



Recent amendments in the budget for international taxation and recent development in Permanent Establishment

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Agenda

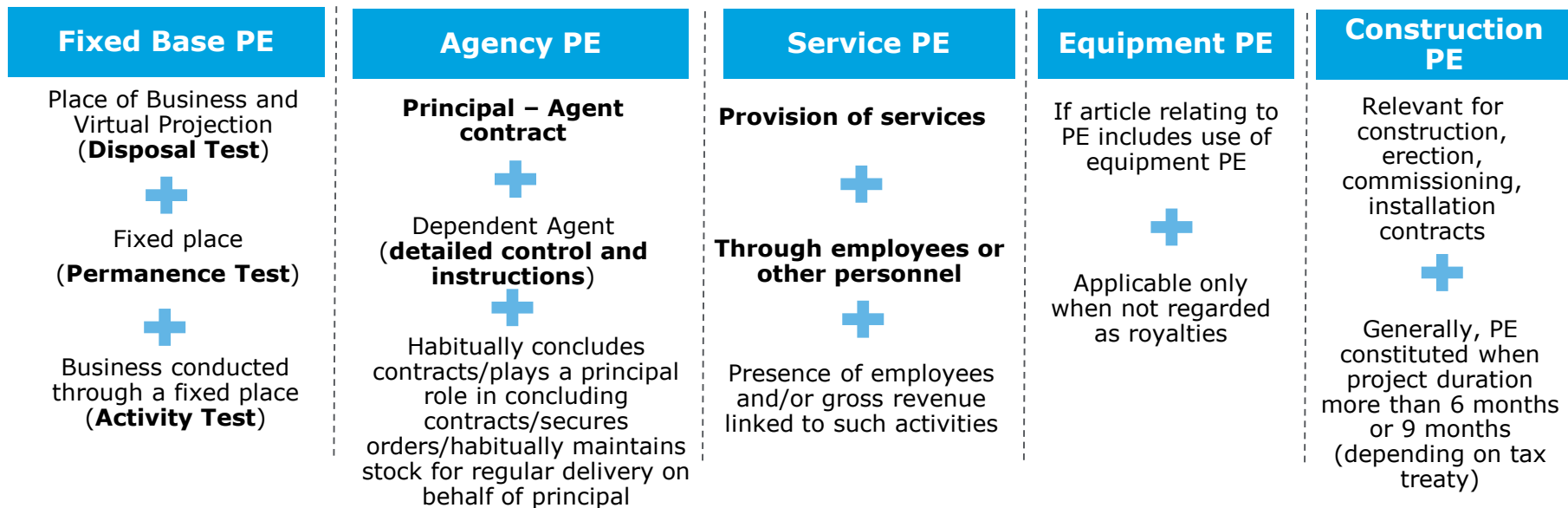
- Concept of Permanent Establishment (PE)
- Judicial precedents
 - Formula One World Championship Limited
 - E-funds IT Solutions Inc.
 - Production Resource Group, In Re
 - Other key Indian rulings
- India annual budget update
- Consequence of PE
- Way forward
- Questions

Concept of PE

Concept of PE

What is PE?

- The concept of PE determines right of a source state (India) to tax profits of a non-resident from business in a source state (India). Three important factors in PE
 - Determination of PE
 - Profit attribution to PE
 - Taxation mechanism for a PE to any avoid double taxation
- What are the types of PE?

