyers and also sent goods to them directly, would not mean that only liaison work was done by the liaison office. However, receiving information, enquiries and feedback for passing it on to the Head Office and co-ordination activities have been held as preparatory in nature.

- The Czech Republic and Slovak Republic have observed that a commercial representation office, that is involved in commercial negotiations for import of products in Source State, does not carry on auxiliary or preparatory activities, if essential parts of the contracts (e.g. quality, quantity, time frame and terms of delivery) are determined by such office.
- In the case of GE Energy Parts Inc[36]., the Delhi Tribunal held that as the activities carried out were substantial and core, the liaison office of one of the group entity was a fixed place PE of the assessee as well as of other overseas entities in the group for which such activities were carried out.
- The Delhi High Court held in Mitsui & Co. Ltd. that where the revenue had been unable to show that the liaison office of the assessee was used for the purpose of business or trading activity, the Tribunal was correct in holding that the assessee did not have a PE in India and was therefore exempt under the provisions of the DTAA between India and Japan. It observed that it was not enough for the revenue to show that the assessee had an office, factory or a workshop etc. within the meaning of Article 5(2) of DTAA; For the purpose of Article 5(1), the revenue was required to show that such place was a fixed place of business through which the business of an enterprise is wholly or partly carried out.

Therefore, the fact whether a liaison office constitutes a PE will have to be examined based on facts and circumstances of each case and it cannot be presumed that a liaison office will always be excluded from the purview of Article 5.

[36] ITA no. 6049/DEL-2010

2.17.3 Advertising activity

There is no PE in Source State when a fixed place of business engages solely in promotional advertising for the goods manufactured by the foreign enterprise.

Indian treaties

Article 5(3)(e) of the India-US Tax Treaty specifically excludes from PE, the maintenance of a fixed place of business solely for the purpose of advertising for the enterprise.

2.17.4 "For the enterprise"

In terms of Article 5(4)(e), a fixed place of business in Source State has to be maintained "for the enterprise" and hence, if it renders services not only to its enterprise but also to other enterprises, it does not fall within the exception to Article 5(4).

2.18 Article 5(4)(f) of the UN Model

Article 5(4)(f) provides that where a fixed place of business combines any of the activities mentioned in sub-paragraphs (a) to (e) then, as long as the combined effect of the overall activity of such fixed place of business is preparatory or auxiliary, a PE should not be deemed to exist. As highlighted subsequently in this publication, one of the key recommendations by OECD in its BEPS Action Plan 7 report towards countering artificial avoidance of PE status, is to restrict the application of a number of exceptions to the definition of permanent establishment to activities that are preparatory or of auxiliary nature and for ensuring that it is not possible to take advantage of these exceptions by the fragmentation of a cohesive operating business into several small operations.

Article 5(4)(f) should not be interpreted rigidly and ought to be considered in the light of facts and circumstances. However, as may be clear from the above recommendation by OECD in its BEPS Action Plan 7 report, an enterprise cannot fragment a cohesive operating business into several small operations in order to argue that each part is merely engaged in a preparatory or auxiliary activity.

2.19 Articles 5(5) and 5(7) of the UN Model: Agency PE

Articles 5(5) and 5(7) deal with the concept of "dependent agent PE". It is important to note and relate from the subsequent discussion in para 11 of this publication, that the OECD in course of the Base Erosion and Profit Shifting (BEPS) project, has proposed substantial changes to the concept of dependent agent PE. The Model tax conventions are being modified appropriately. However, it is important to note the basic purport of these articles in detail to appreciate the modifications suggested under BEPS project and the judicial precedents which may ensure it in future.

Article 5(5) of the UN Model reads as follows:

"Notwithstanding the provisions of paragraphs 1 and 2, where a person-other than an agent of an independent status is acting in a Contracting State (source state) on behalf of an enterprise of the other Contracting State (resident state), that enterprise shall be deemed to have a permanent establishment in the first mentioned Contracting State in respect of any activities which that person undertakes for the enterprise, if such a person:

(a) has and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph; or

(b) has no such authority, but habitually maintains in the first mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise."

Article 5(7) of the UN Model reads as follows:

"An enterprise of a Contracting Source state shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise, and conditions are made or imposed between that enterprise and the agent in their commercial and financial relations which

differ from those which would have been made between independent enterprises, he will not be considered an agent of an independent status within the meaning of this paragraph."

Paraphrasing, Article 5(5) and 5(7), a PE is constituted for another person if the following conditions are satisfied:

- there is a person;
- he is acting on behalf of an enterprise;
- he is acting in Source State;
- he is not an independent agent to whom Article 5(7) applies, and
- the conditions in either sub-paragraph (a) or (b) of Article 5(5) are satisfied
- activities are not limited to those mentioned in Article 5(4)

That is: the person has an authority to conclude contracts in the name of the enterprise; such authority is habitually exercised; and the person's activities are not limited to those mentioned in Article 5(4) [Article 5(5)(a)] or there is no authority as specified in Article 5(5)(a); the person habitually maintains in Source State a stock of "goods or merchandise; and from such stock, the agent regularly delivers goods or merchandise on behalf of the principal [Article 5(5)(b)].

2.20 Independent agent

Paraphrasing Article 5(7), a person will not constitute a PE of another person ("principal") if:

- such person is a broker, general commission agent or any other agent ("agent");
- he acts in the ordinary course of his business;
- he is independent of his principal.
- his activities are such which could not be considered as devoted exclusively or almost exclusively on behalf of his principal; and
- conditions made or imposed between him and the principal in their commercial and financial relationship do not differ from those which would have been otherwise made between independent enterprises.

An agent of independent status needs to be independent both legally and economically. Refer detailed discussion in Para 5.33 in this regard.

2.21 Article 5(5) of the UN Model:

Article 5(5) refers to "Agency PE". It contains a deemed inclusion clause" and commences with a non-obstante clause overriding Article 5(1)/(2). Accordingly, a foreign enterprise may be treated as having an Agency PE in Source State even though it may not satisfy all the tests in Article 5(1) (such as not having a fixed place of business at its disposal in Source State within the meaning of Article 5(1) and 5(2), or not satisfying the time threshold of six or twelve months).

2.22 Articles 5(5) and 5(7) of the UN Model

Articles 5(5) and 5(7) must be read together. On such combined reading, the following two principles emerge:

- Article 5(5) applies only to a case where the person who acts on behalf of a non-resident is not an agent of independent status within the meaning of Article 5(7).
- Even when an agent fails to come up to the standard of independence mentioned in Article 5(7), the issue regarding PE is not closed but has to be resolved in terms of Article 5(5). In other words, a dependent agent does not automatically constitute a PE for its principal unless it (agent) satisfies the requirements of Article 5(5)(a) or (b).

2.23 Article 5(5) and 5(1)

If a dependent agent works at the fixed place of business of its non-resident principal in Source State, a PE of the principal may exist under Article 5(1) and (2), even if the agent is not authorised to conclude contracts. In other words, if the principal has a PE within the meaning of Article 5(1) and (2), it is not necessary to show that the agent would fall under Article 5(5).

2.24 Whether a website can be treated as an Agency PE

It is necessary that a "person" is acting in Source State on behalf of a foreign enterprise. The term "person" is defined in Article 3(1)(a) as including an

individual, a company and any other body of persons. A website is not a "person" and thus, cannot constitute an Agency PE.

2.25 Agency relationship

It is necessary that the agent should act "on behalf of" a foreign enterprise in Source State. Section 182 of the Indian Contract Act defines" agent" as a person employed to do any act for another or to represent another in dealing with third parties. An "agent" is one who works for another in accordance with his authority while dealing with third parties or who canvasses for his principal. He may be a person who is, responsible for, or can act or enforce anything on behalf of, his principal. His activities accrue to the benefit of the principal and are inter-connected with his principal's business. An "agent-principal" relationship presupposes an identity of interest or character or personality and unity in profit making, A principal has some control over its agent's activities and can interfere with performance of agency function.

An "agent" is different from a contractor or "sub-contractor'. In order to determine the existence of a "principal-agency" relationship, one has to look into the substance or essence of the agreement rather than its form.

2.26 Dependent agent

Article 5(5) refers to "a person" without any qualification. As such, a dependent agent could be:

- any entity, including individuals or companies: or
- employees of the foreign enterprise, or non-employees;
- residents of Source State or non-residents.

What is defined as a "dependent agent PE is not the dependent agent, per se, but it is by virtue of a foreign enterprise having a "dependent agent" that the enterprise is deemed to have a PE. It is the brokers, agents, etc. who constitute "Agency PE" and not their employees. It may have to be decided on actual facts as to whether persons employed to carry on a principal's activities are independent. Substance over form approach must be used to determine this, and nomenclature in agreement and other documents may not be sufficient, if there is evidence to the contrary. For instance, there could be a case of blank agreements signed by the foreign enterprise available with the agent, who then would fill up the same while entering into a

contract. As such, though prima facie and in form the agreement is entered into by the foreign enterprise, in substance the same was executed by the agent, leading to existence of DAPE.

In the GE Energy Parts Inc[37]. ruling, the Delhi Tribunal held that GE India (comprising expatriates deputed to India and the employees of the Indian entity) constituted a dependent agency PE of the assessee and the other entities in the group, as it had authority to conclude contracts on their behalf. The Tribunal also observed that though the number of GE overseas entities managed by GE India was more than one, all the entities were in the businesses of the GE group and GE India was not an agent of independent status working for other third parties in India.

2.27 Satisfaction of conditions under Article 5(5)(a) or (b) of the UN Model

Mere dependency of an agent is not sufficient to constitute an Agency PE. Having regard to the use of the word "if" in Article 5(5), an Agency PE would be constituted by only those dependent agents who satisfy the conditions of Article 5(5)(a) or (b). In eBay International AG[38], the Mumbai Tribunal has held that though the Indian group companies of eBay based on their conduct could be treated dependent agent of eBay International, a dependent agency PE in terms of Article 5(5) of the India – Switzerland tax treaty was not formed as the agents did not perform any of the activities mentioned under Article 5(5). The Tribunal laid down that it is only when the person doing activities for the foreign enterprise in India, turns out to be dependent agent, that the case is to be further scrutinized on the touchstone of para 5 of Article 5 of the DTA for determining as to whether it has resulted into PE or not. If any of the conditions given in para 5 of Article 5 of the DTA is satisfied, then such dependent agents will constitute dependent agent PEs of the assessee in India. In the otherwise case, the test of PE will fail.

2.28 Article 5(5)(a) of the UN Model

If the conditions mentioned in Article 5(5)(a) are satisfied, then, a PE exists for all the purposes for which an agent acts for its foreign principal and not

[37] ITA No. 6049/DEL-2010

[38] 2012 (ITA No.6784/M/2010)

only to the extent it (agent) exercises its authority to conclude contracts in the name of the foreign enterprise.

Further, Article 5(5) refers to a person acting on behalf of" an enterprise" and provides that "that enterprise shall be deemed to have a permanent establishment". The use of the words "an" and "that" would imply that the existence of a PE under Article 5(5)(a) has to be determined separately for each group company independently, and existence of a DAPE for one of the group companies would not mean that the entire group of the foreign enterprise has a PE in the source country.

2.28.1 Authority to conclude contracts

Only persons having and exercising an "authority to conclude contracts in name of the enterprise" can lead to a PE for the foreign enterprises". The principles in connection with the determination of authority to conclude contracts, are explained below:

(i) A person can be said to have such authority if: he has sufficient authority to bind the enterprise in Source State and to decide the final terms of the contract. i.e. whether he can act independently, on his own, freely, and without control from the principal, is he authorised to negotiate all elements and details of a contract which are binding on the enterprise.

(ii) It is not necessary that an agent should enter into contracts "literally" in the name of the enterprise; as long as he has an authority to conclude contracts which are binding on the enterprise, the case is covered within Article 5(5) even if those contracts are not actually in the name of the enterprise.

(iii) It is the "actual authority" which is relevant. To illustrate: an agent may be considered to possess such actual authority when he solicits and receives orders but does not formally finalise them, the principal routinely approves them and the orders are sent directly to a warehouse from where goods are delivered by the principal.

(iv) The term "has" refers to the legal existence of an authority to conclude contracts', it is not necessary that the agent should have been formally given a power of representation. Lack of active involvement by a principal may indicate that the agent has an authority to conclude contracts on behalf of its principals.

(v) On the other hand, there is no authority to conclude contracts when: an agent signs contracts only after obtaining approval from its principal or based on standard terms determined by its principal, an agent is performing his duty. The words "duty" and "authority" do not connote the same relationship, in as much as what is considered to be a "duty" cannot be considered to be an "authority". A "duty" connotes an obligation which a person is bound to perform. By making a payment in Source state on behalf of his principal, the agent is only performing his duty for which he is remunerated and is not exercising any authority.

Illustrations: Lack of authority to conclude contracts

- An internet service provider who merely provides a server on which a foreign enterprise hosts its website, does not have an authority to conclude contracts in the name of the foreign enterprise.
- Mere service of duplicate copies of the orders on an agent does not make the agent as a person who has powers to conclude contracts.
- An investment adviser obtaining information and passing it to the investment manager is not concluding contracts,
- A BPO (back office unit) in India does not have an authority to conclude contracts when it renders support services to foreign clients on account of reconciliation, research, etc.

2.28.2 Habitual exercise of authority to conclude contracts

(a) Habitually

An agent must habitually exercise an authority to conclude contracts. The expression "habitually" refers to a systematic course of conduct on the part of the agent and would mean "repeatedly" and "not in isolated cases. The extent and frequency of activity necessary to determine whether the agent is habitually exercising his authority, cannot be laid down precisely and will depend upon the nature of the contracts and business of the principal.

(b) Exercise

In order to trigger Article 5(5), mere existence of the authority to conclude contracts is not sufficient; it is essential that the authority is actually"

exercised" by the dependent agent in Source State. He should, through actual conduct, utilise such power. This fact is to be determined on the basis of the commercial realities of the situation and for this purpose substance prevails over form, and no straight-jacketed rule can be laid down.

The expression" exercise" denotes "application of a right" or "exertion of influence or power". An agent, who negotiates all elements of a contract on behalf of its principal is binding the principal, and hence acts not for himself but for the principal to this extent.

However, mere participation in negotiations by an agent on behalf of its principal without binding the principal does not amount to "exercise" by the agent of an authority to conclude contracts in the name of the principal.

2.28.3 Article 5(5)(a) is subject to Article 5(4)

Article 5(5)(a) has to be read in light of Article 5(4); hence, activities of a dependent agent (including employees) which are restricted to such purposes as mentioned in Article 5(4) do not create a PE for the principal.

2.29 Article 5(5)(b) of the UN Model

Article 5(5)(b) is absent in the OECD Model. Article 5(5) of the UN Model, which is substantially broader in scope than Article 5(5) of the OECD Model, limits the scope for tax evasion. The onus is upon the Revenue to prove that Article 5(5)(b) is attracted especially when the taxpayer produces evidence that the local agent does not maintain any stock of goods on behalf of the foreign principal.

A toll manufacturing arrangement may get covered under this agency PE constituting activity, Under this arrangement, typically the group company supplying the manufacturing services (the ‘manufacturer or toll manufacturer’) provides the plant, machinery and labour force necessary to manufacture the relevant product. The contracting company (the ‘principal’) supplies the relevant raw materials, and will often also have ownership of all the intellectual property relating to the products, such as patents and trademarks.

On a plain reading, it appears that the expression "has no such authority" indicates the absence of authority of the nature mentioned in Article 5(5)(a).

2.29.1. Physical Stock: Whether necessary?

On a plain reading, Article 5(5)(b) applies only if the dependent agent physically maintains a stock of goods or merchandise in Source State. In this context, observations of the AAR while dealing with business of dealing in Business Information Reports (BIRs) and whether payments to a non-resident entity for electronic purchase of BIRs by an Indian group entity in case of Re: Dun And Bradstreet Espana[39] are interesting to note. This is specifically so in the context of physical stock maintenance under e-commerce scenario The AAR observed that "there can be no difficulty in accepting that in the case of e-commerce, it is not necessary to maintain a physical stock and inventory and that a line access to inventory would be sufficient to equate it with maintenance of stock".

However, for the sake of completeness, it may be noted the AAR ruled in favour of the applicant holding that the Indian group entity DBIS cannot be treated as constituting a PE of the non-resident simply because DBIS has password access to the BIR repository of the non-resident entity. The AAR observed that "*in this case to have access to the server farm of the applicant, each time DBIS entertains a customer for a BIR, it has to approach the applicant and it is only after knowing the particulars of the BIRs required by DBIS, that the applicant grants access to its server farm by DBIS. This is akin to sale rather than delegation of sale function to DBIS by the applicant. It is a clear case of the applicant permitting DBIS to take a BIR from the stock maintained by the applicant and not maintaining stock of BIRs by DBIS itself".*

2.29.2 Sales related activities

The expression "from which he regularly delivers goods or merchandise on behalf of the enterprise" denotes a delegation of sales function, rather than a sale…

One could say that no PE exists if all sales-related activities and maintenance of stock of goods take place outside Source State, and mere delivery by an agent takes place in Source State; however, a PE exists, if the sales-related activities (e.g., advertising or promotion) are also conducted in Source State on behalf of the principal and have contributed to the sale of such goods in Source state.

[39] 2005 272 ITR 99 AAR

2.29.3 Article 5.(4)(c) of the India-US Tax Treaty

Article 5(4)(c) of the India-US Tax Treaty considers a dependent agent to constitute a PE of his principal if "he habitually secures orders in the first-mentioned state, wholly or almost wholly for the enterprise". As per the Protocol to the India US Tax Treaty, Article 5(4)(c) is attracted, if the following conditions are satisfied:

- the agent frequently accepts orders for goods or merchandise on behalf of his principal;
- substantially all of the agent's sales- related activities in Source State consist of activities for his principal;
- the agent habitually represents to persons offering to buy goods or merchandise that acceptance of order by the agent constitutes the agreement of the principal to supply goods or merchandise under the terms or conditions specified in the order; and
- the enterprise takes actions which give purchasers the basis for a reasonable belief that such person has authority to bind the enterprise.

2.30 Article 5(7) of the UN Model

Article 5(7) contains a deemed exclusion clause. The test in Article 5(7) is objective. Model Commentaries state that it has been inserted for the sake of clarity and emphasis, although logically an independent agent cannot constitute a PE of the foreign enterprise.

2.30.1 Independent Agent

An agent will not constitute a PE of its principal if, inter alia, he is "an agent of independent status" that is, "independent" of the enterprise. The expression "independent" means "not subject to the authority or control of any person; free to act as one pleases, autonomous. Such independence has to be comprehensive that is, legal, functional and also economic and financial. This, inter alia, depends on the extent of the obligations of the agent in relation to its principal. Generally speaking, the requirements of "independence" may be met where:

- the agent operates from a position of strength, knowledge or skill in relation to the foreign enterprise; or,

- he has overall control over an autonomous business conducted by him, bears the risk of his business, and receives reward through the use of his skills and knowledge.

In Morgan Stanley & Co Inc[40], M, a US company, along with other foreign group companies, availed of support services from MSAS, an Indian group company. The AAR[41] held that the functions and the activities of MSAS are wholly and exclusively dependent on the applicant both legally and economically as is evident from the fact that for the year 2003-04, the entire revenue was received from Morgan Stanley Group only; there was no revenue from any independent party.

The onus is on the principal to show that a particular agent is of an independent status. Determination of independence is a factual exercise, and all facts and circumstances must be taken into account. For this purpose,

(i) the exact working of the agent;

(ii) the correspondence between the agent and the principal;

(iii) the mode of functioning of operations;

(iv) the quantum of work done;

(v) the services rendered;

(vi) the contracts undertaken for outsiders (that is, other than the principal and the companies controlled by it) would have to be examined to determine whether the agent is of an independent status or not;

However,

(i) the fact that the agent is a subsidiary; or

(ii) the mode of receipt of commission (e.g. whether in Indian currency or foreign currency) would not make any difference in ascertaining independence

2.30.1.1. Legal independence

(a) Relevant factors

The factors relevant in determining legal independence of an agent are summarised below:

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[40] (2007) 292 ITR 416 (SC)

[41] 2006[284ITR260]AAR

- Whether the agent's commercial activities for his principal are subject to detailed instructions or comprehensive control by the principal; or the extent to which the agent exercises freedom in the conduct of his business on behalf of the principal (an independent agent is generally not subject to significant control with respect to the manner in which he carries out his work).
- Whether an agent's scope of authority is affected by limitations on the scale of business which may be conducted by it (agent) (e.g., an agent whose principal has contractually imposed a condition of exclusivity may not be independent depending on the overall facts).
- Whether an agent represents multiple principals? An agent who represents multiple principals may be legally independent. However, even where he acts for a number of principals in the ordinary course of his business and none of these is predominant in terms of the business carried on by him (agent), legal dependence may yet exist if the principals act in concert to control the acts of the agent.
- Whether the principal is relying on the special skill and knowledge of the agent (such reliance would mean independence).

(b) Irrelevant factors

The factors which may not be relevant in determining legal independence of an agent are summarised below:

- Limitations on the scale of business which may be conducted by the agent.
- Extent to which the agent exercises freedom within the scope of the authority conferred by the agency agreements.
- The control that a parent company exercises over its subsidiary in its capacity as a shareholder (This principle is expressly recognised in Article 5(8) of the UN Model).
- Existence of checks and balances within an international group of companies to ensure that group companies work as a well knit group, catering to the needs of the others, each being entitled to use the international group brand names.
- All disabilities and disqualifications in the agency agreement are fastened to the agent alone.

2.30.1.2 Economic independence

While determining whether the agent is "economically independent", the following factors are relevant:

- *Extent to which the agent bears "entrepreneurial risk" or "business risk".* "Business risk" primarily refers to the risk of loss. An agent that shares "business risk" with its principal, or has its own "business risk", is "economically independent" because its activities are not integrated with those of the principal.
- *Whether the agent acts exclusively or nearly exclusively for the principal.* While it is not determinative, an agent is less likely to be independent if its activities are performed wholly or almost wholly on behalf of only one principal over a long period of time. An agent who represents multiple principals may be economically independent. An exclusive relationship may indicate that the principal has economic control over the agent. However, an agent, although exclusive, who has the capacity to diversify and acquire other clients without substantial modifications to its current business and without substantial harm to its business profits, is not economically dependent.

Agency devoted "wholly or almost wholly" on behalf of one principal

The "activities" referred to in Article 5(7) are that of the broker, general commission agent, or any other agent and not of the foreign enterprise.

The word "wholly" means entirely, completely, fully, totally. The expression "almost wholly" means almost entirely, very near to wholly, a little less than whole; in terms of percentage, it means anything more than 90%. Thus, an agent does not carry out activities "wholly or almost wholly" for its principal when its (agent's) activities for the foreign enterprise yield say, 75% to 80% of its (agent's) income and income from other principals is, say between 20% and 25%.

What is relevant is that the agent's activities are for a single principal and not that the principal's activities are carried on by a sole agent. Hence, the mere fact that the entire work of the foreign enterprise in Source State is done through a sole agent does not result in a "dependent agency" relationship. A contrary view was expressed by the Mumbai ITAT earlier in DHL Operation B.V[42].

[42] (142 Taxman 1) (Mum)

In deciding whether or not the activities of an agent are confined to one principal:

- the correspondence between the agent and principal has to be examined;
- the mode of their functioning and operations, has to be examined in totality.
- existing facts and not prospective facts have to be examined
- the fact that the agency agreement prohibits the agent from accepting any agency of a competitor without first obtaining the principal's consent, is not relevant.

Judicial opinion is divided on whether "other activities" of the agent should be considered in determining a PE.

2.31 Ordinary course of business

An agent will not constitute a PE of the principal only if, inter alia, he is acting in the "ordinary course" of his business. A broad view has to be taken in these matters. The expression "ordinary course of their business" has been interpreted as follows:

- The word "ordinary" means "normal.
- The expression "in the ordinary course of business" is also used in section 32(2) of the Indian Evidence Act in which it has been held to mean "the current routine of business usually followed by a person" or "in which he was ordinarily or habitually engaged"; the business itself may be of a temporary character".
- The OECD Commentary provides that" ordinary course" of business of an agent refers to the business activities customarily carried out within the agent's trade as a broker, commission agent or other independent agent; other business activities carried out by such agents are to be ignored; in certain cases (e.g., where the agent's activities do not relate to a common trade), other complementary tests may be used.

Reference needs to be made to normal custom/ trade i.e. activities that are customary for brokers, general commission agent or other agents operating in the same line of activity as the enterprise's agent, to perform. For this evaluation, one may need to go by a customary practice applicable in a given

industry as compared to what may be applicable in respect of a given agency relationship

- An agent carrying on his own business is acting in the" ordinary course" of his business. For this determination, the theoretical powers or the legal amplitude of the activities permissible under the agent's Memorandum of Association are not relevant
- An agent is acting in the "ordinary course" of his business, if his activities are incidental to his main business, or if his activities are an integral part of his business.

In view of the above, an agent cannot be acting in "ordinary course" of his own business if he performs activities which economically belong to the sphere of the foreign enterprise rather than to that of his own business operations. Where the agent and principal are affiliated, the relevant comparison may be made in respect of the business activities carried out within the group as well as industry practice or normal custom of the trade in which the agent is engaged.

Examples:

- A newspaper publishing company, whose principal business is publication of newspapers in Source State, and which also carries on business of collection of advertisements for foreign newspapers, acts in the “ordinary course" of its business when it enters into solicitation agreement (for procuring advertisements) with foreign principals.
- The Department of Posts accepts money orders for transfer of funds within India. Engaging itself in the same type of business with international ramifications, that is, money transfer services across international borders, is just an extension of its business and hence, is in the ordinary course of its business.
- An entity, that produces television software (say X) and which licenses its software to a broadcasting entity (say Y), acts in the ordinary course of its business" when it (X) solicits advertisements for Y and is able to factually prove that such solicitation is incidental to its (X's) business of producing television programmes,
- Where a commission agent sells goods of an enterprise in his own name and also habitually acts, in relation to the enterprise, as an agent having an authority to conclude contracts, he would be deemed

in respect of the agency to be acting outside the ordinary course of his own trade or business.

