



The Chamber of Tax Consultants

Certificate course on Multilateral instruments

October 12-13, 2018

Panel Discussion – Case studies

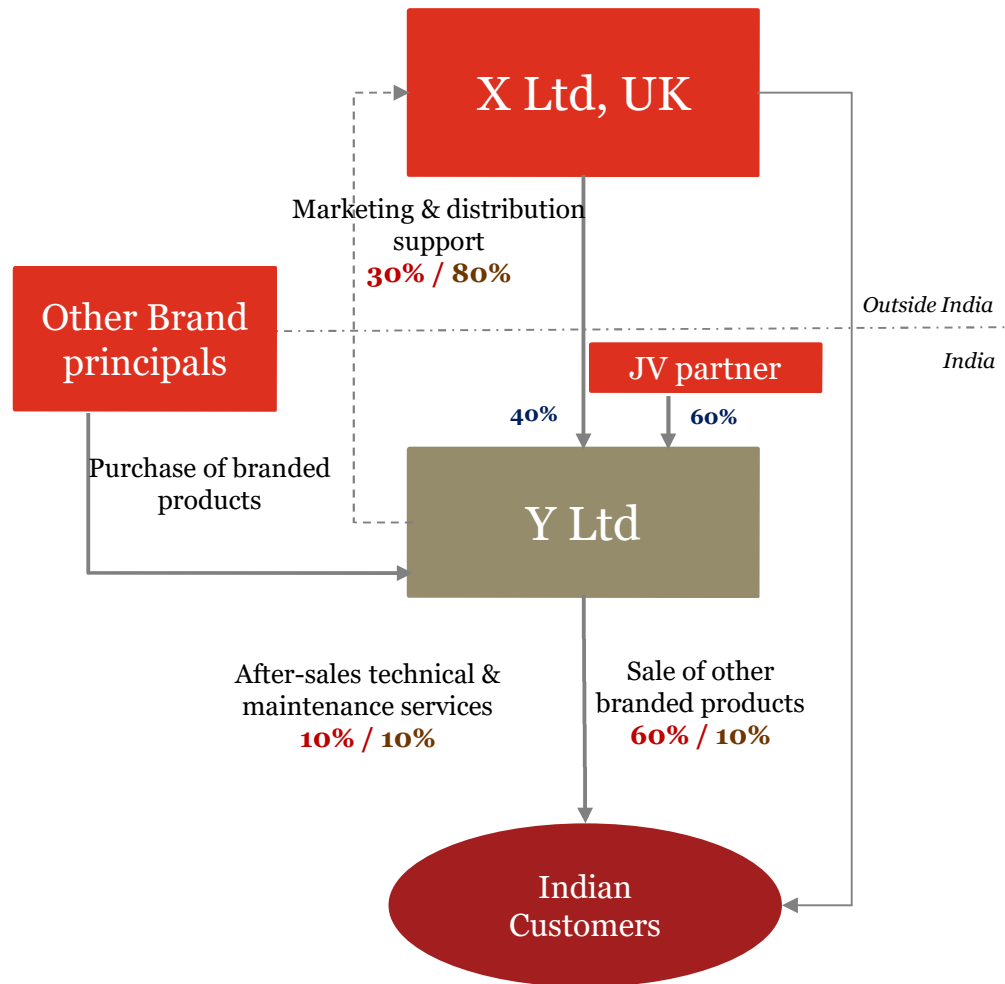
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I

*Case study I –
Agency PE*

Case Study I – Agency PE



- Y Ltd provides marketing & distribution support services to X Ltd
- Y Ltd promotes products produced by the X Ltd
- Customer places order with X Ltd
- Sales of X Ltd from customers in India significantly increase as a result of marketing activity by Y Ltd
- Activities carried out by Y Ltd & X Ltd – refer case study
- Y Ltd has other independent business interests
 - After-sales technical & maintenance services
 - Sale of other brand products

Key issues for consideration

1. Dependent Agency - Business Connection [under amended S. 9(1)(i)]
2. Agency PE under current India-UK treaty
3. Agency PE under India-UK treaty post MLI amendment

Dependent Agent – Amended S. 9(1)(i)

Explanation 2(a) to S. 9(1)(i)

- a) has and habitually exercises **IN INDIA**, an authority to conclude contracts on behalf of the non-resident ~~unless his activities are limited to purchase of goods or merchandise for 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—***
- ***in the name of the non-resident; or***
 - ***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***
 - ***for the provision of services by the non-resident; or***

Activity Test - Principal role

- Act as sales force – nexus to the sale
- Relative involvement of foreign principal
- Documentary evidence
- Nature of participation in meetings / calls
- Customer perception
- Holding out as Agent

Wider scope...