2.32 Article 5(6) of the UN Model

Article 5(6) of the UN Model reads as follows:

"Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting Source state shall, except in regard to re-insurance, be deemed to have a permanent establishment in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies."

Article 5(6) does not correspond to any provision of the OECD ModeL A PE under Article 5(6) is based on the assumption that the agent through whom premiums are collected and risk insured, is present in the country (Source State) where the risk is located. There are two exceptions in Article 5(6):

- It does not apply to reinsurance.
- If an insurance agent is independent, no PE exists.

2.33 Article 5(8) of the UN Model

Article 5(8) of the UN Model reads as follows:

"The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other."

Article 5(8) is clarificatory. It clarifies that a company of State of Residence is not deemed to have a PE in Source State merely because it controls, or is controlled by, a company that is a resident of Source State. The determination of whether a company is a PE of a related company or not is to be made solely on the basis of the requirements under the other paragraphs of Article 5 and the mere existence or possibility of existence of close relationships is not sufficient to constitute a PE. Hence, the existence of a subsidiary does not, of itself, make that subsidiary company a PE of its parent nor is a PE constituted on account of identical shareholding.

Likewise, since each company constitutes an independent legal entity, the mere fact that the subsidiary company is managed by its parent or that the parent exercises strict control over activities of its subsidiary and desires stringent financial reporting, does not constitute the subsidiary a PE of the parent

The above aspects were considered in the case of Carpi Tech SA. Based on facts and the provisions of Article 5 of the India-Switzerland tax treaty, the Chennai Tribunal held that the Indian subsidiary represented by its Managing Director constitutes a fixed place PE and a dependent agent in India.

Chapter 3

Certain unique characteristics of PEs under Indian Tax Treaties

Most Indian treaties contain provisions regarding service PEs and at times these provisions differ substantially from the UN Model.

Indian tax treaties generally cover all services other than those referred to or covered by the article on royalties and fees for technical services in the respective treaty.

The UN Model specifies a time limit of 6 months to constitute a PE, whereas some Indian treaties specify a shorter period of time (e.g. the treaties with Australia, Canada, Norway, Singapore, Switzerland, the United Kingdom and the United States specify a 90-day time limit). The time limit to constitute a PE is further reduced if services are rendered to associate enterprises. For example, the Indian treaties with Norway, Singapore, Switzerland and the United Kingdom specify 30 days for services between associated enterprises (against the normal time limit of 90 days). In the case of the tax treaties with Australia, Canada and the United States, a PE comes into existence immediately if services are between associated enterprises (i.e. if services are provided for even a single day to an associated enterprise).

Some tax treaties with India (e.g. the treaties with Brazil, Bulgaria, Germany, Ireland, Italy, Japan, Jordan, Kyrgyzstan, Malta, Morocco, New Zealand, Qatar, Singapore, Spain, Sweden, Turkey, Ukraine and the United Kingdom) contain an additional clause whereby a PE is deemed to be in existence where "an enterprise provides services or facilities in connection with, or supplies plant and machinery on hire used or to be used in, the prospecting for, or extraction or production of, mineral oils in that State". However, under the treaty with Spain, a PE is constituted if activities related to the extraction or production of mineral oils are carried on for more than 30 days, whereas under the treaties with Brazil, Japan and Turkey, the specified duration is for more than 6 months. The treaty with Singapore provides for a threshold of more than 183 days.

The tax treaties with Australia, Canada, China (People's Rep.), Kuwait, Mauritius, Namibia, Nepal, Norway, Saudi Arabia, Singapore, Sri Lanka,

Switzerland, Thailand, the United Arab Emirates, the United Kingdom and the United States contain a service PE clause. The service PE clause is absent in all other Indian tax treaties.

The tax treaties with Kuwait, Sri Lanka and Thailand provide that a PE is created by 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 (for the same or a connected project) within a contracting state for a period or periods aggregating more than 183 days. However, the provision of services would constitute a PE under the treaty with the United Arab Emirates if activities of that nature continue for a period or periods aggregating to more than 9 months in any 12-month period. The Indian tax treaties with Bangladesh, the Czech Republic, Syria, Tanzania and Zambia include the following additional clause:

An enterprise of a Contracting Source state shall be deemed to have a PE in the other Contracting State if it carries on a business which consists of providing the services of public entertainers (such as theatre, motion pictures, radio or television artistes and musicians) or athletes in that other Contracting State unless the enterprise is directly or indirectly supported wholly or substantially, from the public funds of the Government of the first mentioned Contracting State in connection with provision of such services.

Foreign insurance companies may not establish branches (PEs) in India. They may participate in a joint venture (by way of a joint venture company incorporated in India) with Indian companies in accordance with India's foreign direct investment policy.

With respect to tax treaties, article 5(6) of the UN Model reads as follows:

Notwithstanding the preceding provisions of this article, an insurance enterprise of a Contracting Source state shall, except in regard to re-insurance, be deemed to have a PE in the other Contracting State if it collects premiums in the territory of that other State or insures risks situated therein through a person other than an agent of an independent status to whom paragraph 7 applies.

This paragraph does not correspond to any provision of the OECD Model. A PE under article 5(6) is based on the assumption that the agent through whom premiums are collected and risk insured is present in the source country where the risk is located. There are two exceptions in article 5(6):

- this provision does not apply to reinsurance; and
- if an insurance agent is independent, no PE exists.

Most Indian tax treaties are based on the UN Model. However, the tax treaties with the following countries do not contain the insurance clause:

Bangladesh, Belgium, Brazil, Bulgaria, Canada, China (People's Rep.), the Czech Republic, Denmark, France, Germany, Hungary, Israel, Italy, Japan, Korea (Rep.), Malta, Mauritius, Mongolia, Namibia, Nepal, the Netherlands, New Zealand, Norway, Oman, Poland, Singapore, South Africa, Spain, Syria, Tanzania, Turkey, Ukraine, the United Arab Emirates, the United Kingdom and Vietnam.

Chapter 4

Key Implications on Constitution of PE of a Foreign Enterprise in India

While Article 5 of the tax treaties define PE, Article 7 provides for allocation of taxing rights to the source state. Article 7 of India's tax treaties provides that when a foreign enterprise constitutes PE in India, appropriate profits as allocable in relation to activities undertaken by such foreign enterprise in India should be attributed to such PE in India. In India, such attributable profits are taxed at the rate of 40% (plus applicable surcharge and cess) on a net basis, subject to applicable domestic tax provisions.

The PE profit attribution exercise, as explained in greater detail in the ensuing pages is a complex exercise. It may be noted that once a PE is constituted, profit attribution principles not only mandate analysis of the functions of the PE, but also of the assets employed by it coupled with the risks assumed by the PE. This analysis, popularly known as the FAR analysis in the context of Transfer Pricing Regulations, is also on the verge of evolution. In the context of digital economy, countries like China or India have been advocating expanding the scope of profit attribution in source jurisdiction, based not just on FAR analysis but also considering based on an additional parameter of 'market' analysis. Thus, there is an ongoing debate whether profit attribution methodologies should be modified to include FARM analysis instead of FAR analysis as recommended by the OECD.

In summary, a PE's factual and functional aspects are essential for evaluation of profit attribution, and these must be documented in the Transfer Pricing study, to help the company defend its tax position.

Following are few key imperatives / requirements once a foreign company constitutes a PE in India:

- Maintenance of books of accounts and supporting records in accordance with the provisions under the Companies Act 2013
- Audit of accounts by an accountant and a duly signed and verified audit report obtained in the prescribed format before the due date of filing the return of income

- Permanent Account Number (PAN), Tax Deduction and Collection Account Number (TAN) and GST and other indirect tax registrations, as may be applicable.
- Filing of return of income in India, reflecting PE's income and expenses, assets and liabilities.
- Fulfilling withholding tax obligations and compliances as per Indian income tax law on the expenses incurred by the PE.
- Fulfilling GST and indirect tax obligations and compliances as per GST and other indirect tax laws

Chapter 5

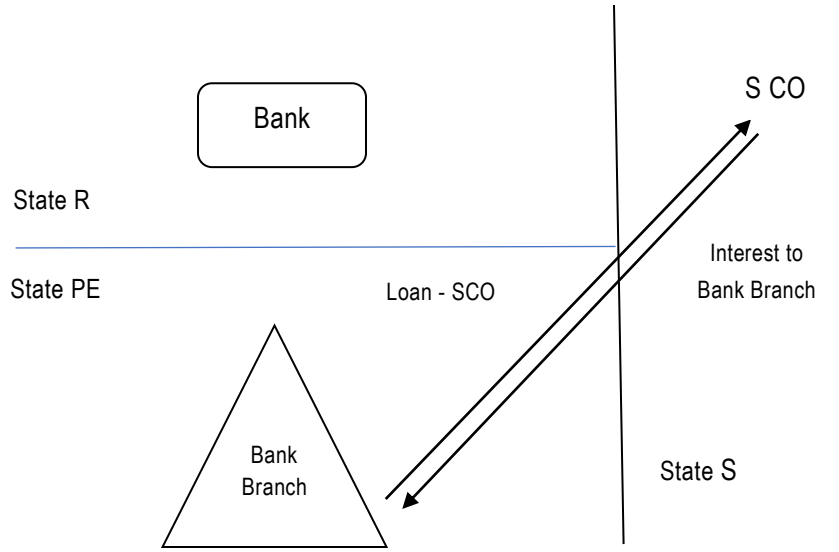
Triangular cases through Permanent Establishments

Triangular cases, in the context of permanent establishments, refer to scenarios which typically arise where a person who is resident in two contracting states for tax purposes (a dual resident), or a person who is resident in one state and has a permanent establishment (PE) in another, has transactions with a resident of a third contracting state. Triangular cases as the name suggests involve more than two contracting states. Bilateral tax treaties do not always effectively meet their objective of providing double tax relief to contracting states in transaction scenarios involving more than two contracting states.

This publication seeks to provide basic understanding about triangular scenarios / cases arising due to situations of Permanent Establishments and Reverse Permanent Establishments. The ensuing paragraphs attempt to broadly explain these two scenarios and certain allied fundamental aspects for the benefit of the readers.

5.1. PE Triangular Cases

PE triangular cases arise where a person who is resident in one contracting state (the “residence state” or “State R”) earns income from sources in a second contracting state (the “source state” or “Source state”) and such income is attributable to a PE of the person in a third contracting state (the “PE state” or “State PE”). All the three contracting states may or may not have bilateral tax treaties with each other. This situation may be best demonstrated through the following word diagram:



In this illustration, a bank resident is contracting state R and has a branch office in contracting state PE. The branch has extended a loan to a company resident in source state and earns interest against such loan. For completeness of facts, the relevant tax treaties between the contracting states are as follows:

a. R-S tax treaty (Typically, PE state cannot access this treaty and thereby avail of any relief pursuant thereto)

b. R-PE tax treaty (Typically, S state cannot access this treaty and thereby avail of any relief pursuant thereto)

c. S-PE tax treaty (Typically, R state cannot access this treaty and thereby avail of any relief pursuant thereto)

In a PE triangular scenario, taxes may be imposed as per the domestic laws of all three contracting states. The source state may generally impose tax on the basis of source, whereas the PE state may also impose taxes based on the business activities carried on there by the person deriving the income. Additionally, the residence state, may impose tax on the basis of the residence of the person earning the income. The residence state depending on existence of tax treaties, may provide double taxation relief unilaterally according to its domestic tax law, to the extent provided for in such law. In order to compute the tax relief, it's essential to apply the tax treaties. In this scenario of a PE triangular case, there are two applicable tax treaties:

- the treaty between the residence and the source contracting states (the "R-S treaty"); and

- the treaty between the residence and the PE contracting states (the "R-PE treaty").

In this case, it may be noted that since PEs are not "persons" for treaty purposes and therefore not entitled to treaty benefits, the treaty between the PE contracting state and the source contracting state (the "S-PE treaty") will typically not apply. The source contracting state will therefore be bound to apply the conditions of the R-S treaty. In this instant case of interest income earned by the branch of the bank from the source contracting source state, such source state is entitled to impose a tax on such income applying the rates under the R-S tax treaty (generally under Article 11). The PE state, on the other hand, will be required to apply the conditions of the R-PE treaty. As per the business profits article of this treaty, the PE state will generally be entitled to impose tax on the profit attributable to the PE, including any income which may be considered to be sourced in a third state.

Ultimately, the residence state must apply the conditions of both the R-S treaty and the R-PE treaty and will have an obligation to provide relief under both these treaties (under the relief article: generally, article 23A or article 23B). Thus, depending on the category of income, the domestic law of the states involved, and the terms of the applicable tax treaties, tax may be imposed on the income in the source state, the PE state and the residence state. It may be inferred from the multiple state taxation scenarios, that the residence state may not be able to provide complete relief from double taxation of the said income in two other contracting states i.e. the source and PE contracting states. To the extent, complete treaty relief is not granted against taxes paid in the PE contracting state and the Source contracting state, there will be unrelieved double taxation in these PE triangular cases.

In this context and the illustration, a few basic aspects in relation to tax relief anomalies which arise in triangular cases, may be noted as follows:

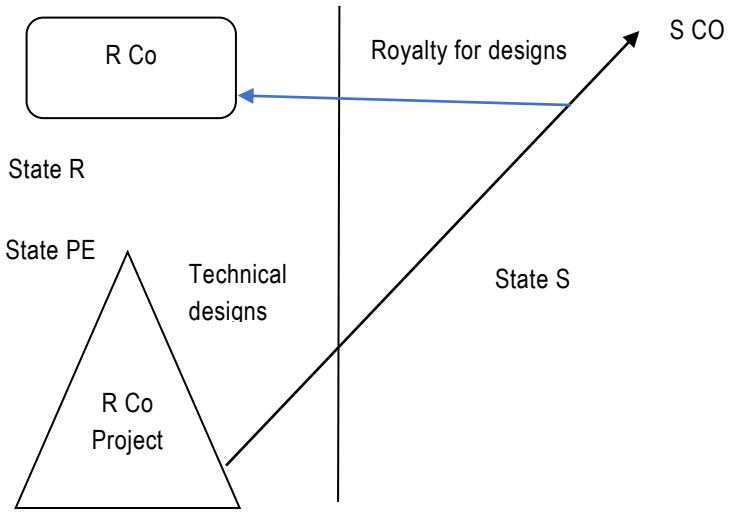
- The resident state's (R's) ability to ultimately grant complete tax relief against taxes paid the PE and Source states (PE and S) normally depends on factors, including the relative tax rates of the three contracting states (after the application of any relevant treaty limitations), whether the PE state grants relief for tax imposed in the source state, and, if the residence state grants relief using the credit method, the way in which the credit is calculated. Moreover, there may be differences in tax relief methods under the different relevant tax

treaties viz. the R-S tax treaty may provide for exemption method while the R-PE tax treaty may provide for credit method.

- It is highly debatable whether PE source state should grant relief from taxation in relation to taxes paid in the Source state, following applicable non-discrimination principle under the tax treaty between the resident state and the PE state. This is because a PE is not treated as a person entitled to tax treaty relief and therefore the PE state is not obligated to provide relief to PE, as it would normally have provided to its residents.

5.2. Reverse PE Triangular Cases

Reverse PE triangular cases occur where a person resident in one contracting state (say "State R") receives income (say royalty income) from a person (say a company) resident in a second contracting state (say "Source state"), where income originates from a PE (being a project office / branch office) of the company located in a third contracting state (say the "PE state" or "State PE"). This situation may be illustrated through the following word diagram:



Article 12 of tax treaties generally allows royalty income "arising" in a contracting state (and paid to a resident of the other contracting state) to be taxed in the state where it arises. Whether royalty income "arises" in a particular state is determined in accordance with Article 12, which provides that royalty income will arise in a contracting state if it is paid by a resident of

that contracting state or if it is connected with a PE of the payer located in that state. However, if the PE is located in a third contracting state (say State PE), the royalty income will continue to arise in the residence state of the payer (i.e. Source state). In a reverse PE triangular case, this royalty income is considered to arise in two different contracting states for the purposes of the two applicable tax treaties. Consequently, in a reverse PE triangular case, source-based taxation may be imposed in both the residence state of the payer (Source state) and the PE state (State PE) under Article 12 of their respective treaties being the R-S tax treaty and R-PE tax treaty.

It may be noted that fundamentally while PE triangular cases tantamount pose situations of unrelieved double taxation, in some cases there may be situations of low taxation or non-taxation of income too. For instance in a PE triangular case, if the source state ("Source state") does not levy tax on an income earned by a PE (of a resident in State R) based on provisions of tax treaty between State PE and Source state (S-PE tax treaty), the PE state also does not tax such income in State PE based on domestic law incentives to foreign sourced income and on the other hand based on the R-PE tax treaty, State R exempts any income subjected to tax in State PE, there may be situations of low or no taxation.

There are three primary factors underlying all the issues arising in PE triangular cases.

(a) Overlap between the source rules contained in tax treaties: Contextually, for the purposes of the R-PE tax treaty the interest income attributable to the PE is effectively considered to be sourced in the PE state because of the PE's banking activities, whereas for the purposes of the R-S tax treaty, the income is considered to have its source in the contracting source state. Consequently, both the source state (S) and the PE state (PE) may be entitled to impose tax on source basis in accordance with R-S and R-PE tax treaties, while the residence state (R) may be unable to provide complete tax credits against the taxes levied by the PE and Source states.

(b) PE is a hybrid concept: It is clear that a source state cannot impose tax on a foreign entity unless such foreign entity has a PE in the source state from where business activities are carried on. Therefore, a PE which is a threshold for taxation of business and allied income by a source state (PE state in the context of the above illustration), does

have features akin to a resident of the source state, Consequently, the PE state is entitled to impose tax on the worldwide income attributable to a PE, including income of the PE arising in a third state (Source State or Source state in the above illustration).

(c) Inherent nature of bilateral tax treaties: The bilateral nature of tax treaties means that their provisions generally only apply to bilateral situations i.e. between two contracting states. These treaties do not factor in multilateral situations. For instance, the R-S tax treaty does not factor in and thereby provide for any implications arising out of the R-PE treaty or S-PE treaty.

Chapter 6

Permanent Establishment Implications due to the COVID-19 Pandemic

The COVID-19 pandemic which claimed the lives of countless globally, compelled governments to take strict and in some cases unprecedented measures to protect their citizens, economies and societies, such as restricting or stopping travel and implementing strict quarantine requirements. These forced restrictions on people movement to maintain social distancing discipline impacted many cross-border workers. These workers were unable to physically perform their duties in their country of employment. These workers may had to stay at hotels, corporate guest houses etc. and telework because of the exceptional economic situations. Similarly, there could be cross border implications in relation to suddenly non-operational construction / mining sites or other installations involving foreign expats who were stranded in other contracting state. These unprecedented situations worldwide raised many cross- border tax issues, which have an impact on the right to tax between countries, which is currently governed by international tax treaties that govern / allocate taxing rights across contracting states.

In the context of PE exposures, some businesses apprehended that their employees stranded in countries other than the country in which they regularly work / reside, and that working from their home / hotel offices during the COVID-19 crisis will create a “permanent establishment” (PE) for them in those countries, which would trigger new filing requirements and tax obligations in the countries where they were stranded. The OECD explained it is unlikely that the COVID-19 situation will create any changes to a PE determination.

In the backdrop of the above, the OECD published a report titled “Analysis of Tax Treaties and the Impact of the COVID-19 Crisis” dated 3 April 2020 as an initiative of its specific recommendations to the tax administrations and taxpayers of sovereign nations worldwide. A brief summary of OECD;s guidance in form of explanations and clarifications in the above-mentioned OECD report, in the context of PE, is as follows:

6.1 Use of Home office

As per the OECD, generally, a PE must have certain degree of permanence and be at the disposal of a foreign enterprise in order for that place to be considered a fixed place of business through which the business of that foreign enterprise is wholly or partly carried on. The report refers to and quotes Paragraph 18 of the OECD's Commentary on Article 5 of the OECD Model Convention, to reiterate that even though part of the business of an enterprise may be carried on at a location such as an individual's home office, that should not lead to the conclusion that that location is at the disposal of that enterprise merely because that location is used by an individual (e.g. an employee) who works for the enterprise.

Without specific mandate from the foreign enterprise, the carrying on of intermittent business activities at the home of an employee does not make that home a place at the disposal of the enterprise. The OECD explained that "*during the COVID-19 crisis, individuals who stay at home to work remotely are typically doing so* ***as a result of government directives: it is force majeure not an enterprise's requirement.*** *Therefore, considering the extraordinary nature of the COVID-19 crisis, and to the extent that it does not become the new norm over time, teleworking from home (i.e. the home office) would not create a PE for the business/employer, either because such activity* ***lacks a sufficient degree of permanency or continuity*** *or because, except through that one employee, the enterprise has no access or control over the home office. In addition, it provides an office which in normal circumstances is available to its employees."*

Needless to add, the above explanation would hold good in cases of employees of foreign enterprises working from hotel / corporate guest houses in a contracting state.

6.2. Agency PE

The comments of the OECD in the context of any possible dependent Agency PE exposure qua an individual working from home for foreign enterprises are as follows:

The question may also arise whether the activities of an individual temporarily working from home for a non-resident employer could give rise to a dependent agent PE. Under Article 5(5) of the OECD Model, the activities of a dependent agent such as an employee will create a PE for an enterprise

if the employee habitually concludes contracts on behalf of the enterprise. Thus, **in order to apply Article 5(5) in these circumstances, it will be important to evaluate whether the employee performs these activities in a "habitual" way.**

An employee's or agent's activity in a State is unlikely to be regarded as habitual if he or she is only working at home in that State for a short period because of force majeure and/or government directives extraordinarily impacting his or her normal routine. Paragraph 6 of the 2014 Commentary on Article 5 explains that a PE should be considered to exist only where the relevant activities have a certain degree of permanency and are not purely temporary or transitory. Paragraph 33.1 of the Commentary on Article 5 of the 2014 OECD Model provides that the requirement that an agent must "habitually" exercise an authority to conclude contracts means that the presence which an enterprise maintains in a country should be more than merely transitory if the enterprise is to be regarded as maintaining a PE, and thus a taxable presence, in that State. Similarly, paragraph 98 of the 2017 OECD Commentary on Article 5 explains that the presence which an enterprise maintains in a country should be more than merely transitory if the enterprise is to be regarded as maintaining a PE in that State under Article 5(5).

6.3. Construction site PE

In the context of Construction site PE, the OECD notes as follows - It appears that many activities on construction sites **are being temporarily interrupted by** the COVID-19 crisis. **The duration of such an interruption of activities should however be included in determining the life of a site** and therefore will affect the determination whether a construction site constitutes a PE. In general, a construction site will constitute a PE if it lasts more than 12 months under the OECD Model or- more than six months under the UN Model. Paragraph 55 of the Commentary on Article 5(3) of the OECD Model explains that a site should not be regarded as ceasing to exist when work is temporarily discontinued (temporary interruptions should be included in determining the duration of a site). Examples of temporary interruptions given in the Commentary are a shortage of material or labour difficulties.

In light of the fact that the OECD views as captured in its recommendations is only a guidance in context of COVID-19 induced temporary situation of restriction, the issue will largely still remain context specific. There shall be a

fair degree of uncertainty about the length of the interruption due to COVID-19 and even seasonal factors, which could in turn lead to necessity for appropriate records by taxpayers. Especially in case of mining and construction and installation projects, this aspect may bear relevance,

On 21st January 2021, the OECD issued an updated guidance note on tax treaties and impact of Covid-19 pandemic, essentially as a measure of revisiting the above guidance during April 2020. This updated note recognised that the unprecedented public health protection measures viz. travel restrictions, which continued throughout 2020 are likely to continue during 2021 in certain jurisdictions. The OECD's revised guidance note is thereby aimed at providing greater certainty to taxpayers during this exceptional period, where these public health protection measures are still in effect. The OECD's Secretariat recognized that while various Governments worldwide have issued guidanceto taxpayers to alleviate their unwanted apprehensions. While this guidance has been directionally helpful, this was expected to have temporary effect as the unforeseen pandemic may not bear a permanent impact on business and mobility. Therefore, the updated guidance note in recognition of the fundamental fact that many public health protection measures are still effective, factors in some additional fact patterns and circumstances which were not covered by the April 2020 report. The updated guidance very importantly, seeks to examine whether the conclusions arrived at during April 2020 continue to apply in situations where these unprecedented measures persist for significant period. In its updated guidance, the OECD factored in various country practices and guidance during the Covid period. The relevant additional guidance is important to note.

6.4. Use of home office

The OECD largely confirmed its comments / views as expressed in int's earlier guidance. It recognises that if an individual continues to work from home even after the public health protection measures have ceased to have effect, such place may be regarded as having certain degree of permanence. However, this change alone will not constitute such place as the fixed place PE of the foreign enterprise. A further fact and circumstance- based evaluation will be necessary to determine whether such home office is now at the disposal of the foreign enterprise following the continuation or permanency of change in working arrangements. The OECD has noted from Paragraph 18 of its commentary on Article 5 of the OECD Model Convention

that where a home office is used on a continuous basis for carrying out business activities of an enterprise and based on the facts and circumstances it is clear that the enterprise has required such individual to use such home office instead of providing his own where the nature of activity requires an office to be provided, then such home office may be treated to be at the disposal of the enterprise. In contradistinction, when a cross border worker uses his home office in a particular jurisdiction to perform most of the business activities instead of from the office provided by the employer in the other jurisdiction, then such home office cannot be said to be at the disposal of the concerned enterprise. Therefore, in conclusion, if individuals continue to tele-work from home as a result of public health protection measures imposed or recommended by government of one of the jurisdictions, to prevent spread of the Covid-19 pandemic, the home office will not constitute PE of the foreign business enterprise.

6.5. Agency PE

The updated guidance note states that if an employee continues to work from home jurisdiction for a non-resident employer after the Covid-19 pandemic, on a habitual basis and continues to conclude contracts on behalf of the non-resident enterprise / employer, then it is more likely that the employee being an agent would be regarded as habitually concluding contracts for the non-resident employer and thereby being a dependent agent.

6.6. Construction site PE

The April 2020 guidance had recognised that in the context of temporary disruption of activities at construction sites due to the Covid-19 pandemic impact, the period of disruption should be included in determining the life of a site and therefore will affect the determination whether a construction site constitutes a PE. This updated guidance now recognizes that since there is no bright line test recommended in the OECD commentary about “temporary interruption of activities in the construction site”. Therefore, jurisdictions may have different views about the duration of “non-temporary” interruption or on different conditions that make the interruptions different / distinct from those as mentioned in Paragraph 55 of the commentary to Article 5 of the OECD Model Tax Convention. The OECD concluded that jurisdictions may consider that in light of the extra-ordinary circumstances caused by the Covid-19 pandemic and based on the facts and circumstances, where operations are prevented due to public health measures recommended or imposed by the Government of the jurisdiction where the construction site is located, such

interruption could be excluded from the calculation of the time threshold for construction site PE.

Chapter 7
Attribution of Profits to PE

7.1. Certain basic aspects

Once PE of a foreign enterprise is determined to exist, commences the more complicated step of profit attribution to such PE. It is generally a settled principle that only if the profits are capable of being attributed to the PE, will the tax liability arise. However, as may be noted below, profits of a foreign enterprise independent of its PE may also be attributed to such PE, in case of certain contracting states.

Article 7 of the MTC provide for attribution of profits. Article 7 of the OECD Model Tax Convention deals with the limitation of the right of the source state (say Country S as per our first illustration) to tax the business profits earned by the resident of the other state (say A Co of Country R as per our first illustration). The limitations basically relate to:

(a) whether Country S can tax ACO and

(b) if yes, how much of ACO's profit can be taxed.

Generally, when a foreign enterprise constitutes a PE in a source state, the source state may tax only that part of such enterprise's profits which are attributable to such PE.

The importance of Article 7 as one of the key income distributive rule under the tax treaties basically stems from some of the following factors:

a) A permanent establishment does not have a legal entity status, similar to a company, a firm, etc. It is a fictional tax subject. A permanent establishment ("PE") is not a separate legal entity of the parent corporation.

b) Each contracting state may apply its own method for determination of PE's profits.

c) At times, the method for attribution of profits is not consistently used. Sometimes, the main method of profit allocation being the fiction of separate entity approach is used while sometimes an apportionment method is also used.

OECD's report on attribution of profits suggests two approaches as follows:

1. Relevant Business Activity approach &
2. Functionally Separate Entity approach.

Under the "relevant business activity" approach, Article 7(1) imposes a limit through Article 7(2) on the quantum of profits which may be attributed, being nothing in excess of what the whole enterprise could have earned as profits from the relevant business activity of the Permanent Establishment, directly or indirectly. As elaborated subsequently, this approach could support the force of attraction principle in computing attributable profits due to PE's existence in the source state.

Unlike under the above approach, the functionally separate entity approach does not affect determination of the quantum of profits to be attributed to the PE. Instead it provides that the host / source state's right to tax does not extend to the profits that the enterprise may derive from that state otherwise than through the PE therein. Imperatively, force of attraction principle is not supported under the construct or interpretations as per functionally separate entity approach.

In a case where the PE of an enterprise is actively involved in the negotiation, conclusion, execution and other critical stages of a contract entered into by the enterprise, wherein other divisions of the enterprise have also participated, attributable profits of the PE from such contracts may be computed as follows:

Profits arising out of contracts = Contribution by the PE/ Total contribution of the enterprise as a whole

Claim of expenditure while computing profits attributable to the PE:

Profits attributable to a PE should be arrived at after deducting the expenses incurred by the enterprise for the purposes of the PE. These expenses ought to be those incurred by or for the purpose of the PE, representing resource outflow. The functional analysis of the whole enterprise including the PE would determine whether expenses incurred for purposes other than that of the PE can be claimed as an expenditure attributable to the PE.

Article 7 of the tax treaties normally specify the contours of PE expense claims, wherein they also specify certain limitations on allowing expenses and exclusions. Illustratively, let's refer to Paragraph 5 of Article 7 of the India UK tax treaty as follows:

Subject to paragraphs 6 and 7 of this Article, in the determination of the profits of a permanent establishment, there shall be allowed as deduction expenses which are incurred for the purposes of the business of the permanent establishment, including executive and general administrative expenses so incurred, whether in the State in which the permanent establishment is situated or elsewhere, which are allowed under the provisions of and *subject to the limitations of the domestic law* of the Contracting State in which the permanent establishment is situated.

Further, Paragraph 3 of Article 7 of the India – USA tax treaty, states as follows:

In the determination of the profits of a permanent establishment, there shall be allowed as deduction expenses which are incurred for the purposes of the business of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere, in accordance with the provisions of and *subject to the limitations of the taxation laws of that State*. However, no such deduction shall be allowed in respect of amounts, if any, paid (otherwise than towards reimbursement of actual expenses) by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprises, by way of interest on moneys lent to the permanent establishment. Likewise, no account shall be taken, in the determination of the profits of a permanent establishment, for amounts charged (otherwise than toward reimbursement of actual expenses), by the permanent establishment to the head office of the enterprise or any of its other offices, by way of royalties, fees or other similar payments in return for the use of patents, know-how or other rights, or by way of commission or other charges for specific services performed or for management, or, except in the case of a banking enterprise, by way of interest on moneys lent to the head office of the enterprise or any of its other offices.

From the above, besides the delineations of PE expense claims, it may be noted that the treaties stipulate that the PE expenses can be claimed subject

to the relevant provisions of the domestic laws of the state in which the PE is constituted. From the Indian domestic law standpoint, provisions under section 44C of the Income Tax Act 1961 ("the Act") is relevant. The provisions of section 44C of Act restricts the deductibility of head office expenditure incurred outside India by a non-resident, in computing the income of a PE in India.

There could be instances where certain expenses are incurred either before or after the PE's existence. In these instances, the provisions of section 3 and 4 of the Act read with the provisions of Article 7 of the treaty would determine admissibility of the claim of such expenses.

7.2. Force of attraction principle under the tax treaty

Under the provisions of Explanation 1 to section 9(1) of the Act, defining "business connection", there is a force of attraction rule as may be noted from the phrase below in italics:

"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"*

However, the principle of force of attraction rule is relatively debated and talked about in the context of Indian tax treaties

The phrase "only so much of them as attributable to that permanent establishment" in the last sentence of paragraph 1 under Article 7(1) of most tax treaties is important to note – this is the "no Force of Attraction rule". This provides that the profits which might be earned by a foreign enterprise, within a source state independently from its PE in that state may not be allocated to that PE.

It may be noted that the Force of Attraction rule is not present in the OECD Model Tax Convention. The UN and US Model Tax conventions have limited force of attraction rules. Although the OECD model and its commentary have been held to be persuasive for the purpose of interpretation of Indian DTAAs, the fact that the OECD model discounts the Force of Attraction rule does not discount its usage in Indian DTAAs.

Some tax treaties provide for taxing income/profits from direct transactions effected by the non-resident, provided the transactions are of the same or

similar kind as those effected through the PE (**Limited Force of Attraction Rule**). For instance, India's tax treaties with USA, UK, etc. Based on the extant UN Model Convention, it is difficult to find tax treaties which provide for taxing profits/income from all transactions whether they are attributable to PE or not or whether they are of the same kind of transactions carried on by the PE or not (**Full Force of Attraction Rule**).

Articles 7(1)(b) and 7(1)(c) of the UN Model Convention provide for the Force of Attraction rule in the following words:

"(b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment; or

(c) other business activities carried on in that other State of the same or similar kind as those effected through that permanent establishment"

These two categories clearly embody the Force of Attraction rule. The UN Model commentary on Para 1 of Article 7 also substantiates the same, wherein it is mentioned that the force of attraction principle is not removed due to necessities of developing countries and that the model would allow limited application of this rule upon fulfilment of the following conditions:

"if an enterprise has a permanent establishment in the other Contracting State for the purpose of selling goods or merchandise, sales of the same or a similar kind may be taxed in that State even if they are not conducted through the permanent establishment; a similar rule will apply if the permanent establishment is used for other business activities and the same or similar activities are performed without any connection with the permanent establishment."

Therefore, the UN Model incorporates the limited force of attraction rule. This principle is incorporated by India in various treaties. There are a few other treaties which are worded a bit differently. Article 7 of the Indo-UK DTAA falls under this category. Clause 1 of Article 7 of the India UK treaty provides that:

"The profits of an enterprise of a Contracting Source state shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent, establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enter price may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment."

Therefore, before coming to any conclusion about taxability of 'business income' especially when there exists a PE in another country, it is important to verify whether there exists a clause on Force of Attraction in Article 7 of the relevant tax treaty. It is also important to check the Protocol and Notes exchanged between the two countries on this clause. Some of the key countries with which India has Force of Attraction rule (directly or indirectly) in the treaties with them are Belgium, Canada, France, Germany, Italy, Japan, Singapore, USA, besides UK.

In the case of Roxon OY, a Finnish company, (2007) 106 ITD 489 Mum, the Mumbai Bench of the Income-tax Appellate Tribunal held that the rule, underlying the modern treaties is an improvised and highly restricted 'force of attraction rule'. This "restricted force of attraction" rule, in essence, additionally expands Source state taxation by permitting Contracting States where non-residents maintain traditional PEs to tax other income that is attracted to PE, even though that income is not directly related to the PE. In UN Model Convention (1979 draft), this newer version of the force of attraction rule, finds place. Thescope of Article 7 extends only to activities carried out by a foreign enterprise in a source State — which are similar to those carried on through its PE in the source State — and not to all the activities of such an enterprise. It is to be noted that Article 7 of the applicable Indo-Finnish tax treaty is based on the UN Model Convention and, to that extent, incorporates restricted force of attraction rule. The distinguishing feature of Article 7 of India Finland DTAA vis-a-vis Indian tax treaties with most other countries which are on OECD Model Convention, is that it incorporates a limited force of attraction rule inasmuch as not only the profits attributable to PE are taxable in the source State, but also the profits on direct transactions entered into by the head office of the PE in the State in which it is situated, to the extent these transactions are of the same or similar kind, are as well liable to be taxed in the source State.

It's extremely important to note that in case of M/s Clifford Chance vs Asst. DIT (ITA Nos. 5034/Mum/2004, 5035/Mum/2004, 7095/Mum/2004, 3021/Mum/2005 and 2060-61/Mum/2008) upon reference, the Special Bench of the Mumbai ITAT observed that a comparative study of Article 7(1) of the India-UK DTAA and Article 7(1) of UN Model Convention shows that there is material difference in the provisions of these two Articles. Article 7(1) of the UN Model Convention itself points out the scope of profits of an enterprise in contracting state which carries on business in other contracting state through

PE situated therein that may be taxed in other contracting state and includes within its ambit, in addition to the profits of the enterprise attributable to that PE, the profits attributable to sales in that other state of goods or merchandise of the same or similar kind as those sold through that PE as well as the profits attributable to other business activities carried on in that other state of the same or similar kind as those effected through that PE. The Special Bench noted that "*Article 7(1) of the India-UK DTAA, on the other hand, provides that the profits of an enterprise in a contracting state through PE situated therein may be taxed in other contracting state but only so much of them which are directly and indirectly attributable to that PE. What is indirectly attributable to the PE for the purpose of Article 7(1) is explained in Article 7(3) of the India-UK Treaty DTAA which clearly provides that where a PE takes an active part in negotiating, concluding or fulfilling contracts entered into by the enterprise, then, notwithstanding that other parts of the enterprise have also participated in those transactions, that proportion of profits of the enterprise arising out of those contracts which the contribution of the PE to those transactions bears that of the enterprise as a whole shall be treated for the purposes of para (1) of this Article as being the profits indirectly attributable to that PE. If Article 7(1) of the India-UK DTAA is read with Article 7(3) thereof, we are of the considered view that the provisions thereof are not at all akin to the provisions of section 7(1)(b) and 7(1)(c) of the UN Model Convention and it would not be correct to say that the connotations of "profits indirectly attributable to permanent establishment" extend to the two categories of income as specified in clause (b) and clause (c) of Article 7(1) of the UN Model Convention and incorporate a force of attraction rule. When the connotations of "profits indirectly attributable to permanent establishment" are defined specifically in Article 7(3) of the India-UK DTAA which clearly explains the scope and ambit of the profits indirectly attributable to the PE and the provisions of said article being unambiguous and capable of giving a definite meaning, there is really no need to refer to the provisions of Article 7(1) of UN Model Convention which are materially different from the provisions of Article 7(1) of the India-UK DTAA read with Article 7(3) thereof."*

Therefore, according to the Special Bench, the provisions under the United Nations Model Conventions are different from the provisions of Article 7(1) read with Article 7(3) of the India-UK tax treaty. Article 7(3) clearly explains the scope and ambit of the profits indirectly attributable to the PE, the force of attraction principle would not be applicable to the India-UK tax treaty. The

Special Bench specifically confirmed that the ruling of the Division Bench of the Mumbai ITAT in case of Linklaters LLP vs. ITO 40 SOT 51 (Mum) on the applicability of the Force of Attraction principle in the context of India – UK DTAA is not good law.

The Force of Attraction principle is also acknowledged in Articles 11 and 12 of the UN Model, wherein wording similar to Article 7 has been repeated in Article 12 has been reproduced below:

"The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with (a) such permanent establishment or fixed base, or with (b) business activities referred to in (c) of paragraph 1 of article 7. In such cases the provisions of article 7 or article 14, as the case may be, shall apply."

Hence, in cases where income from Interest or Royalties is involved, where the beneficial owner of income by the way of interests or royalties carries on his business in the other Contracting State through a PE, the Force of Attraction rule is applicable.

It is also interesting to note that the Force of Attraction rule has been specifically exempted from application in case of certain Indian DTAAs. Article 7(1) of the treaties with Cyprus and Sri Lanka provide that it does not apply if the enterprise proves that such sale or activity could not have been reasonably undertaken by the PE. Additionally, it is important note that in certain tax treaties application of the Force of Attraction rule is subject to proof of non-avoidance of tax. For instance, the protocol to the India Germany tax treaty provides as follows:

In respect of paragraph 1 of Article 7, profits derived from the sale of goods or merchandise of the same or similar kind as those sold, or from other business activities of the same or similar kind as those effected, through that permanent establishment, may be considered attributable to that permanent establishment if it is proved that:

(i) this transaction has been resorted to in order to avoid taxation in the Contracting State where the permanent establishment is situated, and

(ii) the permanent establishment in any way was involved in this transaction.

The UN Commentary of 2011 (Para 7) provides that the Force of Attraction rule does not apply where the foreign enterprise is able to demonstrate that the sales or business activities were carried out in the source state other than through the PE, for legitimate business reasons and not for obtaining treaty benefits.

The basic principle of the Force of Attraction rule is simple - when an enterprise is said to have a PE in another country, it exposes to taxation the entire income that it earns from carrying on activities in that other country, whether or not through that PE. This principle embodies a vociferous application of source-based taxation and capital importing countries or developing countries have supported this rule in their tax treaties for a long time. It tries to disincentivise an enterprise from taking undue advantage of a PE by routing transactions directly from their country.

With respect to attribution to a PE, the UN Model principally believes in a Capital and Labour Import Neutrality (CLIN) approach as opposed to the Capital and Labour Export Neutrality (CLEN) approach of the OECD Model. CLEN is a concept by which an investor has neutrality irrespective of source jurisdiction of income i.e. he pays the same total tax irrespective of whether he earns the income from a domestic source or a foreign source. CLIN is a concept of neutrality by which capital funds originating in various jurisdictions should compete at equal terms in the capital markets of any country, therein giving every nation a right to tax equally any income earned within its territory. The Force of Attraction rule can be seen as a far-reaching application of CLIN by the UN Model.

Since India predominantly emphasises on source based taxation being a capital importing nation, one may come to the conclusion that the rationale for including expressions like “indirectly attributable‟ in its treaties must also be the same i.e., to promote source-based taxation through the Force of Attraction rule

7.2.1 Whether Force of attraction rule applies to goods and merchandise and also services?

As a fundamental principle of interpretation of law, it is important to note the language of Article 7 in tax treaties for determining the scope of Force of Attraction rule. It may be noted that in the case of Lahmeyer International GmbH v. ACIT [TS-630-ITAT-2019(DEL)] the revenue authorities applied the

Force of Attraction rule under the India Germany tax treaty to the taxpayer as the taxpayer was engaged in provision of services in India. While the Hon'ble Court favourably adjudicated the matter for the taxpayer on the ground of tax avoidance objective not being fulfilled, it is important to note that the Force of Attraction rule under India-Germany tax treaty is applicable to profits derived from the sale of *goods or merchandise* of the same or similar kind, or *from other business activities* of the same or similar kind.

Contextually, it may be inferred in case of certain Indian tax treaties like those with Belgium, Netherlands where the phrase '*or from other business activities of the same or similar kind*' is absent, under such tax treaties, the taxpayer may evaluate whether a claim that the Force of Attraction rule ought not apply to scenario of provision services in India, is maintainable.

7.2.2 Whether the Base Erosion and Profit Shifting project (BEPS) and the Multilateral Instrument (MLI) has an implication vis-à-vis Force of Attraction rule?

Since Force of Attraction rule is a UN Model concept and absent in the OECD Model, therefore the BEPS Action Plans or the MLI does not have any implications on the Force of Attraction Rule

7.3. The Authorised OECD Approach (AOA)

The tendency to prefer the functionally separate entity principle had already gained major popularity in most industrialized countries but the OECD has set their ultimate recommendation for future references. So, in the end the business transactions between head office and PE are to be recognized as dealings to be assessed in a similar way as transactions between separate legal entities for transfer pricing purposes.

The Authorised OECD Approach (AOA) was introduced by the OECD to align the rules for business profits under tax treaties with those of the arm's length principle of Art. 9 of the OECD and the OECD Transfer Pricing Guidelines. Under the AOA, the profits of the different parts of an enterprise are allocated under the fiction that the PEs /(PE) are distinct and separate entities. The core principles of this "functionally separate entity" approach were included by the OECD in various reports, which were combined in a consolidated version in 2008. After partial implementation in the 2008 Update of the OECD

Commentary, this ultimately led to a new wording of Art. 7 and a revised Commentary in the 2010 Update of the OECD Model Convention. In addition, the OECD in 2010 released a new version of its Report on the Attribution of Profits to a PE.

Under the AOA the profit allocation to a PE is based on the following principles:

1. The PE is a separate enterprise engaged in the same or similar activities; and,
2. The PE is independent from the rest of the enterprise of which it is a part and any other legal person, which means that its profits must be determined by means of the arm's length principle.

Therefore, Article 7(2) new of the OECD Model Convention provides that the profits attributable to the PE are "the profits that the PE might be expected to make if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, the assets used and the risks assumed through the PE and through other parts of the enterprise."

Briefly put, Authorised OECD Approach requires identification of following for ascertaining the amount of profit attributable to the PE:

- Significant people functions carried out by PE having regard to profit generation;
- Risks arising on account of such functions that should be attributed to the PE;
- Assets economically owned by PE for performing such functions.
- Attribution of free capital having regard to the functions, assets and risk.

In the light of the above, the profit would be attributed to the PE by applying principles of transfer pricing on the premise that PE and the foreign enterprise of which it is a part are two separate entities.

Chapter 8
Emerging Landscape

8.1. Modifications to the PE definition under BEPS Action plan 7

The concept and definition of PE forming part of the tax treaties, as understood from the preceding paragraphs have been playing a vital role in taxing the profits of a foreign enterprise in the source / host state. The PE definition as noted above also stipulates the instances of constitution of PE and even exceptions of certain activities from such rules.

With the objective of facilitating reasonableness and transparency in taxation of cross border transactions in this age of new technologies and smart solutions and also preventing erosion of tax base of sovereign states due to the tax arbitrage mechanisms (Base Erosion and Profit Shifting) adopted by certain multinational enterprises, the OECD under the recommendation of G20 nations released 15 comprehensive action plans to curb tax base erosion. These action plans endeavour to capture and tax profits in the states where economic activities have been performed, thereby preventing businesses from artificially reducing taxable income or shifting income to low tax jurisdictions, where no economic activities have been performed.

Out of the 15 BEPS Action plans, one of the most critical aspect and keenly pursued by India, is Action Plan 7 on preventing the artificial avoidance of PE status. BEPS Action Plan 7 recommends the following modifications to the extant PE definition.

8.1.1. Widening the ambit of definition of dependent agent

The Action Plan seeks to curb tax leakages through commissionaire arrangements. In a commissionaire arrangement, the commissionaire agent represents a principal but concludes contracts in its own name. Such commissionaire agents generally do not bind the principal. Since these agents act in their own name, albeit on behalf of the non-resident principal, through these commissionaire arrangements, a non-resident is able to sell its products in another country without constituting a PE therein. The

Commissionaire only pays the tax on the commission earned by it, consequently resulting into a non-payment of taxes in the source or host state on the profits derived from sale of goods / services.

The Action plan seeks to broaden the agency PE rules to include not only contracts entered in the name of the foreign enterprise but also the contracts in the name of the agents where the ownership of the goods remains with the foreign enterprise. Additionally, the action plan seeks to amend the criteria for qualification of a dependent agent to include not only the persons who habitually contract but also the persons who habitually play the principal role leading to the conclusion of the contracts which are routinely concluded without any material alteration by the non-resident entities. Further, the action plan provides that in case of transactions with related parties by a person acting exclusively or almost exclusively with such related parties, the arm's-length test will not be relevant to determine the independence status of such person.

Therefore, a foreign enterprise may constitute a dependent agent PE, if an intermediary being an agent of such non-resident habitually plays the principal role leading to the conclusion of the contracts. If the intermediary being an independent agent does not act in the ordinary course of business or such intermediary works exclusively or almost exclusively for the foreign enterprise as a related party, such intermediaries shall constitute PE of the foreign enterprise. With these changes in the tax conventions and the tax treaties, the concept and attributes of independent agent as discussed in paras 5.30 and 5.31 above, has currently undergone substantial modifications.

As India follows a common law system, the action plan's recommendations pertaining to commissionaire arrangements will not be relevant in the Indian context. However, since India has not expressed reservation on the other recommendations above, those measures are likely to form part of Indian tax treaties unless the other treaty partners express reservations against such inclusion.

8.1.2. Narrowing the specific activity exemptions from PE status including anti-fragmentation rule

As noted earlier, Article 5(4) of the OECD Model Tax Convention 2014 exempts certain activities viz. maintenance of stock of goods for storage,

display, delivery or processing, procuring or collecting information from constitution of PE.

BEPS Action plan 7 seeks to allow the above exemption only upon fulfilment of the preparatory / auxiliary condition. In other words, under the BEPS regime, maintenance of facilities for stocking goods, delivery of goods, procurement of goods, etc. shall not constitute PE of the foreign enterprise only if these activities are preparatory or auxiliary relative to the overall activities of such foreign enterprise. This is because, the action plan takes cognizance of the possibility that in the current dynamic business landscape, these activities may no longer undertake a preparatory / auxiliary character but instead constitute a key part of the business value chain due to its essential character in the business. Illustratively, foreign e-commerce companies with warehouses and significant workforce in India may not be able to claim shelter from PE exposure in India, as such warehousing and allied functions shall constitute essential functions of its business.

The Action Plan 7 also proposes an anti-fragmentation rule. The rule seeks to curb the practice of artificially avoiding constitution of PE by fragmenting cohesive operating businesses into small but complementary business operations and imparting an impression that such individual business activities bear preparatory or auxiliary character. However, in substance they collectively constitute a large or integral part of the overall business of the foreign enterprise in the source state, whether through individual or group of related enterprises.

Since India has not expressed any reservation against this proposal, this will most likely feature in the India treaties. Therefore, it may be pertinent to evaluate implications of sourcing arrangements from India as these could constitute significant / integral activities towards existence of PE in India.

8.1.3. Splitting up of contracts to avoid PE in the context of building / construction sites or installation project

BEPS Action Plan 7 also addresses the issue of splitting up of contracts between group entities to dodge the prescribed time threshold under Article 5(3) of the OECD Model Tax Convention (generally 12 months) to avoid constitution of a PE for building sites and construction / installation projects.

The Action Plan notes that multinational enterprises typically split up a single project that may be connected both commercially and geographically into several parts through allocation of activities to different entities within the group. The duration of these individual activities is generally restricted / planned to be lower that the recommended time threshold, such that the constitution of PE in a source state is avoided. In this backdrop, the Action Plan recommends that this form of artificial avoidance by way of splitting up a single project may be addressed either through the principal purpose test rules (as per Action Plan 6) or following certain test guidelines as per Action Plan 7. Briefly, BEPS Action Plan 7 recommends the following guidelines to determine whether the time threshold recommended under Article 5(3) has been breached:

- Determine the total duration of the activities undertaken by the enterprise as a whole
- Determine the duration of connected and commercially coherent activities which may have been split / segregated geographically
- The aggregates of (i) and (ii) may help in determining possible breach of the time threshold.

Determination of whether and how certain activities are connected would depend on the facts and circumstances of the case. Certain factors which may be relevant for this determination include:

(i) Whether the contracts involving the different activities were concluded with the same person

(ii) Whether there are separate or additional contracts for various activities leading to the final outcome of the project.