Dependent Agent – MLI provisions

Explanation 2(a) to S. 9(1)(i)

or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are—

MLI provision

habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise

Material difference OR is it implied in “Conclusion” condition ?

Dependence Test

- In the ordinary course of business
- Independence – legal & economic
 - *Detailed instruction & comprehensive control (day-to-day) by Principal*
 - *Entrepreneurial risks borne by agent for his work*
 - *Cost plus v/s variable pay*
 - *Special skill sets & expertise knowledge of the Agent*
 - *Working with one or many principals*

Agency business vs Total business

Independent Agent

- **First Proviso to Explanation 2 to Section 9 (1) (i)**

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

- **India – UK Treaty (Current) – Article 5(5)**

*An enterprise of a Contracting 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**, where such persons are acting in the ordinary course of **their** business.*

- **MLI – Article 12 (2)**

*2. Paragraph 1 shall not apply where the person acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise of the other Contracting Jurisdiction carries on business in the first mentioned Contracting Jurisdiction as an **independent agent** and acts for the enterprise in the ordinary course of **that** business.*

Dependence Test vis-à-vis

Agency Business only

- *MLI language*
- *Galileo (Del ITAT)*

OR

Total Business of DA

- *S.9*
- *Current India-UK tax treaty*
- *Western union (Del ITAT)*
- *Lubrizol (Mum ITAT)*
- *TVM (AAR) & ors*

Act more favourable post MLI changes ?

Wholly / almost wholly condition

- **Second Proviso to Explanation 2 to Section 9 (1) (i)**

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

- **India – UK Treaty (Current) – Article 5(5)**

*However, if the activities of such an agent are carried out wholly or almost wholly **for the enterprise** (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to same common control) he shall not be considered to be an agent of an independent status for the purposes of this paragraph.*