(iii) Whether the above activities / contracts are logically / sequentially linked to form an united whole

(iv) Whether the same personnel are executing the various activities / contracts as part of an integrated project

India has consistently supported the position that connected projects involving related parties may be individually tested to check for breach of PE time threshold. The recommendations by OECD under the BEPS Action Plan 7 bolster the position adopted by India.

8.2. PE implications in the era of digital economy

Digitalisation and its fast pace has resulted in complete transformation of business conduct. It has led to evolution of business processes and models lending them a physical presence agnostic attribute. Since conventionally international tax policies and rules have been aligned to the concept of physical presence nexus of non-residents in the source state, to establish the tax obligations of the non-residents in a source state, lack of physical presence in the era of digital economy poses a major challenge to tax policy makers and tax administrations in identifying the taxable nexus of non-residents.

Advances in digital technology have not changed the fundamental nature of the core activities that businesses carry out as part of a business model to generate profits. For generation of income, businesses still need to source and acquire inputs, create or add value, and sell to customers. Similarly, for supporting their sales activities, businesses have always needed to carry out activities such as market research, marketing and advertising, and customer support. Digital technology has significant impact on how these activities are carried out, for example by enhancing the ability to carry out activities remotely, increasing the speed at which information can be processed, analysed and utilised. Moreover, since distance and geographical proximity pose no hindrances to digital means of trade, the number of potential customers that can be reached, also increase. As a result, certain processes previously carried out by local personnel can now be performed cross-border by automated equipments and services, changing the nature and scope of activities to be performed by staff. Thus, the growth of a customer base in a country during this digital era does not always need the level of local infrastructure and personnel that would have been needed in a “pre-digital” age. This increases the flexibility of businesses to choose where substantial business activities should take place, or to move existing functions to a new location, even if those locations may be removed both from the ultimate market jurisdiction and from the jurisdictions in which other related business functions may take place.

Hence, increasingly the focus shifts towards where the economic activities or value additions are performed. The residence or physical presence of multinational enterprises in a particular jurisdiction has relatively lesser relevance in this constantly evolving digital business space. The OECD in its

interim report on the Tax Challenges arising from Digitalisation during 2018 highlighted following three unique features of the digital business models which have had significant impact on the allocation of taxing rights and global income.

- Scale without mass
- Heavy reliance on intangible assets, which are key to these business models
- High volume of data and user participation including network effects

According to the said report, the countries have difference of opinion on whether and to what extent these features contribute to the value creation by enterprises and thus member countries on the OECD's inclusive framework have agreed to undertake a consensus based coherent and concurrent view on the economic nexus and profit allocation rules by 2020.

It had already been recognised in the past that the concept of PE referred not only to a substantial physical presence in the country concerned, but also to situations where the non-resident carried on business in the country concerned via a dependent agent (hence the rules contained in paragraphs 5 and 6 of Article 5 of the OECD Model). As nowadays it is possible to be heavily involved in the economic life of another country without having a fixed place of business or a dependent agent therein, concerns are being raised regarding whether the existing definition of PE remains consistent with the underlying principles on which it was based. For example, the ability to conclude contracts remotely through technological means, with no involvement of individual employees or dependent agents, raises questions about whether the focus of the existing rules on conclusion of contracts by persons other than agents of an independent status remains appropriate in all cases.

Although addressing the challenges of digital economy taxation is a vivid aspect of research and deliberation among policy makers and taxpayers even currently, OECD's BEPS Action Plan 1 report of 2015 on "Addressing the tax challenges of the Digital Economy", amongst various alternatives to tax digital economy, suggested broadening of the ambit of the PE definition, on the lines indicated under BEPS Action Plan 7. This alternative may have the least amount of disruption, compared to the other two alternatives - levy of withholding tax or an equalization levy.

Amongst the various proposals which the European Commission (EC) came up with for taxing digital economy during early 2018, the first proposal dealt with inclusion of significant digital presence within the definition of Permanent Establishment (PE). Thus, as per the European Commission, a member state could tax companies on the profits generated in such state even if these companies do not have a physical presence in such a state. A company would be considered to have significant digital presence in a Member state if it satisfies certain prescribed threshold conditions with respect to relevant revenue base, customer base or contract base in a given year. The European Parliament's proposal about a deemed (digital) permanent establishment which is deemed to exist when a non-resident taxpayer provides access to or offers a digital platform such as an electronic application, database, online market place, storage room, or offers search engine or advertising services on a website or in an electronic application or involvement of local domain name or payment options. These could be termed as digital factors or certain remote transactions contributing towards existence of a digital PE. Needless to add, with the technological advancement, these factors would only evolve.

Besides the digital factors such as those above, there could be revenue factors and user based factors as well. Revenue factors primarily focus on the revenue generated from sales by a foreign state within a source state through its digital activities therein. The user based factors illustratively would typically include the number of registered users per month or per fiscal year, the volume of digital contracts concluded, and/or the volume of the digital content collected by the taxpayer. The digital content may include both personal data content and user created content, such as product reviews and search histories.

Kuwait's and Saudi Arabia's revenue authorities have introduced the concept of a "Virtual Services PE" deemed to exist with no physical presence but the rendering of services for more than the tax treaty threshold period (usually 183 days). India, too introduced the concept of Significant Economic Presence (SEP) to denote business connection of the non-resident in India. While this aspect has been touched upon separately in the subsequent paragraphs, conceptually, it may be noted that a 'significant economic presence' (SEP) concept is a fundamental change for the existing permanent establishment framework. The concept of SEP PE should only be considered in connection with a consideration of the rules that would attribute profit to a

SEP PE. If the SEP taxation is based on net income principle it may better align with the existing principles of taxation. A significant economic presence could make the case for a 'permanent establishment' (PE), of which the taxation principles including attribution of profit require elaborate definition and explanation for ease of implementation.

Simply put, once the significant economic presence is determined in different jurisdictions, it shall be necessary to determine the following key aspects, in order to allocate (taxable) profits to the concerned source states.

(i) what creates value and

(ii) where that value is created

Besides the traditional manner of allocation of profits based on an analysis of the functions performed, assets used and risks assumed, taking into account the arm's length principle, the OECD through BEPS Action Plans 8-10 lays considerable emphasis on the place where the significant people functions are performed. Thus the current transfer pricing rules, require revision in order to allocate profits to the source states where significant economic presence of a foreign enterprise is located.

There are certain challenges in relation to concept of SEP PE / Virtual PE. Illustratively, these challenges could be in relation to the determination whether a digital factor (say, a domain name, payment system, digital platform) is local or not. Additionally, the associated tax administration burdens in issuing guidelines for concerned businesses and public reaction besides re-negotiation of tax treaties capturing the digital / revenue /user based characteristics are aspects which require considerable deliberation.

The relationship with current rules on PE should also requires consideration. For instance, could one taxpayer have two permanent establishments (one physical and one virtual)? And should the exemption of auxiliary services in article 5(4) of the OECD Model Tax Convention be deleted? As has been mentioned previously by many, it may be difficult to ring-fence the digital economy in a meaningful way. It would even be more challenging to introduce a fundamental change of profit allocation rules to a ring-fenced part of the economy. Such a fundamental change would immediately trigger the question why the same principles should not be applied to a physical permanent establishment.

It would be important to note, that there is still concern regarding countries seeking to tax a digital presence even in the absence of any other activities.

A wide extension of the PE definition to tax these digital presence scenarios, could also lead to uncontrolled double taxation.

Unilateral measures by countries as the ones above are increasingly becoming reality. Although OECD currently supports the virtual PE concept qua significant economic presence, more as a measure to address the digital economy challenges as per BEPS Action Plan 1, the underlying issue that digitalisation presents with respect to the concept of economic presence and the interplay with the notion of permanent establishment will need to be deliberated at international level with a view to achieving global consensus, as opposed to counter-productive unilateral measures.

It must be noted that since OECD has long recognised the need to come up with a consensus based rule for taxing digital economy (essentially MNE's with significant digital presence as opposed to physical presence) and substantial work is underway to release such a rule for adoption by countries adopting BEPS measures Essentially, these research literatures reflect clear emergence of new nexus rules far beyond the traditional nexus rule of PE, that relate to the situs of customers / consumption / marketing intangibles etc. for companies with digital delivery models or with significant consumer facing models. Evolution is constant and readers must be constantly conscious of this reality. While the global consensus on the manner of taxation of the digital economy based on the extensive consultation papers of the OECD, appear to be still distant, it may be highlighted that on 6th August 2020, the UN Tax Committee released a proposed optional UN model tax treaty article (the Proposal) that, (radically departing from OECD's proposals to new nexus norms in the digital era) would grant taxing rights to the treaty country where customers of a treaty-partner automated digital services provider are located. Briefly stated, the UN Committee proposed to add a new Article 12B to the UN Model Double Taxation Convention (UNMC), requiring foreign providers of automated digital services to pay income tax at source by means of either (i) a withholding on gross income (whose rate is to be agreed upon by the parties to the treaty), or (ii) on net income pursuant to an apportionment formula. Under the Proposal, the foreign automated digital services provider is allowed to choose whether to assess the tax on a gross basis or on net income.

8.3 Amendments to section 9(1)(i) by the Finance Act, 2018

As discussed earlier, the comparable term to PE under the Indian tax law is "business connection". Section 9(1)(i) of the Act provides that all income accruing or arising, whether directly or indirectly, through or from any business connection in India, shall be deemed to accrue or arise in India. The Finance Act, 2018 has brought in amendments to align the scope of 'business connection' under the Act with the recommendations of the BEPS Action Plan. The same are discussed hereunder.

8.3.1 Scope of "business connection" aligned with modified PE rule as per Multilateral Instrument

As explained above, the OECD under BEPS Action Plan 7 reviewed the definition of 'PE' with a view to preventing avoidance of payment of tax by circumventing the existing PE definition through ways including commissionaire arrangements or fragmentation of business activities. In order to tackle such tax avoidance schemes, the BEPS Action plan 7 recommended introduction of an anti- fragmentation rule and modifications to the Dependent Agent PE provisions under the DTAA. The recommendations under BEPS Action Plan 7 have now been included in Article 12 of Multilateral Convention to Implement Tax Treaty Related Measures (Multilateral Instrument - MLI), to which India is also a signatory. Consequently, these provisions will automatically modify India's bilateral tax treaties covered by MLI, where treaty partner has also opted for Article 12. However, as the provisions of the domestic law, being narrower in scope, are more beneficial than the provisions in the DTAAs as modified by MLI, such wider provisions in the DTAAs are rendered ineffective by virtue of section 90(2) of the Act.

Accordingly, with a view to align the domestic law with the DTAA as modified by the MLI, the Finance Act, 2018 has amended clause (a) of the Explanation 2 to section 9(1)(i) to provide that with effect from assessment year 2019-20, "business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident, 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.

8.3.2 "Business connection" to include "significant economic presence"

Apropos the discussion in para 7.2 above, OECD under its BEPS Action Plan 1 addressed the tax challenges in a digital economy wherein it has discussed several options to tackle the direct tax challenges arising in digital businesses. One such option is a new nexus rule based on "significant economic presence". Accordingly, the Finance Act, 2018 has inserted an Explanation 2A to section 9(1)(i) to provide that with effect from assessment year 2019-20, 'significant economic presence' in India shall also constitute 'business connection'. For this purpose, 'significant economic presence' 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:

It is further provided that only so much of income as is attributable to such transactions or activities shall be deemed to accrue or arise in India and also that the transactions or activities shall constitute significant economic presence in India, whether or not the non-resident has a residence or place of business in India or renders services in India.

The afore-stated conditions are mutually exclusive. The threshold of "revenue" and the "users" in India will be decided after consultation with the stakeholders. Further, unless corresponding modifications to PE rules are made in the DTAAs, the cross border business profits will continue to be taxed as per the existing treaty rules. The Finance Act 2020 deferred application of the new rule of Significant Economic Presence till Assessment Year 2022-23, pending global consensus on taxation of digital economy.

Chapter 9
Judicial Precedents

9.1 Fixed Place PE

(i) GE Energy Parts Inc. v. CIT [2019] 101 taxmann.com 142 (Delhi)

Facts of the case:

The taxpayer GE Energy Parts Inc. (GEPI) was a tax resident of the United States and was a part of the GE Group. GEPI supplied equipment to customers in India relating to the oil and gas business, energy business, etc. GEPI was engaged in various sales activities in India. Business heads were appointed to head the operations in India and were on the payroll of GE International Inc., US (GEII). The support staff was provided by an Indian entity, GE India Industrial Pvt. Ltd. (GE India). One of the group entities of GEPI, i.e. General Electric International Operations Company Inc., US (GEIOC), had a liaison office in India to undertake liaison activities. The liaison office had entered into a Global Service Agreement (GSA) with GE India to provide certain support services to the group company, not including commercial activities.

GEPI did not file a return of income in India. A survey was conducted at the premises of the liaison office of GEIOC whereby certain documents were found. On the basis of information gathered during the course of survey, it was revealed that in addition to the liaison activities, it had conducted commercial and trading activities. The ADIT issued notices to various entities of the GE Group incorporated in UK, Japan, US, etc., including GEPI. The ADIT observed that marketing and sales activities took place in India. Expatriates from GEII and employees of GE India were always involved and participated in the negotiation of prices which took place in India. In view of this, the ADIT held that GEPI had, inter alia, a fixed place PE as well as an agency PE in India. The CIT(A) and ITAT upheld the order of the ADIT. Aggrieved by the order of the ITAT, the GEPI preferred an appeal before the Delhi High Court.

Decision summary:

The Delhi High Court confirmed the decision of the ITAT and observed that:

(a) The premises of the liaison office were at the constant disposal of the

expatriates, who, although on the payroll of GEII, were working in India under the direct control and supervision of the GE overseas entities.

(b) From the job descriptions, self-appraisals and manager assessments, etc. it was evident that the expatriates were India country heads or working at the top positions and GE India was conducting the business of GE overseas entities in India and was directly and wholly involved in negotiating and finalizing the contracts.

(c) Based on the nature of activities done by GE overseas entities and GE India, it surfaced that GE India was doing core marketing and sales activity and GE overseas entities were doing only auxiliary activities, in aid and support of the activities of the marketing activities carried out by GE India.

(d) The activities carried on by GE India from premises of the liaison office were substantial and core activities and not merely preparatory or auxiliary.

(e) The activities carried on by the foreign entity from the liaison office were substantial and core in nature, and not merely of a preparatory or auxiliary character, the liaison office could constitute a fixed place PE of the foreign entity.

(ii) MasterCard Asia Pacific Pte. Ltd., In re (2018) 94 taxmann.com 195 (AAR – New Delhi)

Facts of the case:

MasterCard Asia Pacific Pte. Ltd. (MAPPL) belongs to the MasterCard group, one of the leading global payments solution providers. As a part of the global restructuring, Indian business of transaction processing services was assigned to MAPPL.

The customer bank is provided with a MasterCard Interface Processor (MIP) that connects to MasterCard's network and processing centres. A MIP is about the size of a standard personal computer and is placed at customer's locations in India. MIPs are owned by the Indian subsidiary, i.e. MasterCard India Services Pvt. Ltd. (MISPL). The transaction processing services comprises the process of authorisation, clearing and settlement.

The role played by MIPs is significant in facilitating the authorisation process, and without this initial verification/validation by MIPs, the authorisation would not happen.

Decision summary:

The AAR was of the view that this is a significant activity for authorisation part of the transaction processing and cannot be said to be preparatory or auxiliary.

The facts clearly established that MIPs, though shown to be owned by MISPL, are not under the control or disposal of MISPL. The term 'at the disposal of' would mean right to use and having control over that place/equipment. It is clear that MAPPL has right to use MIP and has control over it. It is also admitted by both the revenue authorities and the tax payer that MIPs are not under the disposal of customer banks in whose premises these MIPs are located. This reinforces the view that the MIPs are under the disposal of MAPPL since all risk mitigation functions are performed by it and all decisions with respect to MIPs are taken by it.

As regards the clearing and settlement functions, transaction processing has three stages: (i) authorization (ii) clearing and (iii) settlement. It is not necessary that PE will be created only if the fixed place/equipment is involved in all three stages. Involvement in even one stage (without it being preparatory or auxiliary) can create PE, provided they are significant. The distinction of these three stages would be important for profit attribution and not for creating a PE.

The AAR thus held that MAPPL is carrying out its business of facilitation of authorization of transaction through a fixed place, i.e. MIPs, since MIPs situated in India are at its disposal. The functions performed by MIPs in facilitation of authorisation transaction are not preparatory or auxiliary in character and are significant functions. Hence, MIPs create a fixed place PE of MAPPL in India.

MasterCard network creates fixed place PE:

The AAR held that it was also important to determine whether MasterCard network creates PE or not. While MIP is involved only in the authorisation process, MasterCard network is involved in all the three phases of transaction processing.

MAPPL had submitted that the clearing process establishes a settlement position. In the clearance process, each transaction would make one bank liable to pay another bank. The data relating to transaction between two banks is transferred within India and outside India through transmission

towers, leased lines, fiber optic cable, nodes and internet (owned by third party service provider), which is a part of the MasterCard network.

MasterCard Network in India consists of MIPs owned by MISPL, transmission towers, leased lines, fiber optic cable, nodes and internet- owned by third party service provider, and application software - Master Connect and MasterCard File express, owned by MAPPL. Ownership of equipment/space is not relevant to decide whether it creates a PE. The AAR was of the view that it should pass the test of permanence, fixed place and disposal. There is no doubt that just like MIP, the network also passes the test of permanency and fixed place. It also passes the test of disposal since it is admitted in the transfer pricing report of MISPL that MCT LLC (a group company) is responsible for management and maintenance of MasterCard Worldwide Network remotely from the USA. In fact, Application software - Master Connect and MasterCard File express are owned by MAPPL and controlled by them, and are at the disposal of MAPPL. MIP is at the disposal of MAPPL. The part of network provided by third party service provider in India is also at the disposal of MAPPL. MAPPL had submitted that the network in India is also secured by MasterCard to prevent fraud and to enhance security. Thus, it was held that MasterCard Network in India is at the disposal of MAPPL.

The software and process technology (which are part of MIPs and owned by MAPPL or licensed to it by the owner) is installed in the premises of the customer banks in India. The application software (Master Connect and MasterCard file, owned by MAPPL) is installed in the computers of banks. The connectivity to MIP and banks' computers is provided by various service providers through cables as well as internet.

In view of the above, the AAR held that MasterCard network also creates a fixed place PE of MAPPL in India.

Indian subsidiary, MISPL creates subsidiary PE:

The subsidiary of MAPPL, i.e. MISPL carries out transaction processing activity of MAPPL ; to that extent, facility, service, personnel and premises of MISPL are at the disposal of MAPPL. The AAR observed that it is through these facilities, service, personnel and premises, MAPPL is carrying on transaction processing activity and undertaking risks which are not reflected in the Functions, Assets and Risk analysis [FAR] of MISPL.

The transaction processing work is being carried out through MIPs and MasterCard network in India but not reflected in the FAR profile of MISPL.

MISPL is only shown to be carrying out support activity in its FAR and it is not carrying out actual transaction processing service which is happening in India through MIPs claimed to be owned by it. Thus, for this transaction processing activity, that is happening in India, and which is not reflected in the FAR of MISPL, subsidiary company MISPL created PE of MAPPL. Thus, the other work of MAPPL is being carried out by the facilities, services, personnel, premises, etc., of MISPL which are available to MAPPL and hence constitute its PE.

Bank of India premises constitutes fixed place PE:

The AAR observed that more than 90 percent of transactions involve domestic INR settlement for which Bank of India passes necessary entries. Further, for constituting space at Bank of India as fixed place PE of MAPPL, it is necessary that the functions of MAPPL are carried out through that space.

The employees of Bank of India carrying out the settlement function on behalf of MAPPL, are under control and supervision of MAPPL and the space occupied by them in Bank of India is at the disposal of MAPPL. It is true that Bank of India is also carrying out other activities as it is an established bank in India. However, it is well understood that for constituting PE the space may not be exclusively used by the non-resident enterprise. OECD has also agreed to this principle in Note 4 of OECD commentary on article 5 of Model Tax Convention. Thus, it was held that Bank of India premises constitutes fixed place PE of MAPPL.

(iii) Production Resource Group (2018) 401 ITR 256 (AAR)

Facts of the case:

The applicant was a Belgian company engaged in the business of providing technical equipment and services for events including lighting, sound, video and LED technologies.

It entered into a Service Agreement with the Organizing Committee of the Commonwealth Games, Delhi to provide specified services on a turnkey basis. It rendered the services in conformity with the agreement for two days i.e. at the opening ceremony and at the closing ceremony of the Games.

The applicant's employees and equipment were in India for a period of only 66 days for preparatory, installation and dismantling of equipment.

Decision Summary:

The AAR held that the applicant had a PE in India as it was provided with a lockable place for storing its tools and equipment within the stadium i.e. where the revenue generating activity would take place. Coupled with the space, the lighting facilities erected by the assessee, were also held to be a part of the place of business. The contention that services were rendered only for two days was rejected on the basis that this was a turnkey project covering the entire duration of the Games and more.

It also held that permanence of the place was to be gauged only for as much time as the business required. The AAR also considered certain other factors like sub-contracting of some of the activities, insurance of the project, mandatory licensing of the place, etc.

(iv) Formula One World Championship Ltd (2017) 394 ITR 80 (SC)

Facts of the case:

FOWC (the taxpayer), a U.K. resident company; the Federation Internationale de l' automobile (FIA), an international motor sports events regulating association and Formula One Asset Management Limited (FOAM) entered into certain agreements whereby FOAM licensed all commercial rights in the FIA Formula One World Championship (Championship) to FOWC for a period of 100 years w.e.f. January 01, 2011.

The taxpayer entered into a race promotion contract (RPC) with Jaypee Sports International Ltd. (Jaypee) on September 13, 2011, under which it granted the right to host, stage and promote the Formula One Grand Prix of India event at the Buddh International Circuit in Noida.

An artwork license agreement (ALA) was also entered into between FOWC and Jaypee on the same day whereby FOWC permitted Jaypee to use certain marks and intellectual property belonging to FOWC for a consideration of $ 1 million. Various other agreements were also entered into between the parties to give effect to their understanding relating to racing event in India. The taxpayer and Jaypee both approached Authority for Advance Rulings (AAR) for determination of tax position having regard to the factual matrix of the case.

The AAR concluded that the consideration received by FOWC is in the nature of royalty and FOWC does not have a fixed place of business/PE in India. FOWC filed writ challenging the ruling of the AAR on the issue of

royalty and Revenue filed writ challenging the ruling of the AAR regarding the issue of existence of a PE in India. The High Court reversed the findings of the AAR on both the issues and held that the amount received by FOWC would not be treated as royalty. It was held that FOWC had a PE in India and therefore, consideration received shall be taxable in India.

FOWC contented that the Buddh International Circuit was not at the disposal of the taxpayer. Jaypee was responsible for conducting the event and had complete control over it. Further, total duration for which limited access to the race venue which was granted to FOWC was not sufficient duration to constitute the degree of permanence necessary to establish a fixed place, PE, in India.

Decision summary:

The Supreme Court upheld the Delhi High Court's finding that the assessee has a fixed place PE in India by virtue of the international circuit i.e. a place where the motor racing event is hosted. Accordingly, the amounts received by it under the Race Promotion Contract constitute the assessee's business income. With a view to examining whether the international circuit was put at the disposal of the assessee so as to constitute its fixed place PE, the Supreme Court noted that the arrangement clearly demonstrated that the entire event was taken over and controlled by the assessee and its affiliates. The Court rejected the assessee's stand that since the duration of the event was only 3 days, the total duration for which limited access was granted to it was not sufficient to constitute the degree of permanence necessary to establish a fixed place PE; It clarified that the question has to be examined keeping in mind that the aforesaid race was to be conducted only for three days in a year and for the entire period of race the control was with the assessee. The Court also held that the construction or ownership of track or organising of events by the other party was immaterial as a common sense and plain thinking of the entire situation would lead to the conclusion that the assessee had earned income in India through the said track over which they had complete control during the period of race.

(v) SeaBird Exploration FZ LLC (2018) TS-162-AAR-2018 (AAR)

Facts of the case:

The applicant was engaged in the business of rendering geophysical services to the oil and gas exploration industry. Its core business activity involved 4C-3D seismic data acquisition and processing, which were aimed

at increasing the exploration success of its oil and gas clients and maximizing their production. In India, it is providing these services to Oil and Natural Gas Corporation Ltd. (ONGC) and other oil companies. It is in this connection that it had entered into a contract with ONGC for 4C-3D seismic data acquisition, processing and interpretation in Mumbai High Field.

The applicant had sought a ruling from Authority for Advance Rulings for the determination of its tax liability in respect of the revenue received under the above said contract with ONGC.

Assessee contented that it cannot be considered as having a PE since it is covered by the specific clause under Article 5(2)(i) [which envisages furnishing of services such as supervision, managerial, consultancy, or general nature, which are employee or personnel oriented and connected with some works contract or project whose term aggregates to more than 9 months], as its period of operation was only 113 days.

Decision summary:

The AAR ruled that the assessee (a UAE tax resident) constitutes a fixed place PE in India under Article 5(1) of India-UAE DTAA in the form of its vessels engaged in seismic surveys on the high seas in connection with the exploration of mineral oil/ natural resources under its agreement with ONGC.

It held that vessels used by the assessee passed all 3 tests for constituting PE under Article 5(1), namely that there was permanence of duration to the extent that is required by the business, there was a fixed place which are the vessels in the high seas in a definite and composite geographical area, and from which its business of survey in connection with exploration is carried out, and lastly this place was at the disposal of the assessee.

AAR opined that in contrast, services of seismic surveys are conducted on the high seas through the seismic vessels. They are not carried on mainly by employees/personnel but primarily by the vessels and equipment mounted thereon and deployed in the ocean; Such are not the services contemplated under para 5(2)(i) of the India UAE DTAA.

The AAR further illustrated examples from the India-USA, India-Netherlands, India-UK, India-Japan DTAAs wherein specific mention of certain time period has been made in respect of an installation or structure used for the exploration or exploitation of natural resources for constituting a PE; It particularly referred to the India-Singapore DTAA which specifically provides

that PE would be constituted if an enterprise provides services or facilities in that contracting state for a period of more than 183 days in any fiscal year in connection with the exploration, exploitation or extraction of mineral oils; About any mention with regard to activities in connection with exploration or connected activities in Article5(2) of India-UAE DTAA, the AAR held that there is no scope for getting into the debate of interplay between paras 1 and 2 of Article 5 of the India UAE DTAA, or to resolve any conflict therein, since the services rendered by the applicant are not covered by any of the sub paras of para 2 of Article 5 or any other para.

(vi) FRS Hotel Group (Lux) S.a.r.l. [2018] 404 ITR 676 (AAR)

Facts of the case:

The Applicant, FRS Hotel Luxembourg was a part of FRS Hotel group & principal operator of the group outside India. It provides services in connection with hotel management, including all services that are necessary for hotel operation.

Bengal Ambuja Housing Development Limited (BAHDL), owner of Swissotel, has entered into various agreements with the applicant for services relating to different phases of its hotel development & operation.

The main agreement is the Centralized Services Agreement (CSA). Some examples of services provided by applicant include facilitation of reservation/booking of rooms, global sales & marketing, finance support, human resources support, operations support, advisory services in connection with capital improvements, including refurbishing, maintenance, etc.

Decision summary:

The AAR stated that there are three important conditions for existence of a PE – fixed place, disposal & carrying on of NR's business through such fixed place. In the present case, the applicant is required to oversee the construction & design of the hotel to ensure that it is compliant with its brand standards. Further, the applicant & its employees had right to access all parts of the hotel at all times as considered necessary. Therefore, Swissotel is a fixed place at the applicant's disposal.

The AAR also stated that the entire operation & management function of Swissotel was with the applicant, including core functions like booking, sales & marketing. BAHDL, the owner of Swissotel, has undertaken that it will not

interfere in the applicant's exercise of the exclusive authority over such operation and management. These agreements were for 10 years and could be further extended. BAHDL was barred from even contacting any of the hotel staff directly, with few exceptions. Thus, the applicant was carrying on its entire business from the premises of Swissotel. Hence, it had a fixed place PE in India. The relationship with BAHDL was on principal-to-principal basis & hence, the applicant was not a dependent agent of BAHDL. Since there was a PE, determination of whether the payment for all these services was royalty or FTS was irrelevant.

(vii) GIL Mauritius Holdings Ltd. [2018] 99 taxmann.com 21 (Delhi - Trib.)

Facts of the case:

The assessee-company, incorporated under the laws of Mauritius, filed its return of income declaring total income at Nil. The assessee entered a sub-contract with HHI and VMGL for providing services in connection with prospecting of extraction or production of mineral oil in India.

The assessee claimed that it does not carry on any business through PE in India, since the duration of work in India for both the contracts (first contract was 109 days and second contract was 136 days) had not crossed the basic threshold time prescribed as per article 5 of India-Mauritius DTAA, i.e., 9 months.

The AO was of the view that the assesee had a 'vessel' at its disposal which constituted a fixed place of business in India and therefore it constitutes Fixed Place PE in India.

The CIT(A) was of the view that the case of the assessee would fall in either article 5(1) or in article 5(2)(g) considering that clause (g) is more specifically connected with the oil and gas industry. However, in both the cases the requirement of 9 months duration would not be there to potentially bring to tax revenue as business income. The first contract was entered into on 1-11-2004. The assessee has submitted that this contract commenced from the date the vessel entered into India i.e. 1-2-2005. Based on the completion certificate by Hyundai it was claimed by the assessee that the project work was completed on 20-5-2005.

Decision Summary:

Based on the facts of the case, the Tribunal noted that the first contract

entered between the assesse and Hyundai did not specifically mention the 'effective date' agreed between the parties and therefore, the commencement date of the contract remains unascertained. The entry date of the vessel in India cannot be taken as a commencement date as the work of subcontractor has to be coupled up with the work of contractor and not only the vessel is required to be mobilized by the assessee-sub-contractor into India but much more than the vessel, several key persons were also required to be mobilized in India. In absence of any valid evidences for the commencement and completion dates of work, there is no other alternative but to take 1-11-2004 as the effective date for the commencement of the work and take the date of 20-5-2005 as completion date and therefore this work was carried out by the assessee in India for 201 days.

With respect to the second contract between assesee and VMGL-VML consortium, the contract was entered into on 15-9-2004. It is claimed that vessel entered into India on 1-12-2004 and contract was completed on 15-4-2005. The terms of the second contract are similar to the first contract. Further, the second contract says that the commencement shall be from the date the agreement is signed. Therefore, the commencement date id 15-09-2004 and the completion date is 15-4-2005 and therefore this work is carried out in India for approximately 212 days. The contract durations of contract one and two both are less than 9 months therefore, the assessee does not have a permanent establishment as per DTAA.

Further, argument of assessee that oil well is not owned by it is not valid as Article 5(2) specifically mentions that the business of the assessee should be carried on through that place and no where there is a condition attached to it that they should be owned by the assessee. Further while holding that assessee has a PE under article 5(2)(g), the Commissioner (Appeals) had not at all examined whether oil well or gas was the fixed place available to the assessee for carrying on its business. Without first giving that finding, the Commissioner (Appeals) has incorrectly assumed that assessee has a PE under that article. That oil well should have been proved to be under the disposal of the assessee in the sense of having some right to use the premises for the purposes of its business and not solely for the purposes of the project undertaken on behalf of the owner of the premises.

Here it is apparent that assessee even if it has the above place it is for the purposes of the above project undertaken as sub-contractor. Even otherwise the Commissioner (Appeals) has not given any finding that such oil well is at

the disposal of the assessee. Thus, the income cannot be charged under that article.

(viii) Convergys Customer Management Group Inc vs ADIT [TA No 1443/Del/2012 and 5243/Del/2011]

Facts of the case:

The appellant, a tax resident of the US, provides information technology (IT)-enabled customer management services. The Taxpayer has a subsidiary in India, IndCo, which provides IT-enabled call centre/back office support services to the Taxpayer on a principal-to-principal basis. The appellant had availed a packaged enterprise application known as PeopleSoft License (Software) which was also used by IndCo and proportionate maintenance cost was allocated to IndCo which was, subsequently, reimbursed by IndCo. The appellant, therefore, argued that the procurement of services was akin to purchasing goods/merchandise and, accordingly, the benefit of the PE exclusion i.e., preparatory or auxiliary function should be available. The same applied with link charges. However, the AO had contended that the said reimbursements were in the nature of Royalty as per the provisions of the Act and Article 12 of the DTAA.

In addition to the above, the AO claimed that the appellant had a fixed place and Agency PE in India on the ground that the appellant's employees frequently visited the premises of IndCo to provide supervision, direction and control over the business operations of IndCo which was at their disposal.

Decision Summary:

In the context of PE, It was held by the ITAT that IndCo is practically the projection of the appellant's business in India and IndCo carries out its business under the control and guidance of the appellant, without assuming any significant risk in relation to such functions. Thus, it was held that it has a fixed place of PE in India. However, it was observed that the prescribed conditions under article 5(4) and 5(5) of the DTAA are not satisfied and hence does not constitute a DAPE in India under the DTAA. The tribunal also prescribed the correct approach to arrive at the profits attributable to the PE.

(ix) ADIT v. Co-operative Centrale Raiffeisen (2015) 154 ITD 153 (Mum ITAT).

Facts of the case:

In this case, the taxpayer was a cooperative membership institution and tax resident of the Netherlands. It belonged to Rabobank Group Worldwide. Rabo India provided banking and advisory services to Indian clients. In turn, Rabo India obtained services of the taxpayer. For such services, the taxpayer received a portion of the fees charged by Rabo India to its clients. During the tax assessment, the AO concluded that the taxpayer had used "good offices" of Rabo India and, hence, had a PE in India.

The taxpayer submitted before the ITAT, inter alia, that Rabo India used the services of the taxpayer, but not vice versa. All the activities of the taxpayer were performed outside India. The taxpayer did not have a place of business in India and its employees did not work in India.

Decision summary:

The ITAT upholding the taxpayer's contention, ruled that the taxpayer could not be regarded as having a fixed place PE in India.

(x) Brown and Sharpe Inc. [2014] 51 taxmann.com 327 (Allahabad)

Facts of the case:

Brown & Sharpe Inc. ('assessee'), incorporated in USA, was a 100% subsidiary of Hexagon AB, Sweden .It established a liaison office ('LO') in India with the permission of Reserve Bank of India (RBI). The LO was established only as a communication channel between the customer & the assesse. The LO received reimbursement of expenses from the parent company for the expenses incurred.

However, the AO and CIT(A) was of the view that the LO was not only a communication channel but the activities were extended to searching for prospective buyers, providing required information and persuading them to purchase the brand of the assesse, discussing of commercial issues pertaining to the contract through the technical representative, after which an order was placed by the buyer directly.

Decision Summary:

It was observed by the HC that the LO was involved in marketing of the parent company by contracting with the employees for sales promotion and

offering the sales incentive. Also, the assessee had hired CRO and technical expert. All these activities therefore, clearly established that the liaison office of the assessee was promoting the sales of the assessee company in India. Thus, it was held that the AO was fully justified in holding that the income attributable to liaison office is taxable in India.

Further, w.r.t reimbursements, it was held that the reimbursement of expenses cannot be treated as income. However, the LO received more amount than the amount actually incurred. Thus, amount in excess of expense was to be treated as an income.

(xi) Ericsson Radio Systems A.B. v. DCIT (2005) TIOL – 103 (DEL SB).

Facts of the case:

Ericsson was a corporate tax resident of Sweden and a leading supplier of telecommunication equipment (hardware as well as software). Ericsson India, one of Ericsson's sister concerns was incorporated in and a tax resident of India. Ericsson entered into contracts with ten cellular (mobile) phone service operators in India for supply of hardware and software.

The Indian revenue authorities argued, inter alia, that Ericsson's overseas employees had used the office facilities of Ericsson India during their business visits to India. The Indian revenue authorities concluded that the use of the said office (by Ericsson's employees) gave rise to Ericsson's fixed place PE in India in accordance with the India-Sweden treaty. Ericsson argued that the office space of Ericsson's India's office space was never at the disposal of the foreign entity.

Decision summary:

The Special Bench of the ITAT observed that although Ericsson's employees had used Ericsson India's office facilities during their business visits to India, the Indian revenue authorities were not in a position to substantiate that Ericsson India had provided office space to Ericsson at the latter's disposal. Therefore, as such, Ericsson's employees were not entitled to use the office facilities of Ericsson India as a matter of right. Consequently, the ITAT ruled that the said office space was not at Ericsson's disposal and therefore, Ericsson could not be regarded as having a fixed place PE in India in accordance with the tax treaty between India and Sweden.

(xii) In re Aramex International Logistics Pvt. Ltd. (2012) 348 ITR 159 (AAR)

Facts of the case:

Aramex International, he taxpayer was a tax resident of Singapore and was engaged in the business of delivering door-to-door shipments and providing related logistics services. It had entered into a non-exclusive arrangement with an Indian group company ("the Indian company") for transportation of packages within India. Similarly, the taxpayer company/other group companies outside India were to transport the packages outside India (which originated from the Indian company in India), for arm's-length consideration being on a principal-to-principal basis. The Indian company was not authorized to enter into any agreement on behalf of the taxpayer company. As per the taxpayer company, the above-mentioned arrangement did not give rise to the taxpayer company's tax liability in India as Aramex International did not constitute any PE in India.

Decision summary:

The AAR held that the above-mentioned arrangement with the Indian company led to the constitution of taxpayer company's PE in India because the Indian company exclusively facilitated the taxpayer company's "Indian part" of the business, through its facilities

(xiii) Renoir Consulting Ltd. v. DDIT (2014) 24 SOT 28 / 45 taxmann.com 112 (Mum ITAT)

Facts of the case:

The taxpayer, Renoir Consulting Ltd was a tax resident of Mauritius and engaged in the business of carrying out consulting projects. During the relevant tax year, it had worked on a major consulting project for an Indian client, which was executed in three phases of total duration of 80 weeks. In connection with the project, the taxpayer company's consultants had visited India for 874 man-days and its principal consultants for 81 days.

As per the taxpayer, it did not have a fixed place of business in India and therefore it did not have a PE in India. On that basis, the taxpayer claimed that its income from the above-mentioned project was exempt from tax in India. The Indian revenue authorities, however, refuted the taxpayer's claim and concluded that the taxpayer had a fixed place of business in India – in the hotel rooms where the staff had stayed – and hence had a PE in India.

Decision summary:

The ITAT held that for a fixed place PE to exist in accordance with article 5 of the India-Mauritius treaty, there had to be a physical location through which a foreign enterprise's business must be carried on. Moreover, such a place had to be at the disposal of the foreign enterprise (right of disposal). By "right of disposal", the ITAT meant a right to use the place for the enterprise's business. The ITAT rejected the taxpayer's contention that it rotated the staff visiting India and, therefore, the duration test for existence of a fixed place PE was not satisfied. Moreover, the ITAT disagreed with the taxpayer's contention that the staff had visited India for merely planning and supervising work after noting the profile requirements for the project.

Additionally, the ITAT rejected the taxpayer company's contention that it did not have a place of business in India (through which the above-mentioned project was executed). Further, the ITAT held that since the taxpayer company knew its affairs intimately, it had the onus to specify as to how and from where it had performed the work. The fact that the staff did not perform work at the client's premises was immaterial. On the basis of the staff's stay in India, the ITAT not only concluded that the staff's activities were not confined to merely conducting meetings with the client, but also inferred that the staff had some place at their disposal during their stay in India. In the light of the above, the ITAT concluded that the taxpayer company had a fixed place PE in India.

(xiv) Whirlpool India Holdings Ltd. v. DDIT (2011) 140 TTJ 155 (Del ITAT)

Facts of the case:

Whirlpool India Holdings was a tax resident of the United States. It was a wholly owned subsidiary of Whirlpool Corporation, United States (hereafter referred to as "Whirlpool"). Whirlpool India Holdings had established a branch office in India for looking after and safeguarding interests of Whirlpool.

Whirlpool had a subsidiary in India (hereafter referred to as "WIL"). WIL was engaged in the business of manufacture and sale of consumer durable goods. Whirlpool wanted to ensure that some senior-level employees were placed in WIL to manage its affairs. However, due to certain restrictions under the Indian corporate law, WIL was not in a position to adequately compensate the said senior-level employees. Therefore, Whirlpool had paid remuneration of the said employees through Whirlpool India Holdings' branch office in India.

As per Whirlpool India Holdings, its Indian branch office did not conduct any business operations and therefore it was not liable to tax in India. However, the revenue authorities took the view that Whirlpool India Holdings' Indian branch office was rendering services to Whirlpool and ought to have recovered from Whirlpool a fee for the same. Therefore, such branch constituted the PE of Whirlpool India Holdings in India. The revenue authorities also held the deputed employees continued to be employees of Whirlpool India Holdings.

Decision summary:

The ITAT rejected the revenue authorities' position and observed as follows:

- Whirlpool India Holdings did not carry on any business in India and did not earn any income through its Indian branch office;
- Whirlpool manufactured goods in more than 11 countries and sold them in more than 120 countries; the extent of operations warranted establishment of a subsidiary of Whirlpool India Holdings in India, i.e WIL; The branch office Whirpool India Holdings was established merely for safeguarding the interests of Whirlpool in India.

The above-mentioned employees were not employees of Whirlpool India Holdings. The employees were deputed by Whirlpool to WIL with a viewing to protecting and enhancing Whirlpool's interests in India;

In view of the above, the ITAT held that Whirlpool India Holdings' Indian branch office did not amount to a PE in terms of article 5 of the India-United States treaty, particularly because:

- the branch office did not carry on any business in India; and
- the above-mentioned employees were employees of WIL.

(xv) Western Union Financial Services Inc. v. ADIT (2007) 104 ITD 34

Facts of the case:

Western Union was a tax resident of the United States. It was engaged in the business of rendering money transfer services. For facilitating money transfers from foreign countries to India, Western Union had entered into an agency agreement with four types of agents in India:

- the Department of Posts (belonging to the government of India);
- commercial banks;

- non-banking financial companies; and
- tour operators.

Western Union paid a commission to the agents for rendering the above-mentioned services.

Western Union had also set up liaison offices (LOs) in India with the permission of the RBI (India's central bank in charge of India's foreign exchange regulations). As per the RBI permission, an LO was not allowed to undertake any commercial, trading or industrial activity in India on behalf of Western Union's head office. Also, an LO was not allowed to sign or negotiate contracts (except those that were directly incidental to the conduct of the operations of the LO). An LO was allowed to perform, inter alia, the following activities:

- distribute brochures and literature describing the activities of the taxpayer company;
- maintain liaison contact with the government authorities, organizations and associations;
- address seminars on the taxpayer company's activities;
- put interested parties in direct contact with Western Union's head office;
- explore legal, commercial and regulatory feasibility of setting up subsidiaries, affiliates, partnerships, joint ventures, licensing arrangements, etc.; and
- investigate business opportunities in Western Union's range of activities and develop business contacts.

The revenue authorities rejected Western Union's claim that it did not have a PE in India. Subsequently, the ITAT upheld Western Union's claim.

Decision summary:

The ITAT observed that Western Union did not have any outlet of its own in India. Therefore, it did not have a fixed place of business in India. The agents appointed by Western Union operated from their own offices. The mere fact that they had put up a board outside their offices indicating that they were agents of Western Union could not render the agents' offices as a fixed place of business/PE of Western Union in India.

The ITAT also observed that Western Union's LOs in India had acted as mere communication links between the agents in India and Western Union's head office in the United States. The LOs' other activities (such as training agents, etc.) were in line with the activities permitted by the RBI. As per the ITAT, the activities performed by the LOs were of an auxiliary or preparatory nature. Therefore, the LOs could not be considered as Western Union's PE in India.

As regards software provided by Western Union and installed in the offices of the agents, the ITAT noted that Western Union did not have a right to enter the offices of the agents. Also, the ITAT observed that Western Union had not parted with the intellectual property right in the said software. Therefore, the ITAT accepted the contention of the counsel for Western Union that mere use of software could not give rise to Western Union's PE in India.

Thus, the ITAT accepted the contention of the counsel for Western Union that Western Union did not have a PE in India in terms of article 5(1) of the India-United States treaty.

(xvi) M/s Valentine Maritime (Mauritius) Limited (2011) 130 TTJ 417 (Mum)

Facts of the case:

The assessee, a tax resident of Mauritius was engaged in the business of marine and general engineering and construction. During the Assessment Year 2001-02, the assessee executed three contracts in India. One of these contracts was for the replacement of the main deck with a temporary deck and the other two contracts were to give barge on hire. The assessee claimed that the duration of each of the contracts did not exceed the threshold limit of nine months as per the Article 5(2)(i) of the India-Mauritius tax treaty. Therefore, the assessee did not have a PE in India. The AO held that since the total duration of all the contracts take together exceeded the threshold limit of nine months, a PE was established in India. The AO referred to the protocol to the India-UK tax treaty which specifically provides that the duration test is to be applied separately to each contract. In the absence of any such specific protocol in the India-Mauritius tax treaty, the assessee cannot consider the duration test separately for each contract. In respect of the contracts for barge hire, the barge itself constitutes a 'fixed place of business' through which the business of the assessee is carried out as per Article 5(1) of the India-Mauritius tax treaty. Accordingly, the receipts

under these contracts would be taxable under section 44BB of the Act. On appeal, the Commissioner of Income-tax (Appeals) allowed the appeal of the assessee against which the Revenue authorities filed an appeal before the Tribunal.

Decision Summary:

The Tribunal held that each of the projects has to be viewed on a standalone basis. The fact that the protocol to the India-UK tax treaty specifically mentions that the duration test has to be applied to each project would not warrant a different interpretation in the case of absence of such provisions in the India-Mauritius tax treaty. Also, according to the Tribunal, an aggregation principle should be applied when the activities are so inextricably interconnected or interdependent that it is essential they be viewed as a coherent whole. The Tribunal emphasized that the fact that projects are for the same principle or on nearby locations would not necessarily mean that these projects are to be seen as a coherent whole - geographically and commercially. In this regard, reliance was placed on the decision of Delhi Tribunal in the case of Sumitomo Corporation. The Tribunal held that as the three contracts were for different purposes, these contracts cannot be viewed as interconnected or interdependent, and accordingly, the duration of each project cannot be aggregated. On the issue whether a barge given on hire can be viewed as a fixed place of carrying on its business, the Tribunal held that since the assessee is in the business of hiring out barges, that activity cannot be carried out on the barge so hired out. Accordingly, the Tribunal held that the barge could not be a PE of the enterprise. In the absence of a PE, the business profits cannot be brought to tax. However, the assessee's receipts from contracts for barge hire were taxable under section 44BB of the Act as held by the AO.

(xvii) Galileo International Inc. v. DCIT (2009) 116 ITD 1

Facts of the case:

Galileo International was a tax resident of the United States. It was engaged in the business of maintaining and operating a computerized reservation system (CRS) for providing electronic global distribution services to airlines, hotels, tour and cab operators, etc. Galileo International maintained and operated a Master Computer System (MCS) consisting of mainframe computers and servers in the United States. The MCS was connected, inter alia, to airline servers with which data was continuously exchanged about

flight schedules, seat availability, fare structures, flight connections, etc. on a real-time basis. Galileo International had appointed an unrelated Indian company (Interglobe) as its sole and exclusive distributor for marketing and distributing the CRS services to travel agents in India. Galileo International had provided free-of-cost, through Interglobe, computers to travel agents in India. Galileo International had retained ownership of the said computers. Galileo International claimed that it did not have a PE in India. The revenue authorities rejected that claim.

Decision summary:

The ITAT observed, inter alia, that the CRS was partially existent in the computers installed at the premises of the travel agents. Those computers could perform the functions of reservation and ticketing and were a part and parcel of the entire CRS. Without approval of Galileo International, the said computers could not be shifted by the travel agents from one place to another. Thus, Galileo International exercised complete control over the computers installed at the premises of the travel agents. In the ITAT's view, this amounted to a fixed place of business for carrying on the business of the enterprise in India.

Thus, the ITAT held that Galileo International had a PE in on account of provision (by Galileo International) of the computers and communication lines to the travel agents in India. The ITAT reached a similar conclusion in Amadeus Global Travel Distribution S.A. v. DDIT, (2011) 11 taxmann.com 153 (Del ITAT) and Abacus International Pte. Ltd., (2013) 34 taxmann.com 21 (Mum ITAT)

(xviii) Director of Income Tax-II (International Tax), New Delhi v/s Samsung Heavy Industries Co. Ltd (also referred to as 'Assessee') (Appeal no. 12183/ 2016)

Facts of the case:

Oil and Natural Gas Company (ONGC) awarded a 'turnkey' contract to a consortium comprising the Samsung Heavy Industries Co. Ltd. ('Assessee') being a Company incorporated in South Korea, is a contract for carrying out the 'work', inter alia, of surveys, design, engineering, procurement, fabrication, installation, and modification at existing facilities, and start-up and commissioning of entire facilities covered under the 'Vasai East Development Project'; The Assessee set up a Project Office ('PO') in India

(Mumbai) to act as a communication channel between Assessee and ONGC. The Assessee filed a NIL income declaring a loss in its return of income in relation to activities carried out in India. The Assessing Officer (AO) held that the entire 'turnkey' contract was indivisible in nature and ONGC was to take over the project upon its completion. Hence, that the work relating to fabrication and procurement of material was very much a part of the contract for execution of work assigned by ONGC, which was carried out by the PE in India;

The AO in his Draft Order then went on to attribute part of the revenues allegedly earned outside India to the PO, as taxable in India, which was upheld by the Hon'ble Dispute Resolution Panel (DRP) as well; Aggrieved by the DRP order, the Assessee filed an appeal with the ITAT which too held that the contract was indivisible in nature. Further, there was nothing on records to ascertain whether the PO was carrying out auxiliary activities and thereby upholding the view of AO and DRP on the matter; The Hon'ble High Court ('HC') held that the question of PO to be held as PE within the meaning of Article 5 of the tax treaty between India and Republic of Korea would be of no consequence. It further held that there was no factual finding on record by the Revenue authorities that 25% of the gross revenue of the Assessee outside India was attributable to the business carried out by the PO of the Assessee. Accordingly, the HC held in the favor of the Assessee, which was consequently challenged by the Revenue Authorities in the Apex Court.

Decision summary:

The Hon'ble Supreme Court held that the taxability of profits arise when the said enterprise carries out 'core activities' through such PE; The maintenance of a fixed place of business which is of a preparatory or auxiliary character in the trade or business of the enterprise would not be considered to be a permanent establishment under Article 5 of the aforesaid tax treaty; The Supreme Court observed that ITAT ignored the fact administrative staff working in the PO were not in a position to undertake core activities of the Assessee; The Supreme Court held that no PE was set-up under Article 5(1) of the tax treaty as the PO cannot be said to be a fixed place of business through which core business activities of the Assessee are carried out.