- **MLI – Article 12 (2)**

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

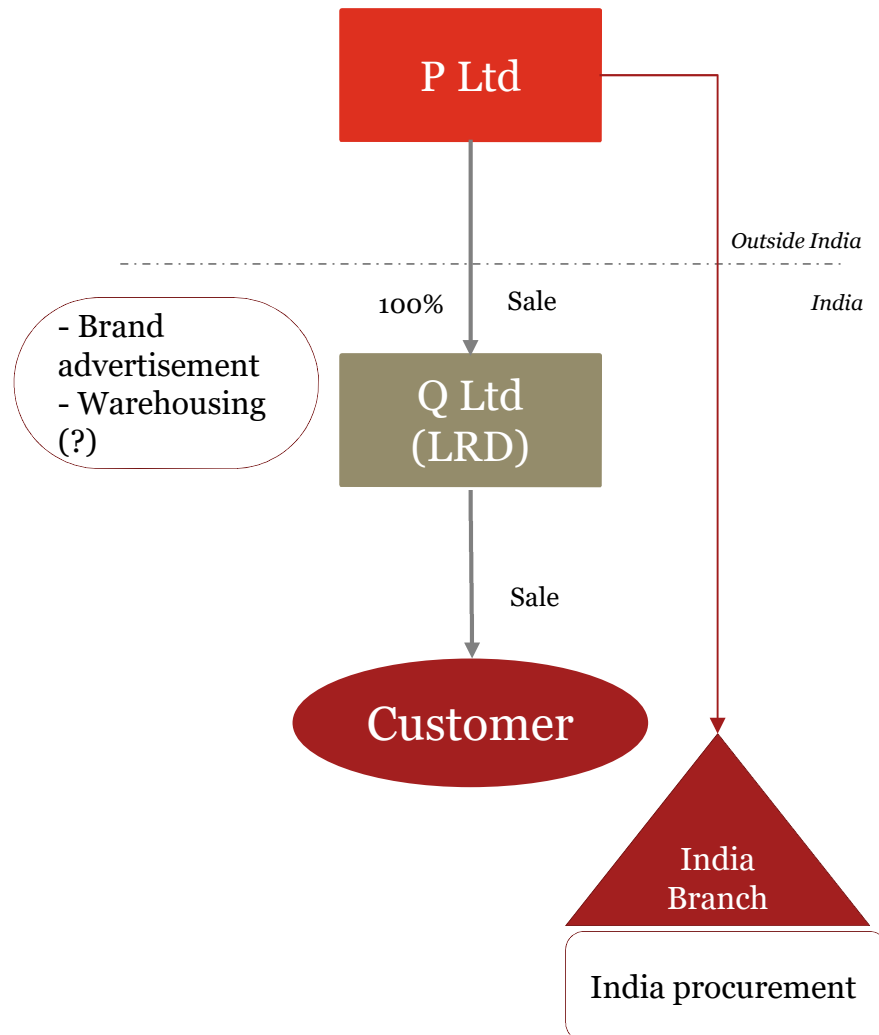
Closely Related Enterprise – as per MLI

- Control
- 50%+ - deemed control
- Not necessarily AEs as per Section 92A(2) (26% shareholding, debt, etc.)

III

*LRD & Anti-
fragmentation*

Case Study II



- P Ltd sells products to its Indian distributor – Q Ltd
- Q Ltd sells products to customers on its own account
 - Assumes limited risks (such as inventory risk, etc.)
 - Bad debt & forex risk borne by P Ltd
 - Detailed operating guidelines by P Ltd
- Independent advertisement & warehousing activity by P Ltd – without involvement of Q Ltd
- Independent sourcing operation by P Ltd Branch

Issues for consideration

- LRD – a PE; de facto agent ?
- Overall Presence – constitutes PE
- Purchase exemption available

LRD – a PE ? De facto agent ?

- Sale in its own name to customers (P-to-P)
 - Actions not *on behalf of* foreign principal
- Action plan 7 (OECD BEPS) does not apply to a LRD
- “Independent operations” critical
 - *Detailed instruction & comprehensive control (day-to-day) by Principal*
 - *Entrepreneurial risks borne for its work (although limited)*
 - *Special skill sets & expertise knowledge qua distributor business*
- HR reporting lines indicative of independence

Brand protection guidelines v/s Operational control on distributor functions

Key MLI Provision [Article 13(2)]

Artificial Avoidance of Permanent Establishment Status through the Specific Activity Exemptions (Option A)

Notwithstanding the provisions of a Covered Tax Agreement that define the term “permanent establishment”, the term “permanent establishment” shall be deemed not to include:

- a) the activities specifically listed in the Covered Tax Agreement (prior to modification by this Convention) as activities deemed not to constitute a permanent establishment, whether or not that exception from permanent establishment status is contingent on the activity being of a preparatory or auxiliary character;*
- b) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a);*
- c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b),*

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

Key MLI Provision [Article 13(4)]

Anti-fragmentation

*A provision of a Covered Tax Agreement (as it may be modified by paragraph 2 or 3) that lists specific activities deemed not to constitute a permanent establishment shall not apply to a **fixed place of business** that is used or maintained by an enterprise **if the same enterprise or a closely related enterprise** carries on business activities at the **same place or at another place** in the same Contracting Jurisdiction and:*

- a) that **place or other place constitutes a permanent establishment for the enterprise or the closely related enterprise** under the provisions of a Covered Tax Agreement defining a permanent establishment; or*
- b) the **overall activity** resulting from the combination of the activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, is not of a preparatory or auxiliary character,*

*Provided that the business activities carried on by the two enterprises at the same place, or by the same enterprise or closely related enterprises at the two places, constitute **complementary functions** that are part of a **cohesive business operations***