(xix) UAE Exchange Centre LLC vs Union of India (CIVIL APPEAL NO. 9775 OF 2011) – 24th April 2020

Facts of the case:

UAE Exchange Centre LLC (UAE Exchange) is a limited company incorporated in the United Arab Emirates, which is engaged in offering, among others, remittance services for transferring amounts from the UAE to various places in India. UAE Exchange was granted approval by the Reserve Bank of India to operate a liaison office in 1996 and for the assessment years 1998-1999 until 2003-2004 filed tax returns showing NIL income without any issue. However, due to some doubts, UAE Exchange filed an application before the Authority for Advance Rulings (AAR) (Income Tax) for a ruling on whether any income is accrued/deemed to be accrued in India from the activities carried out in India. The AAR ruled that income is deemed to accrue in India from the activity carried out by the liaison office and that the profits of the enterprise needed to be taxed in India to the extent attributable to the liaison office activities as a PE. The ruling was based primarily on provisions of India's Income Tax Act, 1961 and the AAR also opined that the exemption for activities of preparatory and auxiliary character under the India-UAE tax treaty did not apply.

With respect to the treaty provisions, the Authority for Advance Rulings concluded that while certain activities could be considered auxiliary, certain activities could not. In particular, one of the modes in which payments are remitted to beneficiaries in India, which involves the liaison office preparing cheques/drafts and dispatching them to the addresses of the beneficiaries in India through courier could not be treated as a preparatory / auxiliary activity. Therefore, the AAR ruled that a PE existed for the UAE Exchange Centre LLC and consequently, the Indian tax authority issued notices to UAE Exchange for tax years 2000-2001, 2001-2002, 2002-2003, and 2003-2004.

Aggrieved by the AAR ruling and tax notices, UAE Exchange Centre appealed before the Delhi High Court by way of writ petition, inter alia, for the quashing of the ruling, the quashing of the notices, and for a direction to not tax UAE Exchange Centre in India because no income had accrued to it or is deemed to have accrued to it in India from its liaison office activities in India.

In its decision, the Delhi High Court found that the Authority for Advance Rulings committed manifest error in appreciating the relevant facts and materials on record and more particularly, misread the purport of Section 90

of the 1961 Act and the settled legal position that the India-UAE tax treaty ought to override the provisions of the Act. In other words, the tax liability of UAE Exchange was required to be assessed on the basis of the provisions in the tax treaty. Accordingly, the High Court was of the opinion that the AAR proceeded on a wrong premise by first examining the relevant provisions of the 1961 Act instead of applying the provisions in Articles 5 (Permanent Establishment) and 7 (Business Profits) of the tax treaty for ascertaining UAE Exchange's liability to tax.

Further, the Delhi High Court ruled that the activities carried on by UAE Exchange in the liaison office were only of preparatory and auxiliary character and were clearly excluded by virtue of the treaty provisions. The High Court then concluded that the activity carried on by the liaison office in India did not in any manner contribute directly or indirectly to the earning of profits or gains by UAE Exchange Centre in UAE and more so, every aspect of the transaction was concluded in UAE, whereas, the activity performed by the liaison office in India was only supportive of the transaction carried on in UAE. Based on its findings, the High Court quashed the AAR ruling, as well as the notices issued by the tax authority. Feeling aggrieved, the tax authority appealed against the Delhi High Court decision before the Supreme Court.

Decision summary:

In its judgment, the Supreme Court upheld the decision of the High Court, finding that even if the activities of the liaison office were regarded as business activity, the preparatory or auxiliary character of such activities excludes the liaison office from being treated as a PE by virtue of Article 5(3)(e) of the India-UAE tax treaty. Since the mere existence of an office cannot be deemed to constitute a PE unless business activity is wholly / partly carried on from therein, it can therefore not subject tax liability in terms of Article 7 of the tax treaty.

(xx) GE Nuovo Pignone SPA - [2019] 101 taxmann.com 402 (Delhi - Trib.)

Facts of the case:

Assessee is a non-resident and is incorporated in Italy. It is a leading supplier of compressor/pumps and related services in oil and gas industry, and during the year under consideration, assessee supplied spare parts/equipment to various customers in India, in addition to returned income.

For A.Y. 2009-10 GE Nuovo Pignone SPA, Gurgaon consideration assessee filed its return of income on 29/09/09, declaring total income of Rs.65,17,82,323/-, being revenue from onshore services as royalty and FTS, under provisions of section 44 DA of the Act. Subsequently, notice under section 148 of the Act was issued on 30/03/15, by Ld.AO, after taking necessary approval as required under section 151 of the Act, because based on a survey operation carried out at the office premise of General Electric International Operation Company Inc., India Liaison office (GEIOC) copies of various documents were, obtained and statements of various persons were also recorded. Inquiries were made as to sales made by various GE Overseas entities (including the assessee), employees working from the liaison office of General Electric International Operation Company Inc., Liaison Office ('GEIOC'), roles and responsibilities of various employees etc.

On the basis of various documents found during the course of survey in the form of agreements /purchases order/copies of contracts the assessments were completed in this case for AY 2001-02 to AY 2008-09, wherein it was held that the assessee was having business connection as well as Permanent establishment ('PE') in India. Further, it was contended by the revenue authorities that the PE was engaged in activities which cannot be termed as auxiliary and preparatory. Additionally, the revenue authorities contended that 35% of the total business profits pertain to marketing activities carried out in India (the business profits were calculated @ 10% on the sales prices to the customers in India). The contentions of the AO were upheld by the Dispute Resolution Panel and aggrieved with the same, the assessee preferred an appeal before the ITAT.

Decision summary:

The ITAT ruled that where in case of assessee non-resident, business was mainly carried out from Indian Liason Office GEIOC which was not merely preparatory or auxiliary in nature, it was to be held that GEIOC constituted fixed place PE for assessee. The ITAT observed that where on basis of materials gathered, during survey at India Liaison Office of non-resident assessee, it was evident that assessee had a PE in India and it had failed to disclose revenue received from sales made to Indian customers through its Indian Office, income having escaped assessment, reassessment proceedings were justified.

It further ruled that where PE of the assessee, an Italy based company in India, conducted core activities and extent of activities by assessee in

making sales in India was roughly one fourth of total marketing effort, 26 per cent of total profit in India would be attributable to operations carried out by PE in India

(xxi) Hitachi High Technologies Singapore Pte Ltd [TS-558-ITAT-2019(DEL)]

Facts of the case:

The assessee company, incorporated under the laws of Singapore, is a wholly owned subsidiary of Hitachi High-Technologies Corporation (HHT), a company incorporated under the laws of Japan. The appellant is engaged in trading operations across ASEAN countries and also carries out sourcing and trading operations in respect of various products and equipments. In the year August 1988, the assessee established a Liaison Office ('LO') in India [earlier known as Nissei Sangyo (Singapore) Pte Ltd] for rendering preparatory and auxiliary services, including market research and liaison activities. Branches of the LO were set up in Delhi, Bangalore and Mumbai; however, the branches of LO at Bangalore and Mumbai were subsequently closed. In July 2007, Hitachi Singapore established a Branch Office in India. A survey operation under section 133A of the Act was carried out at the premises of the Branch Office of the appellant on 24.04.2008 and statements of the employees were recorded. Statements of the employees prompted the Assessing Officer to initiate proceedings u/s 147 of the Act for assessment years 2002-03 to 2007-08. During the course of reassessment proceedings, the assessing officer had, inter-alia, alleged that LO was engaged in executing/negotiating contracts for the appellant in India and was not merely undertaking preparatory and auxiliary activities and, therefore, the LO was Permanent Establishment ('PE') of the appellant in India in terms of Article 5 of the India Singapore Double Taxation Avoidance Agreement ('DTAA'). Being aggrieved the order of the AO and subsequently the Dispute Resolution Panel (the DRP), the assessee preferred an appeal before the ITAT.

Decision summary:

The ITAT observed that the nature of the activities of the LO, if read with the relevant answers to the questions given in the statements recorded at the time of survey, admittedly, the employees were engaged in marketing, sales promotion and market research activities which are sine qua non for a trading business, i.e. the appellant's business. The LO was actively involved in

ascertaining customer requirements, price negotiation, obtaining of purchase orders, following up on delivery of material and payments. In our understanding of facts, none of these activities can be termed as having preparatory or auxiliary character keeping in mind that LO was functioning since 1988. The LO was directly participating in core activities of the trading business of the appellant. The only activity in which the LO was not involved was preparing of invoices and receiving payments. In the present case of HTS, its very own office in India is being sought to be held as its PE for the reason that it performed business activities which went way beyond what could be described as 'preparatory or auxiliary' character under Article 5 of India-Singapore DTAA. In view of the above, the ITAT ruled that the LO constituted a fixed place PE of the appellant company.

(xxii) ULO Systems LLC - [2019] 101 taxmann.com 490 (Delhi - Trib.)

Facts of the case:

Assessee is a company incorporated in UAE and is engaged in business of undertaking grouting work for companies in the oil and gas industry. The assessee has been carrying on grouting services in which a layer of cement is laid on underwater structure. Assessee has also made some supplies from outside India to Indian companies, the income arising from these activities, has been claimed by assessee as non-taxable in India. Ld.Counsel on behalf of the assessee submitted that similar activities are carried on by assessee for all assessment years under consideration. The position has been admitted by Ld. CIT DR. Ulo Systems Llc, Noida vs Dcit (International Taxation).

For assessment years under consideration assessee filed its return of income declaring 'nil' income. The return was then selected for scrutiny. Ld.AO observed that for years under consideration, assessee undertook contracts with Dolphin Offshore Enterprises India Ltd, Valentine Maritime Mauritius, Global Industries Offshore, BG Exploration and Production India Ltd, GIL Mauritius Holding and Clough Oil and Gas. No income from these contracts has been offered to tax in India, on the ground of absence of Permanent Establishment (P.E.) of assessee in India. Ld.AO treated income from grouting to be taxable services arisen out of a Fixed Place PE under Article 5(1) of India-UAE DTAA and income from offshore supplies as business profits taxable in India, Being aggrieved by order of Ld.AO, the assessee preferred objections before DRP in respect of all assessment years

under consideration and the DRP upheld stand taken by Ld. AO in respect of services from grouting and holding that income from these activities are taxable due to existence of PE in India under Article 5(1) of India UAE DTAA. The DRP further noted the continuous nature of activities undertaken by assessee and a confirmed view was taken by Ld. AO that assessee had a PE in India. The assessee being aggrieved by the DRP's directions and AO's order, preferred an appeal before the ITAT.

Decision summary:

According to the ITAT, there is no dispute that, assessee's equipments as well as Personnel, were stationed on the vessel of Main Contractor, for carrying out grouting. It is also an admitted fact that equipment is the main place of business to assessee. Further, on analysis of the Clause 7.4 of agreement between assessee and Dolphin, relevant to assessment year 2008- 09, the ITAT observed that the assessee provides free of charge, food and accommodation to the personnel on-board of offshore vessel. Therefore, the ITAT observed that it cannot be denied that the 'vessel', on which equipments were placed and personnel was stationed, as fixed place of business through which business is carried on by assesse. The ITAT noted that for every assessment year under consideration assessee, has a fair amount of permanence through its personnel and its equipments within territorial limits of India to perform its business activity for Contractors with whom it has entered into agreements. Having regard to OECD commentary and Klaus Vogel's commentary on general principles applicable that as long as presence is in a physically defined geographical area, permanence in such fixed place could be relative having regard to the nature of business, it is hereby held that the equipment along with the personnel on vessel of the contractor itself constitutes a fixed place of assessee's business in India since the essential conditions of Article 5(1) of the DTAA are satisfied. The ITAT placed it's reliance on decision of Hon'ble Supreme Court in case of Formula One world Championship Ltd vs CIT (international taxation)-3, Delhi reported in (2017) 18 Taxmann.com 347.

(xxiii) Gemological Institute of America, Inc - [2019] 109 taxmann.com 99 (Mumbai - Trib.)

Facts of the case:

The assessee is a company incorporated in the USA and is also a tax-resident of USA. It is engaged in the business of diamond grading and

preparation of diamond dossiers. The assessee filed its Return of income for Assessment Year 2010-11 declaring a total income at Rs. 3,96,828/- on the plea that it was a tax resident of USA and entitled to be taxed in accordance with the provisions of India-USA Double Taxation Avoidance Agreement ("DTAA") to the extent they are more beneficial. The income so declared was on account of 'Instructor Fee' earned from GIA India Laboratory Private Limited (in short 'GIA India Lab'), which is a company incorporated in India. However, the Assessing Officer was not satisfied as according to him, GIA India Lab, to whom the diamond grading services have been rendered, constituted a permanent establishment (PE) of the assessee in India and, to that extent, the assessee's receipts from the diamond grading services would be taxable in India. The Assessing Officer arrived at this conclusion on the ground that the assessee and GIA India Lab together along with the other entities of the group had, in effect, established a joint venture business in which these two operated as partners. The stand of the assessee was that in terms of the relevant DTAA provisions, to draw the conclusion that the assessee had a PE in India, there should exist a place of business in India or a service PE or an agency PE, whereas all the aforesaid features were lacking. This is the precise area of difference between the assessee and the Revenue, as have found expression based on the proceedings before the AO and the DRP and therefore the primary ground of appeal before the ITAT.

Decision Summary:

In the case of the assessee company, the ITAT noted that there is no joint venture arrangement between the assessee company and GIA India Lab vis-à-vis gem grading services rendered by the assessee company to GIA India Lab since it is GIA India Lab who enters into agreement with the client and bears all the risks including credit risks, client facing risks, etc. Also, in terms of the agreement, GIA India Lab bears the risk of loss or damage to articles while in transit to and from the assessee company and also during the time when the articles are at or in the assessee company's facilities. Therefore, the economic risks of the gem grading services rendered by the assessee company vis-à-vis stones/diamonds of customers of GIA India Lab shipped to it are borne by GIA India Lab and hence, there is no joint venture arrangement whatsoever between the assessee company and GIA India Lab. The ITAT opined that in terms of Article 5(6) of the India USA DTAA, it is provided that the mere fact that a company has controlling interest in the other company does not by itself construe the other company to be its PE. Accordingly, the assessee company is not having a 'fixed place' PE in India.

Additionally the ITAT observed that in terms of Article 5 (1) of the India - USA DTAA, a service PE arises on the furnishing of services in India by the assessee company through employees or other personnel, but only if: activities of that nature continue in India for a period or periods aggregating to more than 90 days within any twelve-month period; or the services are performed within India for a related enterprise. That ITAT noted that in the facts of the instant case, since the said services are rendered outside India and none of the employees/ personnel of the assessee company has visited India and therefore, service PE is not triggered in the case of the assessee company.

Moreover, the ITAT in the context of agency PE noted that in terms of Article 5(4) of the India - US/DTAA, an agency PE is created where a person, other than an agent of an independent status to whom paragraph 5 applies, is acting in India on behalf of an enterprise of the USA, that enterprise shall be deemed to have a permanent establishment in India based on fulfilment of certain conditions. The ITAT observed that in the instant case, GIA India Lab is an independent/separate legal entity in India which is engaged in rendering of grading services. Further, considering the functions and the risks assumed by GIA India Lab visà-vis its business activities in India (as has been recorded in the transfer pricing study report, of which functional and risk analysis has been accepted by the Transfer Pricing Officer both in the case of GIA India Lab and in the case of the assessee company), GIA India Lab is an independent entity which is rendering grading services to its clients ITA No. 1138/Mum/2015 in India. GIA India Lab also bears service risk and all client facing risks vis-à-vis the stones sent to the assessee company for grading purposes (as has been recorded in the Transfer Pricing Study Report). Hence, GIA India Lab is not acting in India on behalf of the assessee company. Further, GIA India Lab is not having any authority to conclude contracts and has neither concluded any contracts on behalf of the assessee company nor has it secured any orders for the assessee company in India. Thus, GIA India Lab cannot be regarded as 'agency PE' of the assessee company in India.

9.2 Service PE

(i) Linklaters, ITA 3250/MUM/2006, Mumbai ITAT

Facts of the case:

The appellant is partnership firm engaged in legal services. The firm is a tax resident of the United Kingdom. It had offices in various other countries, but

not India.(1) The taxpayer received fees from clients in India in exchange for legal consultancy services. In its tax return, the taxpayer stated that in the absence of a permanent establishment in India, the fees that it had received were not subject to tax in India. The AO observed that during the relevant fiscal year, employees of the taxpayer had rendered services in India for more than 90 days. The AO thus concluded that the taxpayer had a service permanent establishment in India under Article 5(2) of the India-UK tax treaty. Before the first appellate authority, the taxpayer contended that if the firm's employees' leave periods were excluded, the number of days over which it had rendered services in India was below the 90-day threshold; and multiple counting of employees in India on a particular day is prohibited. However, the first appellate authority upheld the decision of the AO. Being aggrieved, the assessee firm preferred an appeal before the ITAT.

Decision summary:

The ITAT relying on its earlier decision referred to by the taxpayer, held that the multiple counting of employees on a particular day is prohibited under Article 5(2) of the India-UK tax treaty. Further, the tribunal held that since the employee in question had been on leave and no other employee of the taxpayer had rendered services in India, the period of leave had to be excluded from the calculation. As such, the tribunal held that the taxpayer had not had a permanent establishment in India during the relevant fiscal year; and the fees received by the taxpayer were not taxable in India.

(ii) Samsung Electronics Co Ltd (2018) 92 taxmann.com 171 (Del ITAT)

Facts of the case:

Samsung Electronics Co Ltd is a Korean company engaged in the business of manufacturing and sale of electronic products. Based on a mutual agreement, it deputed employees to its Indian subsidiary. The seconded employees worked under the supervision and direction of the Indian entity.

The lower authorities held that the Indian subsidiary be treated as a deemed fixed place PE of the assessee as the services rendered by the expatriates were essentially for the benefit of the Korean company.

Decision summary:

The Delhi Tribunal observed that the communication by the expatriates covered information on the designs/ preference of the Indian consumers,

stock status, market strategies, etc. This information would help the assessee to design products based on market preference, which will benefit the Indian entity.

The Tribunal thus held that the assessee did not have a PE in India as the expatriates were only discharging their functions as employees of the Indian subsidiary, and not conducting any business for the foreign company in India. It further held that even if it was considered that the assessee was rendering services to the Indian subsidiary through the seconded employees, there would not arise a service PE in the absence of a service PE clause in the India-Korea DTAA provisions as applicable to the relevant assessment year.

(iii) Nokia Networks OY v. JCIT [2018] 194 TTJ 137 (Del ITAT)(SB)

Facts of the case:

Nokia Networks OY [Nokia], a tax resident of Finland, is engaged in manufacture of advanced telecommunication systems & equipment (GSM equipment) used in fixed and mobile phone networks. In 1993, Nokia established a liaison office (LO) in India to carry out advertising activity. Nokia sold equipment manufactured in Finland, to Indian telecom operators, on a principal-to-principal basis and also entered into installation contracts.

Subsidiary called Nokia India Private Limited [NIPL] was established in 1995 and thereafter, installation activities (including existing contracts) were carried out by NIPL. An undertaking was given by Nokia to the customers on the performance of NIPL and that ownership of NIPL will not fall below 51% without the consent of customers in the event of non-performance by NIPL.

Decision summary:

In the view of Majority members, the Fixed place PE does not get established by provision of telephone, fax and car facility to visiting employees. Any activity performed by NIPL under independent contract cannot constitute a PE of Nokia. NIPL entered into installation contracts directly with customers (although guarantee was given by Nokia), the income from which was offered to tax in its hands. Activities carried out by employees of Nokia travelling to India i.e. network planning, negotiation, signing of contracts are preparatory & auxiliary in nature. As there is no fixed place PE, virtual projection itself cannot be a factor for PE creation.

Further, the subsidiary NIPL cannot be reckoned to constitute Nokia's PE, merely because it is controlled by Nokia. Also, NIPL does not have any

authority to conclude contracts on behalf of Nokia. For the marketing support services, NIPL is remunerated at arm's length and activities of the agreement do not relate to supply of equipment. Therefore, it was held that no Agency PE exists.

In the context of LO, High Court had decided that it did not create a business connection or PE of Nokia in India. Also, supply of offshore equipment, which took place outside India was held to be not taxable in India. As per Dissenting member's view, a subsidiary company is merely an alter ego company or virtual projection of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company. Some of the key aspects of 'alter ego' are key employees of subsidiary company, all employees of parent company seconded to India; control of operations of subsidiary company by parent company, incorporation of subsidiary company is just a device to artificially block creation of a PE, no consideration charged for support services, etc. It must be treated as a PE of the parent company in India. Marginal relief granted by reducing quantum of profits attributable to the PE.

(iv) Shanghai Electric Group Co. Ltd. [2018] 170 ITD 34 (Del ITAT)

Facts of the case:

The assessee is a Chinese company supplying equipment to various companies for setting up of power plants in India. It offered income from supervisory services to tax u/s 44BBB and Income from offshore supplies was not offered to tax as the sale of equipment was concluded outside India.

The AO and DRP held that the activity is a composite contract and the assessee's supervisory PE in India was directly involved in supervision and supply of equipment. The contracts entered into by the assessee with Indian power plant owners have no division between services and supply. Also, the Payment was milestone- based.

The assessee admitted that it has a supervisory PE in India as it cannot be ruled out that supply cost of equipment included training cost, testing and inspection cost as well as repairs during defect liability period and the property title passes only on successful installation of the equipment in relation to which performance guarantee is provided.

Decision summary

The entire exercise revolves around the issue, whether there existed a Business connection of assessee in India, and if so whether the supply of

BTG equipment by assessee and payments received by assessee for supply could be attributed to the supervisory PE under deeming provision of section 9 of the Act.

The activities referred to in the agreements satisfy 'business connection' as there is an element of continuity. Supervisory PE of assessee existed in India from the time Indian clients contracted with assessee. Hence, s plitting of transactions under supply and services would be without rational basis. The profits attributable to operations carried out in India as determined by AO are taxable in India. Hence, If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other Contracting State but only so much of them as is directly or indirectly attributable to that permanent establishment.

(v) E-funds IT Solutions Inc (2017) 399 ITR 34 (SC)

Facts of the case:

The Supreme Court dismissed the Revenue's appeal and confirmed the Delhi High Court's ruling holding that the two US-based entities viz. eFunds Corporation USA and eFunds IT Solutions Group Inc., USA (assessees) did not have a fixed place PE, a service PE or an agency PE in India for assessment years 2000-01 to 2002-03 and 2004-05 to 2007-08.

In terms of an agreement, their Indian subsidiary, e-Funds India performed back office operations in respect of ATM management, electronic payments, decision support and risk management services rendered by the assessees.

Decision summary:

The Supreme Court observed that the burden of proving the fact that a foreign assessee has a PE in India and must, therefore, suffer tax from the business generated from such PE is initially on the Revenue. Regarding constitution of a fixed place PE, it observed that the assessing officer, CIT (Appeals) and the ITAT have essentially adopted a fundamentally erroneous approach in saying that the assessees were contracting with a 100% subsidiary and were outsourcing business to such subsidiary, which resulted in the creation of a PE.

It rejected the Revenue's reliance on US Securities and Exchange Commission Report in Form 10K as misplaced as it spoke about e-Funds group of companies worldwide as a whole and held that no part of the main business and revenue earning activity of assessees was carried on through a

fixed business place in India which has been put at their disposal. It observed that the Indian company only renders support services which enable the assessees in turn to render services to their clients abroad.

This outsourcing of work to India would not give rise to a fixed place PE. Regarding Service PE constitution through employees seconded by assessees to Indian entity, the Supreme Court noted that none of the customers of assessees had received services in India and only auxiliary operations were carried out in India, it thus held that as the very first part of Article 5(2)(l) is not attracted, the question of going to any other part of the said Article does not arise. It also noted the High Court's observation that AO has not given any finding on nature of functions performed by seconded employees, whether they reported to E-Funds Corp/ Associated Enterprises while observing that this was not a correct way of deciding whether service PE existed.

The Supreme Court also concurred with the High Court that it has never been the case of the Revenue that e-Funds India was authorized to or exercised any authority to conclude contracts on behalf of the US company, nor was any factual foundation laid to attract any of the said clauses contained in Article 5(4) of the DTAA.

(vi) Adobe Systems Incorporated [2016] 69 taxmann.com 228 (Delhi)

Facts of the case:

The assessee, a company incorporated under USA laws, has a wholly owned subsidiary in India, namely, Adobe India. The assessee provides software solutions for network publishing which include web, print, video, wireless and broadband applications. Adobe India provided software related Research and Development (R&D) services to the assessee, which were paid for by the assessee on cost plus basis in terms of an agreement entered into between the assessee and Adobe India.

Assessing Officer and the TPO accepted the fees paid by the assessee on cost plus 15 per cent basis as being on ALP and Adobe India's assessment was made accordingly, However, subsequently reopened the case for assessment stating that the activities carried out by Adobe India were a part of the assessee's core business activities and, consequently, Adobe India constituted the assessee's PE under article 5(1) of DTAA. Accordingly, a part of the profit accruing to the assessee which was attributable to the activities in India was chargeable to tax under the Act.

The objections to the initiation of reassessment proceedings were rejected. The assesse filed a Writ against the reassessment proceedings.

Decision summary:

The High Court stated that transfer pricing regulations are to be read as providing the framework, to tax the real income of an assessee derived from international transactions with a related party; they cannot be read as provisions to impute any hypothetical income in the hands of an assessee. Thus, the transfer pricing scrutiny/adjustments in respect of the activities of Adobe India must be read to have resulted in capturing the entire income from the said activities in the net of tax.

The real income of Adobe India, which is related to the activities carried out by Adobe India has been brought to tax in its hands and even if there is any dispute relating to the same, it is liable to be resolved in proceedings relating to Adobe India. Even if the subsidiary of a foreign company is considered as its PE, only such income as is attributable in terms of paragraphs 1 and 2 of article 7 can be brought to tax.

In the present case, there is no dispute that Adobe India has been independently taxed on income from R&D services and such tax has been computed on the basis that its dealings with the assessee are at arm's length (that is, at ALP). Therefore, even if Adobe India is considered to be the assessee's PE, the entire income which could be brought in the net of tax in the hands of the assessee has already been so taxed in the hands of Adobe India. Further, there is no material even remotely suggesting that the assessee has undertaken any activity in India other than services which have already been subjected to ALP scrutiny/adjustment in the hands of Adobe India. Thus, even if the Assessing Officer is correct in its assumption that Adobe India constituted the assessee's PE in terms of article 5(1), 5(2)(l) or 5(5) of the Indo-US DTAA, the facts in this case do not provide the Assessing Officer any reason to believe that any part of the assessee's income had escaped assessment under the Act.

Further, as per the assessing officer, the Cost Plus method used by Adobe India for determining the ALP does not fairly capture the profits which could legitimately be taxed under the Act and Profit Sale Method should be used to determine the profits attributable to PE.

Further, the fact that the Assessing Officer has not succeeded in persuading the DRP to accept his point of view, cannot possibly provide him a reason to

now to try and assess profits calculated on PSM in the hands of the assessee. It is not necessary to examine whether the assessee had a PE in India in terms of article 5(1), 5(2)(l) or article 5(5) of the Indo-US DTAA. However, High Court for the sake of completeness, also examined the question whether the Assessing Officer's opinion that the assessee has a PE in India is informed by reason.

The fact that a holding company in another contracting State exercises certain control and management over a subsidiary would not render the subsidiary as a PE of the holding company. This is expressly spelt out in paragraph 6 of article 5 of the Indo-US DTAA. However, in determining whether the requisite parameters are met, it is necessary to bear in mind that a subsidiary is a separate legal entity and its activities, the income from which are assessed in its hands at arm's length pricing, cannot be the sole basis for the purposes of imputing the subsidiary to be a PE of its holding company. In the present case, there is no allegation that the assessee has any Branch Office or any other office or establishment through which it is carrying on any business other than simply stating that Adobe India's constitutes the assessee's PE. Also, there was no evidence that the assessee had any right to use the premises or any fixed place at its disposal.

The Assessing Officer has simply proceeded on the basis that the R&D services performed by Adobe India are an integral part of the business of the assessee and therefore, the offices of Adobe India represent the assessee's fixed place of business. Thus, clearly the right to use test or the disposal test was not satisfied for holding that the assessee had a PE in India in terms of article 5(1) of the Indo-US DTAA. The stipulation as to provide specifications and further assistance in the agreement is only for the purpose of ensuring that the assessee procures the service that it has contracted for from Adobe India. Such clauses in the agreement cannot lead to an inference that the assessee had a PE in India for rendering services, that is, a Service PE in terms of article 5(2)(l) of the Indo-US DTAA.

In the present case, there is no material to form a view that Adobe India acts as an agent or concludes contracts for and on behalf of the assessee. Further, there is no allegation that any of the other conditions specified under clause (a), (b) or (c) of paragraph 4 of article 5 of the Indo-US DTAA are applicable to Adobe India. It is not disputed that Adobe India was assessed on its income determined at ALP and, therefore, there was no occasion for

the Assessing Officer to assume that Adobe India constituted the assessee's PE under article 5(5) of the Indo-US DTAA. Thus, the High court concluded that the petition of the assesee is allowed.

(vii) Morgan Stanley International Incorporated [2015] 53 taxmann.com 457 (Mumbai - Trib.)

Facts of the case:

Morgan Stanley is a tax resident of USA, providing support services to its Indian subsidiary companies. For provision of services, Morgan Stanley had seconded five employees to India under supervision and control of the Board of Directors of the Indian companies. Salary of said employees was paid by Morgan Stanley after deducting TDS under section 192. The same was subsequently reimbursed by the Indian companies to Morgan Stanley. Payments received were on account of reimbursement of expenses, hence the tax was not deducted in India since there was no element of income involved in it.

AO and CIT(A) were of the view that the payment received by the assessee were for rendering the services through its employees and hence shall be taxable in India as per article 12(4) of DTAA, being in the nature of 'fees for included services' (FIS).

Decision Summary:

The Tribunal observed that there are two controversies to the said secondment arrangement –

- one being- what is the nature of such payment and;
- the other being whether the non-resident parent entity constitute the service PE in the host country or not.

It was pointed out that the seconded employees were under direct control and supervision of Indian entity who were managing their activities on day - to - day basis and Morgan Stanley was only paying their salary for the employees' convenience and benefit.

The Tribunal relying on decision of Supreme Court in the case of DIT (IT) v. Morgan Stanley & Co. concluded that since such deputed employees continued to be on pay rolls of Morgan Stanley as they continue to have their lien and are rendering their services in India, service PE will emerge. And if there is a PE, then royalty or FIS cannot be taxed under Article 12, albeit

only under article 7 (Permanent Establishment) of the DTAA, further, 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. Accordingly, AO was directed to compute the payment strictly under terms of article 7 and not under article 12 of the DTAA.

(viii) Centrica India Offshore (P.) Ltd. [2014] 44 taxmann.com 300 (Delhi)

Facts of the case:

Centrica India Offshore Private Limited ('assessee'), was a wholly owned subsidiary of Centrica Plc., UK.

Centrica Plc and its other overseas subsidiaries outsourced their back office support functions to third party vendors in India. In order to ensure that the Indian vendors comply with quality guidelines, an Indian entity i.e. assessee entity was set up to act as an interface between those overseas entities and Indian vendors. For the said support services, it received service charges at cost plus 15% under a service agreement with the overseas entities.

The overseas entities sent employees to India on secondment basis for a fixed tenure. In terms of the secondment agreement, the assesee was to bear all the costs of the monthly remuneration of the secondees which the overseas entity would recharge to the assessee on a monthly basis. However, the overall control and supervision of the employees remains with Centrica Plc.

The AAR held that since the employees had right of lien over the overseas entity, the overseas entities have a service PE in India due to the presence of the employees in India. Therefore, reimbursement of salary cost paid/payable by the assessee to overseas entities under the terms of secondment agreement was in the nature of income accrued to the overseas entities and, therefore, tax was liable to be deducted at source under section 195.

Decision Summary:

The High Court held that the secondees are imparting their technical expertise and know-how to the other regular employees of assessee till the necessary skill-set is acquired by the resident employee group. Accordingly, amounts paid to the overseas entities for the seconded employees could be covered by the India-Canada and India-UK DTAA as fees for technical services.

Further, it was observed that the employees continue to be the employees of the overseas entities and that the assessee had no power to terminate the ultimate contract between the overseas entities and the deputed employees. It therefore also held that rendering services in India by working for a fixed period for the subsidiary of their employer will lead to service permanent establishment (a 'service PE') within the meaning of Article 5 of the India-UK tax treaty (relying on the HC decision in the case of Morgan Stanley (284 ITR 260)).

(ix) JC Bamford Excavators Ltd. [2014] 43 taxmann.com 343 (Delhi - Trib.)

Facts of the case:

JCB India Ltd. (JCB India), an Indian company, is a wholly owned subsidiary of JC Bamford Excavators Ltd. (tax payer), a tax resident of UK.

The tax payer entered into the following two agreements with JCB India

(a) Technology Transfer Agreement (TTA) for grant of license to JCB India for transfer of IP Rights to manufacture, assemble, use and sell licensed products where employees of the taxpayer visited India occasionally for doing stewardship activities (referred to as 'employees of second category') and

(b) International Personnel Assignment Agreement (IPAA) for deputation of 8 employees to JCB India on secondment basis (referred to as 'employees of first category').

It was contended by the AO that Service PE was created in India as the deputation of the 8 employees was for a period of more than 90 days. Further, the tax payer carried on business in India and royalties / FTS received from JCB India was liable to tax as "Business Profits" as it was effectively connected with the PE. However, services rendered by the employees other than the 8 employees above did not constitute PE of the tax payer as the services were in nature of stewardship activities. The said adjustment of the AO was deleted by the CIT(A).

Decision Summary:

The Tribunal stated that the deputed employees of the first category which were sent on secondment basis to JCB India continued to be on the payroll of the tax payer and maintained their lien on their employment. Salary for these employees was sole responsibility of the tax payer. Therefore, the tax

payer had a service PE in India by virtue of the deputation of the employees of the first category.

W.r.t. the amount of royalty received by the tax payer from the grant of IP Rights it was observed that the same was not effectively connected with the service PE of the tax payer in India. Thus, it was held that the consideration was taxable as "Royalties" and not as "Business Profits".

Thus, The Tribunal in this decision has analyzed in detail the concepts of "service PE" and "effectively connected" with the PE. Based on the factual aspects, the Tribunal held that deputation of employees resulted in a service PE in India for the tax payer. Further, it noted that "effective connection" is required to be seen between the PE and the 'contract' from which such fees resulted.

(x) DIT (Intl Taxation) vs. Morgan Stanley and Co Inc (2007) (292 ITR 416)(SC)

Facts of the case:

In DIT v Morgan Stanley and Co Inc, an Indian company "MSAS" provided BPO services (on a cost- plus basis) to "M", its US group company. M's staff was also sent on deputation on request of MSAS to work under MSAS' direction and control. The staff continued to be on M's payroll and MSAS was to reimburse the compensation cost of M without profit element. Performance appraisal, promotion, discipline etc. was to be carried out in consultation with M. M also sent its staff to India for stewardship and other similar activities to ensure high standards of quality by MSAS [which provided BPO services (on a cost plus basis) to M] and to protect business interests of its (M's) shareholders.

Decision Summary:

The Supreme Court applied Article 5(2)(l) of the India-US Tax Treaty [equivalent to Article 5(3)(b) of the UN Model] in relation to the presence of the deputationists. The SC laid down the twin conditions for establishing a Service PE under Article 5(2)(1) of the India-US Tax Treaty i.e.

- where the activities of the foreign enterprise entail it being responsible for the work of the deputed personnel, and
- the employees continue to be on the payroll of the foreign enterprise or they continue to have their lien on their jobs with the foreign enterprise.

The SC also held that personnel of MS & Co. engaged in stewardship services and such activities for MSAS to protect its own interests by ensuring quality and confidentiality services would not constitute a service PE of the parent company in India, hence overturning that aspect of the AAR's ruling. SC upheld the AAR ruling that even if there exists a PE in India, no further profits would be attributable if the compensation paid to Indian affiliate is on the arm's length basis among the parties. Therefore, Economic nexus is an important aspect of the principle of Attribution of Profits. The SC also noted that the transfer pricing study to determine the arm's-length price must sufficiently include the risks taken, and that the most appropriate method depends on the facts and circumstances of each particular case.

9.3 Agency PE

(i) Next Gen Films Private Ltd [TS-409-ITAT-2020(Mum)]

Facts of the case:

Next Gen Films Private Ltd. (assessee-company) is a resident corporate entity. It entered into a commissioning agreement with another UK based non-resident corporate entity namely M/s Desi Boyz Production Ltd. (DBPL) on 01/09/2010 to produce, complete and deliver a feature film namely Desi Boyz as per the terms and conditions agreed therein. The copy of the agreement had been placed on record. As per the terms of the agreement, the assessee as a commissioning party engaged M/s DBPL to produce and deliver a fully complete feature film provisionally named Desi Boyz based on certain storyline. M/s DBPL entered into one production services agreement on same date i.e. 01/09/2010 with another resident entity namely Eros International Films Private Limited (EIFPL/service company).

AO passed an order u/s 201(1) & 201(1A) r.w.s 195 of the Act on 29/03/2014. It transpired that the assessee remitted an aggregate amount of Rs.5716.65 Lacs during FY 2010-11 & 2011-12 to M/s DBPL without deducting any tax at source (TDS). Assessee submitted that this was transaction of buying and selling of a feature film between two independent parties and therefore, TDS provisions as contained in Section 195 were not applicable and the assessee could not be held to be assessee-in-default for non-deduction of tax at source. However, a show-cause notice was issued to the assessee on 17/02/2014 wherein it was stated that as per the terms of commissioning agreement, the assessee participated directly or indirectly in the management and control or budgeting of the company M/s DBPL. AO

concluded that the assessee owned all the rights, title and copyright of the property in the said film. The assessee was involved in all stages of film production as its recommendations and approvals were necessary for making changes in lead actors, cast, story, screenplay, changes in budgets, tax credit / benefits in UK, items of delivery and therefore, it had direct role and control on all the activities in production of the film.

Therefore, the AO held that in all these three entities as well as, M/s DBPL would be Associated Enterprises (AE) within the meaning of Article-10 of India-UK Double Taxation Avoidance Agreement (DTAA / Treaty). Since M/s EIFPL was carrying on the entire film production activities of the film in India and UK locations, M/s EIFPL would be Permanent Establishment (PE) of M/s DBPL in India. Further since, the assessee had control over the management and budgeting of the film production activities of M/s DBPL and being its AE, M/s DBPL constituted PE qua the assessee in India. Therefore, the income of M/s DBPL would be liable to be taxed in India and hence, the payment would require tax deduction at source in terms of Section 195 of the Act. Therefore, AO rejected the assessee's plea and treated the assessee as assessee-in-default as per the provisions of Section 201 of the Act.

Finally, AO estimated profit ratio of 25% against remittances so made by the assessee. The assessee filed appeal before CIT (A), who upheld the order of AO.

Aggrieved with the CIT's order, the assessee filed appeal before Mumbai ITAT.

Decision summary:

Regarding commissioning agreement entered into by the assessee with M/s DBPL, ITAT concluded that the contract between the assessee and M/s DBPL was primarily on principal-to-principal basis. The entire responsibility to produce the film was on M/s DBPL against certain lump-sum consideration. M/s DBPL was required to produce the film and ensure the delivery of the film as per given specifications. The film was to be fully synchronized as to dialogue, music and effects and complete pre-production, production and postproduction of the film in a first-class manner and of a technically acceptable quality and ready for commercial exploitation and suitable to enable the assessee to commercially exploit the film without further processes or expenditure. For the same, M/s DBPL could enter into independent contracts. All the activities of M/s DBPL were to be carried out with assessee's consultation with a view to ensuring that the film was produced exactly as per the specification and in line with storyline.

ITAT found that M/s DBPL acted as independent service provider having entire responsibility to produce the film. It was free to take own decisions for the same and could enter into independent contracts. Any over-spend was to be borne by M/s DBPL. The fact that M/s DBPL worked as an independent entity was further fortified by the fact that as on 31/03/2011, M/s DBPL had obtained independent bank loan of 2.18 Million Pounds from Coutts & Co. which was secured against UK Tax credit. Therefore, M/s DBPL could not be said to be solely dependent upon the assessee for finance requirements. In FY 2011-12, the revenue earned by M/s DBPL from the assessee on account of commissioning of film had been reflected as its turnover. M/s DBPL had reflected loss of 1.67 million pounds as loss on ordinary activities before taxation. This was sole activity being carried out by M/s DBPL.

Therefore, ITAT was of the considered view that the provision of Article-10 of the treaty could not be applied in such a situation since, it could not be said that the assessee participated directly or indirectly in management, control or capital of M/s DBPL. Hence, the ITAT held that M/s DBPL was acting as an independent entity which was required to carry out the assigned work independently and the assessee could not be said to be PE of that entity in India.

The ITAT observed that the status of M/s EIFPL would be that of independent agent and not a dependent agent as alleged by the AO. The ITAT concurred with the assessee's submissions that the said agreement was merely to assist the production of the film and to provide limited services in relation to delivery of a feature film. M/s EIFPL was entrusted with the responsibility of arranging the crew and the requisite equipment which were to be procured from India. The said contract was given to the Indian entity in order to perform the Indian part of the production services and M/s DBPL was to pay the requisite fees. M/s EIFPL carried out its activities as an independent agent. Therefore, it could not be termed as Permanent Establishment for M/s DBPL in terms of Article-5 of the Treaty. Thus, ITAT could not concur with the views taken by lower authorities.

For the AY 2012-13, ITAT noted that since the facts and circumstances of the case were exactly identical to the facts and circumstances of the case for the AY 2011-12, the findings and directions contained therein shall apply mutatis mutandis to this appeal and thus allowed the appeal of the assessee.

(ii) Daikin Industries Ltd. v. ACIT [2018] 94 taxmann.com 299 (Del ITAT)

Facts of the case:

The assessee is a company located in Japan and engaged in the development, manufacture, assembly & supply of air-conditioning & refrigeration equipment. DAIPL is its wholly owned subsidiary located in India.

The assesse sold air-conditioners to DAIPL and also directly to third parties in India however the price charged from direct sales was higher than that charged from DAIPL. The assessee did not undertake any marketing activities for the sales in India. The AO held that marketing activities in India were done by DAIPL simultaneously with making sales in respect of their own distribution activity and therefore DAIPL is a dependent agent PE (DAPE) of the assesse.

Decision summary:

The ITAT stated that assessee's contention that Indian customers are directly approaching it in Japan is not only vague but also devoid of merit. Further, DAIPL also incurred selling & distribution expenses of Rs. 14.38 crore. Therefore, it is doubted that the assesee has received marketing support services in India through DAIPL.

Based on email communication between assessee & DAIPL, though no authority apparently vested in DAIPL to finalize the contracts of direct sales in India, but the activities of negotiating & finalizing the contracts etc., constituting substance of any sale transaction, were held to be performed by DAIPL. The mere fact that assessee was formally signing the sale contracts does not alter the position and therefore, DAIPL created assessee's DAPE in India under Articles 5(7)(a) and 5(7)(b) of the India – Japan DTAA.

Though DAIPL reported the international transaction of receipt of commission from DIL & the TPO accepted the same at ALP in that case, that was only for two services viz., 'to forward the customers' request of procuring products to DIL' and 'to forward DIL's quotation & contractual proposal to the customers'. Since the other functions performed by DAIPL in negotiating & finalizing contracts in India on DIL's behalf remained excluded from the process of ALP determination by the TPO, further attribution of profits to the PE is to be made. Considering the facts, the net profit attributable to the marketing

activities carried out in India held @ 30% of the net profit relatable to sales in India. Net profit in the hands of DAIPL from the commission transaction to be reduced and not the entire gross amount.

(iii) DCIT v. Dominos Pizza International Franchising Inc. [2018] 193 TTJ 963 (Mum ITAT)

Facts of the case:

The assessee, a tax resident of USA, entered into Master Franchise Agreement (MFA) with Indian company, M/s Jubilant Food Works Limited (Jubilant), for franchise of Dominos Pizza Store. Assessee provided certain store/consultancy services to Jubilant. As per the MFA, assessee was to charge 3% of sales at Jubilant's store & further 3% of sales at sub-franchise store; Assessee was also entitled to charge store opening fees. Income from franchise fee % consultancy services provided to Jubilant for opening of store was offered to tax as royalty @ 10% as per the India-USA DTAA.

Decision summary:

The profit or loss from the business belongs to Jubilant or sub-franchisee. No stock of goods or merchandise is maintained by Jubilant or sub-franchisee out of which goods are regularly delivered on the assessee's behalf. The restrictions in the MFA & Sub-franchise agreement viz. entitlement of the assessee to examine accounts, approve suppliers & allow control over advertisement, are only to safeguard brand value and to correctly compute correctly the receipt of royalty. SC ruling in Formula One World Championship distinguishable as unlike in that case, the assessee does not have physical control on the business of the franchisee & sub-franchisee. Accordingly ITAT held that Jubilant does not constitute a dependent agent permanent establishment of the assessee in India.

(iv) Saudi Arabian Oil Company [2018] 405 ITR 83 (AAR):

Facts of the case:

The applicant is a state-owned oil company of Saudi Arabia. It sold crude oil to Indian refineries entirely from outside India such that the title to such crude oil passed outside India on a free- on-board (FOB) basis. The applicant set up an Indian subsidiary named Aramco which provided procurement, business & marketing support services and created awareness about the applicant's products amongst crude buyers and refineries in India. Also, it proposed to set up a support team in Aramco which would closely coordinate & extend required support to provide business/ marketing support activities.

Decision Summary:

Business support/marketing support activities proposed to be undertaken by Indian affiliate entity would not create a Permanent Establishment of Saudi Arabian company in India engaged in offshore sale of oil outside India if such activities are duly compensated on an arm's length basis. The applicant's own employees, based in Saudi Arabia, would negotiate the contract's material terms & conclude/ sign contracts with Indian customers. Aramco utilised establishment for its own business and provided support services to the applicant, for which it was duly remunerated. It did not and further decided it would not hire personnel of the applicant in future when the activities began. The main or core business activities and revenue- earning activity was not carried out by the applicant through Aramco's premises, nor were any premises placed at the applicant's disposal. Hence, the applicant could not be said to have a fixed place PE in India.

In relation to Service PE, the role of directors was only for Aramco and it provided services to applicant & not to applicant's customers. None of Aramco's directors were employees of the applicant. Even if they were past employees of the applicant, they would now render services as directors of Aramco, which was a separate & distinct legal entity.

As NR directors of Aramco would participate from outside India, condition of employees/ other personnel being deputed to India to render services to customers for > specified period, was not satisfied. Also, the clauses of service agreement & addendum, did not permit directors to render any services to applicant such that Aramco constituted a PE of the applicant. Hence, the applicant did not have a Service PE in India. In relation to Agency PE, the proposed addendum expressly excluded activities like negotiation, conclusion, securing orders, etc. from being carried out by Aramco. Further, another clause indicated that applicant retained authority to finalise terms of contracts, to accept or reject offers of customers, etc. As per the service agreement, Aramco was completely prevented from doing any act that could term it as an agent of the applicant. Accordingly, it could be said that Aramco and applicant were independent parties. Thus, applicant did not have an agency PE in India.

(v) Daimler Chrysler AG v. JDIT (2007) ITA No. 317 and 747 (Mumbai ITAT)

Facts of the case:

Daimler Chrysler was a tax resident of Germany and was engaged in the

business of manufacturing and selling automobiles and automobile parts. It had entered into a general agency agreement with its Indian subsidiary (hereafter referred as "the Indian company"). Also, Daimler Chrysler had sold some so-called complete built up (CBU) cars directly to customers in India.

In the course of a tax audit, *inter alia*, the revenue authorities concluded that the arrangement with the Indian company gave rise to Daimler Chrysler's dependent agency PE in India.

Decision Summary:

The ITAT opined that Daimler Chrysler did not have a dependent agency PE in India. The ITAT reached that conclusion on the basis of, *inter alia*, the following observations:

- As regards the direct sales of the CBU cars by Daimler Chrysler to the customers in India, the Indian company had merely acted as a communication channel for providing the relevant information to the customers who were interested in purchasing the cars directly from Daimler Chrysler.
- The Indian company did not have authority to conclude contracts, negotiate price, etc. on behalf of Daimler Chrysler.
- In view of the facts in the present case, the Indian company could not be regarded as habitually procuring orders for the Daimler Chrysler.

(vi) Booz & Company (Australia) (P.) Ltd. [2014] 42 taxmann.com 288 (AAR - New Delhi)

Facts of the case:

The Booz Group ('Applicant') is a global network of group companies. Booz India executed the client's project using its own employees and to the extent required, procure services of technical or professional personnel from the applicant and other affiliates. These personnel would work under the supervision of Booz India with respect to the concerned project. However, the overall control over these personnel is with the applicant. Thus, the AO contended that the inherent and specific dependencies between the affiliates made it very clear that Booz India is a dependent agent of the applicants and therefore, there is existence of Agency PE. Further, he also alleged that because of the quantum and high level of qualified personnel deployed by

the applicant to Booz India, it clearly establishes that the applicant has a service PE in India. Also, the access given by Booz India to the technical and professional personnel deployed to work in a given space has given rise to a fixed place PE.

Discussion Summary:

The AAR ruled that for a fixed place PE one of the conditions w.r.t 'disposal test'is that taxpayer must have element of ownership, management and authority over establishment. Since the establishment belongs to the employer and involves an element of ownership, management and authority over the establishment, it constitutes Fixed Place PE. Further, since the applicant has a business connection in India through Booz India, it constitutes Agency PE as well. Further, in view of fact that the applicants have Permanent Establishment in India, the incomes received by them from the Indian Company are taxable as business profit under Article 7 of DTAA between India and the respective countries.

(vii) Delmas, France [TS-7-ITAT-2012(Mum)]

Facts of the case:

Delmas France (the assessee), a company incorporated in France, was engaged in the business of operation of ships in international traffic. The assessee, for AY 2006-07, claimed that its income was not taxable in India, in view of provisions of Article 9 of India- France tax treaty. The assessee also claimed that its profit was not taxable in India, as it did not have a Permanent Establishment (PE) in India under Article 5 of the DTAA. During assessment proceedings for the said year, the AO noted that the assessee had appointed an agent, which performed agency work in most of the Indian ports. The AO contended that the agents were responsible for concluding contracts on behalf of the assessee in the form of all the clearances from Government Departments. The AO also contended that the agents were doing all the functions, such as brokering and contracting with the parties for loading of cargo, dealing with labour for loading, unloading, collecting the freight on behalf of the assessee and maintaining and operating bank account for the assessee. Accordingly, the AO held that the assessee had a fixed place PE in India in the form of offices of agent as per Article 5(1) of the DTAA. The AO also rejected the assessee's contentions on Article 9, as the assessee did not provide evidence, to link and establish, that the feeder vessels were actually loading cargo into mother vessels. The assessee filed

its objections before DRP against the draft assessment order. The DRP confirmed the conclusions of the AO. Aggrieved with the AO's final assessment order u/s 143(3) read with section 144C of the Act, the assessee preferred an appeal before the Mumbai ITAT.

Decision summary:

The ITAT observed that for formation of fixed place PE, it was necessary that such fixed place was at the disposal of foreign enterprise and it was used for the business of foreign enterprise. ITAT held that in case of agency model of business, though the business of foreign principal would be carried out by the agent, the foreign principal would not have powers, as a matter of right, to use agent's premises to carry on its business. Hence, ordinarily, a 'fixed base PE' would not come into existence in case of agency model.