Aggregation rule

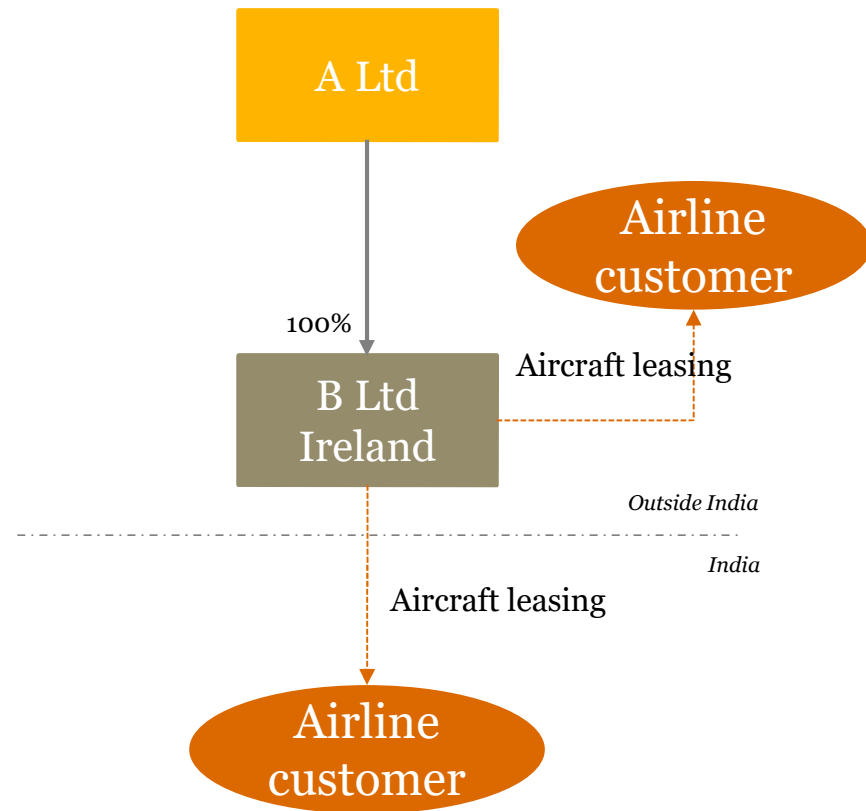
- Per se, advertisement & warehousing should qualify as a Preparatory & Auxiliary activity
- Aggregation rule under new MLI provisions
 - **Fixed place of business**
 - Brand advertisement (media ad v/s hoardings) ?
 - Warehousing ?
 - **At the same place or at another place**
 - **Closely related entity** - Q Ltd activities to be considered
 - *Includes Indian entity (Q Ltd) – activities deemed to be PE even if resident*
 - **Complimentary functions**
 - Procurement business ?
 - **Cohesive business operations**

Geographical & Commercial coherence ?

III

*PPT Impact –
specific benefits
under treaties*

Case Study III – PPT impact on specific benefits under treaties



- A Ltd – global business conglomerate with varied business interests; 200+ subsidiaries / JVs
- Seeking to venture into Aircraft leasing business
- Proposal from tax head to set-up entity in Ireland
 - Leasing hub
 - Tax treaty network with customer countries – No equipment royalty taxation
 - Zero withholding on interest payments to A ltd under tax treaty

Issues for consideration

- Identify relevant factors to evaluate the proposal from a tax perspective

Key MLI Provision (Article 7)

Prevention of Treaty Abuse

1. *Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was **one of the principal purposes of any arrangement or transaction** that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be **in accordance with the object and purpose** of the relevant provisions of the Covered Tax Agreement.*

Key Aspects

- Obtaining benefit was “one of” principal purposes
- Arrangement or transaction including “*establishment, acquisition & maintenance*”
- Exclusion - *object and purpose of the Treaty*
- Over and above LOB test

PPT rule

Principal Purpose

- Objective test
- Case – by – case
- Obtaining benefit
- Not just one of the “purpose” – it will always be
- But “Principal consideration” – key driver of decision
 - Not so when intrexicably linked to *commercial criteria*

One of principal purpose v/s Main purpose

Relevant factors

Internal

- Substantive economic functions using real assets
- Assuring real risks
- Own personnel in country

In-country “value add”

External

- Cost of operations
- Availability of skilled labor
- Economic & political environment
- Ease of doing business
- Reliable legal system
- Sophisticated banking system
- Industry custom
- Customer comfort
- Acquisition of existing business and subsequent expansion thereafter
- Membership of regional grouping, etc.

Commercial & Business friendly

Objective of tax treaty

- Encourage cross-border investment
- Amendment of treaty (lower threshold for dividend exemption, etc.)
- Article 6 (MLI) – Purpose of the Treaty

*Intending to eliminate double taxation with respect to the taxes covered by this agreement without creating opportunities for non-taxation or reduced taxation through **tax evasion or avoidance** (including through treaty-shopping arrangements aimed at obtaining reliefs provided in this agreement for the indirect benefit of residents of third jurisdictions)*

- India jurisprudence – Tax planning v/s Tax Avoidance/evasion
- PPT a form of GAAR - Indian GAAR FAQs

GAAR will not interplay with the right of the taxpayer to select or choose method of implementing a transaction

Thank You

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