ITAT thereafter considered applicability of provisions of Article 5(5) read with Article 5(6) of India- France tax treaty. As per Article 5(5), when a foreign enterprise carrying on a business through a dependant agent in source state, results into formation of Dependant Agent PE (DAPE), subject to fulfilment of certain conditions. As per Article 5(6), when a foreign enterprise carries on a business through a broker or a general commission agent or any other agent of independent status and when such agent acts in ordinary course of its business, it would not result into a DAPE. Article 5(6) further provides that when activities of such an agent are wholly or almost wholly devoted on behalf of such foreign enterprise, he will not be considered as agent of independent status if it is shown that the transactions between agent and the enterprise were not made under arm's length conditions. The ITAT held that both, the AO as well as DRP, had not challenged the fact that the transactions between the assessee and its agent were at arm's length. Therefore, the ITAT held that in the absence of such negative finding, the agent of the assessee was an agent of independent status and accordingly, provisions of Article 5(5) regarding DAPE could not be invoked.

ITAT further held that reliance on decisions in the context of fixed place PE might not be relevant in case of DAPE. ITAT observed that the provisions of DAPE override the provisions regarding fixed place PE, and, therefore, any observations made in the context of fixed place PE do not apply to the DAPE situations. Accordingly, ITAT held that the assessee did not have a DAPE in India in the absence of finding to the effect that the assessee's transactions with its agent were not at arm's length.

(viii) Rolls Royce Singapore (P.) Ltd. [2011] 13 taxmann.com 81 (Delhi)

Facts of the case:

The assessee is a Singaporean company engaged in business of sale of spare parts for oil-field equipment and engines and turbine compressor systems and electronic retrofit projects and services rendered in connection with repair and overhauling of such equipments. The major clients of the assessee in India included ONGC, GAIL, etc. The assesse had reported income from maintenance services as fee for technical services (FTS) chargeable at the rate of 20 per cent in the return of income and it had not declared any income for supply of equipment made to the Indian clients on the ground that it had no PE in India. The Assessing Officer observed that the assessee had an executive agent in India in the form of ANR, whose only source of income in India was from the assessee and was directed by the assessee. And thus, it held that by reason of existence of business connection and source of income, the assesse had PE in India and was liable to pay tax in respect of income earned on supply of spare parts as business profit and determined the profit attributable to business at 25 per cent. The Commissioner (Appeals) agreed with the view taken by the Assessing Officer but reduced the profit attributable to PE to 10 per cent. On cross appeals, the Tribunal upheld the order of the Commissioner (Appeals) and held that even in terms of article 5(8) and article 5(9) of the DTAA, ANR would be deemed to be the 'Permanent Establishment' of assessee in India.

Decision Summary:

On appeal to High Court, the High Court observed that there was an arrangement between the assessee and ANR that the assessee will be remunerated 5 per cent commission of invoice value by the assessee to ANR on the sales. It therefore seemed that the nature of transaction was controlled by the assessee-company and cannot be considered to be made on arm's length. It was also observed that the assessee was in a position to dictate the terms. It was therefore held that there was an agency PE in India for the assessee company.

9.4 Construction PE / Installation PE

(i) Bellsea Ltd. v. ADIT [2018] (ITA No. 5759/Del/2011)(Del ITAT)

Facts of the case:

Bellsea Ltd, assessee, is a Cypriot company engaged in the business of

dredging & pipeline related services for oil & gas installations. The assessee was awarded a contract by Allseas Marine Contractors SA [AMC]. The said contract was part of the original contract awarded to AMC by the Reliance group and Niko Resources.

The AO & DRP held that under Article 5(2)(g) of the India-Cyprus DTAA, an Installation PE is created since the activities exceeded > 12 months due to certain formalities were carried out even after decommissioning of the project/issue of completion certificate as the contract was for multifarious functions & not merely rock placement functions.

The assessee had not set up any kind of project office or developed a site before entering into the contract with AMC for carrying out any preparatory work. The 12 months' duration per se is activity specific qua the site, construction, assembly or installation project. Where the contract has not been awarded, any kind of preparatory work for tendering of contract cannot be reckoned for carrying out any activity as stipulated in Article 5(2)(g).

Decision summary:

The Tribunal placed reliance on the Delhi High Court ruling in National Petroleum Construction Company & held that the threshold of 12 months had not been exceeded as no activity was carried out post completion certificate and also the payment was received prior to it. Hence, the assessee did not constitute an Installation PE under Article 5(2)(g) of the India-Cyprus DTAA as there is no evidence suggesting that any activity post completion had been carried out.

(ii) Sumitomo Corp – [2017] 80 taxmann.com 247 (Delhi)

Facts of the case:

The assessee, a Japanese company, had established a liaison office (LO) as a communication channel in India since the year 1956 with the approval of the Reserve Bank of India (RBI) for facilitating imports from Japan and exports from India on principal to principal basis.

On expanding it operations in two projects and one project or Maruti Udyog Limited(MUL), the LO of the assessee in India was communicating publication of global tenders and the Head Office offered a bid for supply of equipment. The head office had secured various contracts for supply of equipment.

The assessee was to supply equipments and provide assistance for the installation of the same in some cases. During the years under consideration, the assessee received supervision fees for supervising the installation of the machinery and equipment supplied from Japan.

The AO held that the LO & the POs had a PE in India and accordingly, the service fees were taxable in India.

Decision Summary:

The ITAT held that where there are several sites where supervision is going on in India, the rule is that the test of minimum period should be determined for each individual site or installation project. It was observed that the period of supervision under each contract was less than the period of 180 days as contemplated in Article 5(4) of the DTAA. Thus, installation PE cannot be alleged.

With respect to the taxability of supervision fees, the same had to be taxed under Article 12 of India Japan DTAA as fees for technical services.

(iii) HITT Holland Institute of Traffic Technology B.V. v. DDIT(2017) 78 taxmann.com 101 (Kolkata ITAT)

Facts of the case:

HITT, the taxpayer company, was a tax resident of the Netherlands. During the year, the taxpayer had undertaken offshore supply of equipment and offshore provision of services under a project. However, no installation activity had taken place in India during the year. The tax officer took a view that the taxpayer had an "installation PE" in India as per article 5(3) of the India-Netherlands treaty, and thus attributed a part of the amount received as profits to the alleged installation PE of the taxpayer in India.

The Dispute Resolution Panel (DRP) held that the project was an installation project, which is covered squarely under article 5(3) of the India-Netherlands treaty. The taxpayer's claim that no installation activity had happened during the assessment year concerned could not be accepted as the project had to be seen in a holistic way. In the project undertaken, based on the consortium agreement, the taxpayer played a major role and contributed significantly to the composite work, and the project had continued for more than 12 months. The DRP, thus, upheld the order of the tax officer.

Decision summary:

The ITAT held that, in order to constitute an installation PE within the meaning of article 5(3) of the India-Netherlands treaty, the test of duration of time for which the activities are carried out in India becomes relevant. In the present case, the question was how to compute the duration of time. The supply of equipment that has to be installed by the consortium could be said to be a direct preparation for the coming into existence of an installation PE.

The ITAT observed that even if one were to look at the project in a holistic way, the question still remained open as to whether the supply of equipment by itself would constitute an installation PE. The starting point of time would be when the actual installation starts, and the DRP's direction clearly held the view that no installation activity had happened during the relevant previous year.

The ITAT also observed that there are no provisions in the treaty in relation to circumstances such as the present one when it can be said that an installation PE had come into existence. Further, there were no circumstances brought up to show that the parties had resorted to treaty abuse. Accordingly, the ITAT did not agree with the findings of the DRP that there existed an installation PE of the taxpayer.

(iv) Aspect Software Inc. v. ADIT (2015) 155 ITD 409 (Delhi ITAT)

Facts of the case:

Aspect software, the taxpayer company was a tax resident of the United States and was engaged in the business of providing hardware, software and rendering support services that enabled call centre companies to manage customer interactions via voice, email, web and fax. The taxpayer company mainly derived income through supply of “contact solutions”, software licences and provision of services, including installation, maintenance and professional services. The taxpayer company had two subsidiaries in India: (i) ACC, which installed equipment and provided marketing support services to the taxpayer company, and (ii) ATC, which carried out testing and maintenance services. The Indian revenue authorities concluded, inter alia, that the taxpayer company had an installation PE in India.

Decision summary:

The ITAT opined that article 5(2)(k) of the India-United States treaty, which contained the provision in respect of an installation PE, had to be read in its

entirety. Therefore, an "installation project" could not be read in isolation by disregarding the words "building site or construction, installation or assembly project or supervisory activities". And, when that provision was read in its entirety, it was evident that the installation or assembly project had to be in connection with a building site or construction project. In the present case, the taxpayer company did not have any building site or construction project and therefore article 5(2)(k) of the India-United States treaty was not relevant.

Accordingly, the ITAT concurred with the taxpayer company that it did not have an installation PE in India.

(v) Tiong Woon Project and Contracting Pte. Ltd. (2011) 338 ITR 386 (AAR)

Facts of the case:

Tiong Woon Project & Contracting Pte Ltd (TWPC), a Singapore based company, provides crane on rental basis. It secured four work orders which were independent from each and through independent parties in India which involved setting up, fitting, placing, positioning of the fabricated equipment at the site.

These installation projects were executed by using two cranes imported from Singapore and a few personnel were sent from Singapore to India.

The AO argued that for all the four work orders, the cranes and the personnel were in India which constituted a service PE under Article 5(6) of the DTAA as they were engaged in providing services.

Decision Summary:

It was held that the duration test for installation and assembly projects provided under article 5.3 of the DTAA has to pass the test of cohesiveness, interconnection and interdependence. Thus, where the projects are different with different parties i.e. they are independent projects and there is no interconnection and interdependence amongst them, the threshold of 183 days will be considered separate for those independent projects.

(vi) ADIT v. Valentine Maritime (Mauritius) Ltd/ (2011) 45 SOT 34 (Mumbai ITAT)

Facts of the case:

Valentine was a company and a tax resident of Mauritius. It was engaged in

the business of marine and general engineering and construction work. During the relevant tax year, Valentine had executed three contracts in India, hereafter referred as "Contract A1", "Contract A2" and "Contract K".

As per the Indian revenue authorities, for determining as to whether Valentine had a construction PE in India, the duration of the three contracts had to be aggregated.

Decision summary:

The ITAT found that even a plain reading of the construction PE provisions in the India-Mauritius treaty revealed that duration of each construction project had to be taken into account on a standalone basis. That provision was differently worded in the India-Mauritius treaty, as compared to some other Indian tax treaties, for example:

- article 5(2)(k) of the India-Australia treaty provides that "the term 'permanent establishment' shall include especially … a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than six months"; and
- article 5(2)(h) of the India-Thailand treaty provides for a construction PE to include "a building site or construction or assembly project, or supervisory activities in connection therewith, where such site, project or activity continues for the same or a connected project for a period of periods aggregating to more than 183 days".

Accordingly, the ITAT held that it was not sustainable to aggregate the time spent by Valentine on different project sites for applying the threshold of the duration test for determination of its construction PE in India. Also, the fact that Valentine carried out work for the same principal/customer was not sufficient to justify the aggregation of time spent on different projects. Furthermore, even if the work was carried out with respect to different projects in the same area, that was not sufficient by itself to aggregate the duration of such projects. Even if the said projects were commercially coherent in the sense that they were for the same organization directly or through a subcontractor, and geographically coherent in the sense that they were on nearby locations, those two factors did not necessarily, by themselves, mean that the said projects were a coherent whole – geographically and commercially. In the ITAT's view, the true test was in

interconnection and independence – in addition to geographical proximity and commercial nexus. The ITAT noted that there was no finding, by any of the authorities below, to the effect that the three contracts executed by Valentine were inextricably interconnected, interdependent or could only be viewed as a coherent whole in conjunction with each other. Indeed, all three contracts were for three different purposes. None of these contracts were such that they could be viewed as interconnected or interdependent. In view of the above, the ITAT held that Valentine did not have a construction PE in India.

(vii) Krupp UDHE GmbH (2009) (28 SOT 254) (Mum)

Facts of the case:

The assessee is a German company which provided technical know-how, basic engineering services and supervisory activities in connection with construction or installation of specified machineries / assembly provisions to the Indian parties and had received income in respect of the above services offering the same for tax @10% under the provisions of Article 12 of the Indo-German Tax Treaty. The Assessing Officer(AO) noted that a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period exceeding six months would be treated as a PE in terms of Article 5(2)(i) of the DTAA. The AO considered the various sites together while computing the minimum period of six months prescribed in Article 5(2)(i) of the DTAA. The AO held that the assessee had been actively engaged in assisting the installation of various projects and also continued its supervisory activities for many years. Further, since the project lasted for more than six months it constituted a PE irrespective of that technicians / employees of the assessee stayed in India for less than six months. Since the assessee had a PE in India, the provisions of Article 12 under the Tax Treaty would not apply and accordingly, the FTS would be taxed @ 30% in terms of section115A of the Act and not @ 10% in terms of Article 12. CIT(A) held that fees for technical know-how and basic engineering services could not be taxed at the rate of 30 per cent, since both these services were rendered from Germany and, therefore, the question of any PE in India did not arise in respect of such services. Further in respect of rendering of supervisory activities, it would result in establishment of a PE under Article 5(2)(i) of the DTAA as the threshold limit of six months had been crossed in three projects undertaken by the assessee and, therefore, the assessee

would be deemed to have a PE in respect of those three projects. Consequently, it was held that rate of tax at the rate of 30 per cent would be applicable only in respect of fees for supervisory services received from the above three Indian concerns. As far as the other projects were concerned, fees for supervisory services was liable to be taxed at the rate of 10 per cent as per Article 12(2) of the DTAA. The CIT(A) computed the period of six months with reference to each assessment year.

Decision Summary:

The Tribunal held that various Indian treaties (like with Australia, USA, Canada) specifically provided that periods of all sites should be taken together in determining the existence of PE. In the absence of such a provision in Tax Treaty, the period of stay in respect of other sites would not be taken into consideration while determining the constitution of a PE in India. The period of the six months as per Article 5(1)(i) should be counted from the date of commencement of the project only when there is one single indivisible contract for various activities undertaken by the non-resident. The Tribunal also held that in case of one contract involving various activities which are dependent on each other, the minimum period would commence from the date when the first activity commenced. However, where different contracts are awarded which are not inter-dependent on each other, then the period of six months would be counted separately in respect of each activity. Furthermore, had the contracting states intended to commence the period from the date of construction itself irrespective of various other activities, then there was no need for including the words 'project or activities' in the later part of the sentence in Article 5(2)(i) of the Tax Treaty. The Tribunal also held that an activity once commenced continues till its completion, and accordingly, intervening period cannot be excluded while computing the threshold time limit. Furthermore, the rule that period for computing the threshold time-limit commences when the activity commences and ends on the completion of the contract has to be considered. Hence, the minimum period of six months had to be counted activity-wise irrespective of the number of years involved.

(viii) Cal Dive Marine Construction (Mauritius) Ltd. v. DDIT (2009) 315 ITR 334 (AAR)

Facts of the case:

Cal Dive was a tax resident of Mauritius and had entered into an agreement with an Indian company (HOEC) for laying pipelines under the sea. The

scope of work included construction of structures including pre-commissioning of the pipelines. The said work comprised the following:

- transportation and installation engineering;
- pre-trenching, pipe laying and backfilling;
- installation, pre-commissioning and surveys (pre-construction/pre-installation and post-installation); and
- erection, construction, testing and handing over services.

Cal Dive was required to perform the work inside as well as outside the Indian territorial waters. For that purpose, Cal Dive was required to hire barges and tugs and engage Indian and foreign contractors for supply of equipment, labour and services.

The duration of various activities carried out by Cal Dive in India is as follows:

- transportation of pipeline parts from a port in India to the project site: 9 February to 3 March 2009;
- transportation of jacket and deck from a shipyard in Thailand to the project site: 6 February to 8 March 2009;
- dredging and trenching the seabed for burying the pipes: 8 January to 8 March 2009;
- assembly and welding of the pipelines: 10 February to 26 February 2009;
- assembly of jacket and deck: 10 February to 17 March 2009; and
- demobilization (end of the project): 31 March 2009 (approximately).

Six to Eight project management personnel visited India during January and February 2009.

Decision summary:

The AAR ruled that Cal Dive did not have a construction PE in India in terms of article 5(2)(i) of the India-Mauritius treaty. The AAR rejected Cal Dive's interpretation that for determining/reckoning the 9-month threshold period stipulated in article 5(2)(i) of the tax treaty, the time commenced from the date the installation or the construction activity physically began in India. According to the AAR, the preparatory stages leading to the actual

commencement of the work had to be included in the project duration. But, in view of the specific facts in the case of Cal Dive, the AAR found that the duration of the various activities in India did not exceed 9 months.

It is pertinent to note that the AAR rejected the contention of the revenue authorities that the starting point for the duration of work carried out by Cal Dive in India had to be reckoned from the date of signing the contract.

Accordingly, the AAR ruled that Cal Dive did not have a construction PE in India.

9.5 Warehouse PE

(i) Seagate Singapore International Headquarters (P.) Ltd. (2010) 322 ITR 650 (AAR)

Facts of the case:

Seagate Singapore was a tax resident of Singapore. It was engaged in the business of manufacture and sale of hard disk drives. It had been supplying the hard disk drives to original equipment manufacturers in India. In order to minimize the delays in procurement of inputs from the applicant, the original equipment manufacturers had proposed to put in place a Vendor Managed Inventory model. Under that model, Seagate Singapore was to enter into agreements with independent service providers in India for storing hard disk drives in India on behalf of Seagate Singapore and deliver the same to the original equipment manufacturers on a "just in time" basis.

Seagate Singapore submitted that it did not have any presence in India in the form of an office or any other place of business. As per Seagate Singapore, it proposed to enter into a Vendor Managed Inventory agreement with YCH, an Indian company, on lines similar to the model described above. YCH was to stock goods in India on behalf of Seagate Singapore and deliver to Seagate Singapore's Indian customer, i.e. Dell India (P.) Ltd.

As per paragraph 3 of the Vendor Managed Inventory agreement between Seagate Singapore and YCH, YCH was required to segregate the Seagate Singapore products from the other products in its warehouse management system and also to ensure that the Seagate Singapore products were not subject to encumbrance, seizure or possession of any third party. As per the agreement, YCH was liable to make good any loss or damage to Seagate Singapore products arising out of neglect or default committed by the agents

or employees of YCH to the extent of full release value of the product up to a maximum of SGD 100,000 per occurrence. As per the agreement it was stipulated that YCH was to obtain and maintain sufficient insurance for Seagate Singapore products while they were in possession of YCH. Further, YCH was to act as a logistics service provider and importer and it was to be responsible for warehousing the Seagate Singapore products and deliver the same to Seagate Singapore's customer Dell at its special economic zone premises warehouse near Chennai in India. YCH was required to make adequate space available, including the provision of racks to store Seagate Singapore products, and YCH was to bear the capital expenditure to improve the capacity of the facilities. Seagate Singapore's designated agent or contractor was entitled to enter the YCH facility for physical inventory, inspection and audit and for other auxiliary or preparatory activities. YCH was to receive all Seagate Singapore products and send an electronic receipt signal to Seagate Singapore before YCH allowed the Seagate Singapore products to be pulled from the warehouse. YCH was to establish the necessary operating systems to support electronic data interchange and furnish receipt, sale advice and inventory report. YCH was to segregate each Seagate Singapore account in its warehouse management system, undertake inventory tracking and conduct physical inventory checks on monthly basis. YCH was required to allow Seagate Singapore access to and copies of any records with legal, regulatory, operational or informational significance. As noted earlier, the agreements intended to be entered into with other independent service providers in India were to be on similar lines.

Decision summary:

Based on the above facts, the AAR rejected Seagate Singapore's contention that it did not constitute any fixed place of business in India, since Seagate was not to have any premises or facilities or installations owned, leased or kept at its disposal in India. The AAR opined that Seagate Singapore was to have a fixed place of business, which was to be the focal point of its business operations in India. The fact that such a fixed place of business was to be owned or possessed by the logistics service provider did not make a difference. In the AAR's view, the fact that a service provider, instead of Seagate Singapore's employee, was to carry on various operations leading to the delivery of products to the customers did not rule out existence of the fixed place PE.

(ii) Airline Rotables Ltd. v. JDIT (2010) 131 TTJ 385 (Mumbai ITAT)

Facts by the case:

Airline Rotables was a UK company and carried on the business of providing spares and component support for aircraft in India. It had entered into an agreement with Jet Airways, an Indian company engaged in the business of air transportation, for providing certain support services in respect of Boeing 737 aircraft. Airline Rotables was obliged to repair or overhaul components of Jet Airway's aircraft. Besides that, Airline Rotables was also required to provide to Jet Airways replacement components that could be used while original equipment was under repairs or while it was being overhauled by Airline Rotables.

With a view to ensuring adequate availability of necessary equipment, Airline Rotables maintained a stock of equipment at operational bases of Jet Airways in India. But, since Airline Rotables did not have any storage or support facilities in India, the stock in India was in the possession of Jet Airways itself, though as a bailee.

The revenue authorities concluded that Airline Rotables had a PE in India

Decision summary:

The ITAT observed that the following three criteria had to be satisfied for existence of a fixed place PE:

- physical criterion, i.e. existence of physical location;
- subjective criterion, i.e. right to use that place; and
- functionality criterion, i.e. carrying out of business through that place.

Furthermore, the Tribunal explained that mere existence of a physical location was not adequate. That location had to be at the disposal of the foreign enterprise and it had to be used for the business of the foreign enterprise as well. This place had to be owned, rented or otherwise be at the disposal of the non-resident enterprise and a mere occasional use of place was not sufficient. Moreover, that fixed place of business had to be used for the purposes of the business of the foreign enterprise. The ITAT observed that the storage of equipment in India was under the control of Jet Airways. Airline Rotables did not have any place at its disposal in the sense that it was not in a position to carry out its business from that place.

Accordingly, the ITAT opined, inter alia, that Airline Rotables did not have a fixed place PE in India.

9.6 Virtual PE

(i) ITO vs Right Florists Private Limited [2013] 25 ITR(T) 639 (Kolkata - Trib.)

Facts of the case:

Right Florists Pvt. Ltd. ("Right Florists"), an Indian company providing services in India as a florist, entered into agreement with Google Ireland Limited ("Google Ireland") and Overture Services Inc. USA ("Yahoo USA") for advertisement of its services on their search engines, Google and Yahoo, respectively. Right Florists made payments to Google Ireland and Yahoo USA for advertising services and a claimed deduction for these payments. However, the assessing officer disallowed the deduction for payments made pursuant to Section 40(a)(i)2 of the Income Tax Act, 1961 ("ITA") on the ground that no tax was withheld by Right Florists on the said payments under Section 1953 of the ITA.

The main issue for consideration in this case was whether income tax was required to be withheld in respect of payments made to non-residents for rendering advertising services over the internet. It was the case of Right Florists that such payments were in the nature of business profits, which would not be taxable in India in the absence of a permanent establishment in India of such non-residents. On the other hand, the tax department's contention was that the payments were in the nature of FTS and taxable under Section 9 of ITA. For considering the issue at hand, the Tribunal took into account both the provisions of the tax treaties with Ireland and the USA as well as the provisions of the ITA.

Decision summary:

Before going into the aspects of taxation and the evaluation of the specific facts, the Tribunal analyzed the nature of services actually rendered by Yahoo and Google to Right Florists. The Tribunal appreciated that search engines such as Yahoo and Google provided advertisement services in a purely automated manner using algorithms and codes without any human intervention. The Tribunal also mentioned that providing online advertisement services was a complex technical activity, and that these search engines rendered highly technical service with the use of software codes designed to

search for information on the web, and generated, along with search results - sponsored search results, the service which is paid for by the sponsors of those results, like Right Florists in this case.

The Tribunal thereafter examined the provisions of Section 5(2)(b) of the ITA which provides for taxation of income which accrues or arises in India or is deemed to accrue and arise in India and Section 9 which deems certain kinds of income to have accrued or arisen in India. The Tribunal concluded that there was no evidence to hold that Yahoo and Google had business connection in India as none of their activities were carried out in India. While examining the issue of PE under the relevant tax treaty, the Tribunal relied upon the OECD Commentary and the High Powered Committee report on taxation of e-commerce to hold that a website would normally not be considered to have a PE. This is because a website is a made-up of intangible materials like software and electronic data. However, as per the OECD Commentary, while a website by itself could not be considered to be a PE due to the absence of a fixed place, the server from where the website functions could be a fixed place of business and could hence be considered to be a PE.

In the light of the above, the Tribunal was of the view that since a search engine does not carry out its business through its server, a website would not constitute a PE unless its web servers are located in the same jurisdiction. As Google Ireland and Yahoo USA did not have servers in India, the basic rule of PE was not satisfied. Hence, Google Ireland and Yahoo USA could not be said to have a PE in India.

(ii) Real Resourcing Ltd. (2010) 322 ITR 558 (AAR).

Facts of the case:

Real Resourcing was a company incorporated in and tax resident of the United Kingdom. It was a subsidiary of another UK company, S-Three Group Plc. In its application for the advance ruling, Real Resourcing had informed that the nature of services to be provided by Real Resourcing were twofold as follows:

- recruitment services, where Real Resourcing placed a candidate with an Indian company and received payments for providing such service from the Indian company; and
- referral services, whereby Real Resourcing referred potential Indian clients to a third party based in

India for which payments were to be received by Real Resourcing from the said third party in India.

Real Resourcing contended that the payments receivable in respect of these services should not be chargeable to tax in India as it had no PE in India and, moreover, as per the India-United Kingdom treaty, the provisions relating to "fees for technical services" were not attracted. The Indian revenue authorities argued, inter alia, based on the information downloaded by them from the Internet, that Real Resourcing had an office in New Delhi, which was indicative of existence of a PE. Countering the revenue authorities' contentions, Real Resourcing responded that the said office was a virtual office, not an actual or physical office space in New Delhi.

Decision summary:

The AAR held that Real Resourcing could not be regarded as having a PE in India merely on account of a virtual office.