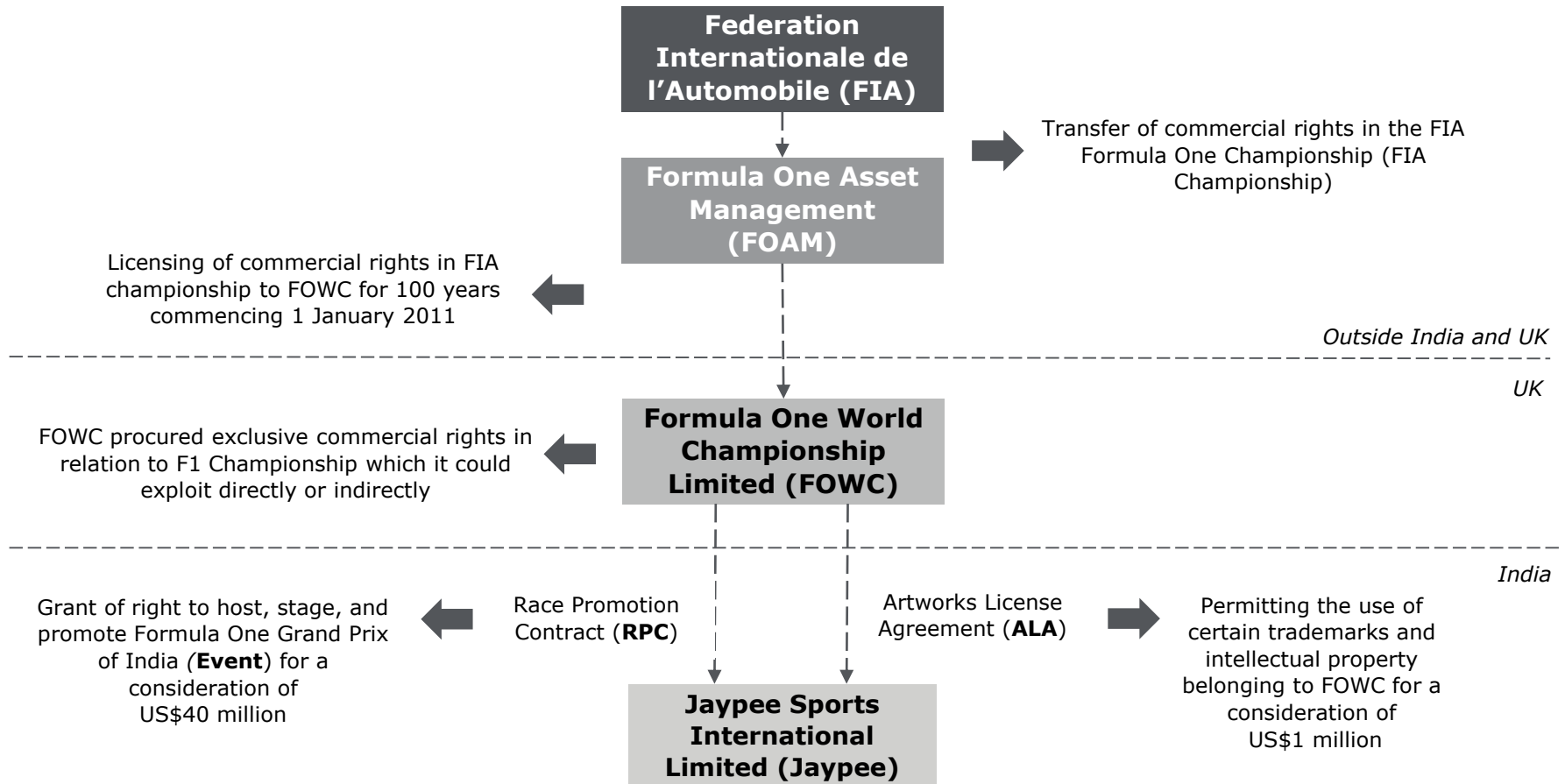


PE should not be constituted where only preparatory and auxiliary activities are performed

Judicial precedents

Formula One World Championship Limited

Formula One World Championship Limited Background



1. The RPC was preceded by another similar agreement between FOWC and Jaypee whereby Jaypee was given a right to promote the Event while RPC gave the right to "host, stage and promote the Event"
2. Jaypee had also signed agreements with affiliates of FOWC for generating television feed and for assigning back circuit rights (media and the sponsorship) and paddock rights to the affiliates of FOWC

Formula One World Championship Limited

Key findings/principles of the Supreme Court

- Article 5(1) provides that PE means a fixed place through which the business of an enterprise is wholly or partly carried on
- Buddh International Circuit is a fixed place
- Principle test for a fixed place PE is whether the premises are at the disposal of the enterprise, i.e., whether the enterprise has the right to use said premises and has control thereupon
- FOWC and its affiliates had complete physical control and access to the circuit
- Various agreements cannot be looked into by isolating them from each other. Their wholesome reading would bring out the real transaction between the parties
- Only FOWC was authorized to exploit the commercial rights either directly or through its affiliates
- By virtue of the Concorde Agreement, the participating teams are bound to engage in the event as per the terms agreed with FOWC

Formula One World Championship Limited

Key findings/principles of the Supreme Court (Cont'd)

- Under the RPC, the rights to host, stage and promote the event are given by FOWC to Jaypee. On the same day, another agreement is signed between Jaypee and three affiliates of FOWC, whereby Jaypee gives back to the affiliates of FOWC circuit rights, mainly media and title sponsorship
- All the revenues from the aforesaid activities go to affiliates of FOWC. No doubt, FOWC is in the business of exploiting these rights, including intellectual property rights. However, these became possible, in the instant case, only with the actual conduct of these races and active participation of FOWC in the said races, with access and control over the circuit
- The Court held that there was a PE of FOWC in India. The Court added that only that portion of the income of FOWC which is attributable to the said PE would be treated as business income of FOWC, subject to deduction of tax under section 195
- FOWC was entitled even in the event of a termination, to two years' payment of the assured consideration of US\$ 40 million.
- Having regard to the OECD commentary and Klaus Vogel's commentary on the general principles applicable, as long as the presence is in a physically defined geographical area, permanence in such fixed place could be relative having regard to the nature of the business

Formula One World Championship Limited

Key principles pronounced by the ruling

Following clauses of the agreement concluded that the Circuit in India was at the **disposal of FOWC (disposal test)**

- Circuit required to be constructed in the form and manner prescribed by FIA and FOWC
- FOWC is responsible for the inclusion of the Event in the F1 Championship
- FOWC had full access to the pit, padlock buildings, etc. during the access period
- Passes issued by FOWC not questioned by Jaypee
- Jaypee not permitted to record any footage of the event in the confines of the circuit or the land
- All intellectual property relating to the event had been irrevocable and unconditionally assigned to FOWC

Mere construction of the track by Jaypee cannot determine who is in actual control of the Event

Permanence test

FOWC having full access to the Circuit only for a limited period of 3 days would not have any bearing on the characterization of this circuit as a fixed place PE as the necessary ingredients for PE are met

As long as the presence is in a physically defined geographical area, permanence in such fixed place could be relative having regard to the nature of the business

Duration of RPC was for 5 years with the option of extending it to another 5 years and hence the period in question was not just limited to 3 weeks in a year but was a continuous one

Business Activity test

Held that the circuit itself constituted a fixed place of business and FOWC carried on a commercial activity through conduct of the races in India

Formula One World Championship Limited

Key takeaways

1

Permanence test – Nature of business has to be examined along with duration of activity for determining existence of PE. Activities involving short-term duration may constitute PE - the six months threshold for the purpose of application of Article 5(1) cannot be taken for granted

2

Substance over form – It is important to understand the substance of the arrangement between parties; to determine who is carrying on what business and the place of business is at whose disposal

3

Actual control – Indian entity though operating independently but on the direction pre-defined by the non-resident may lead to PE

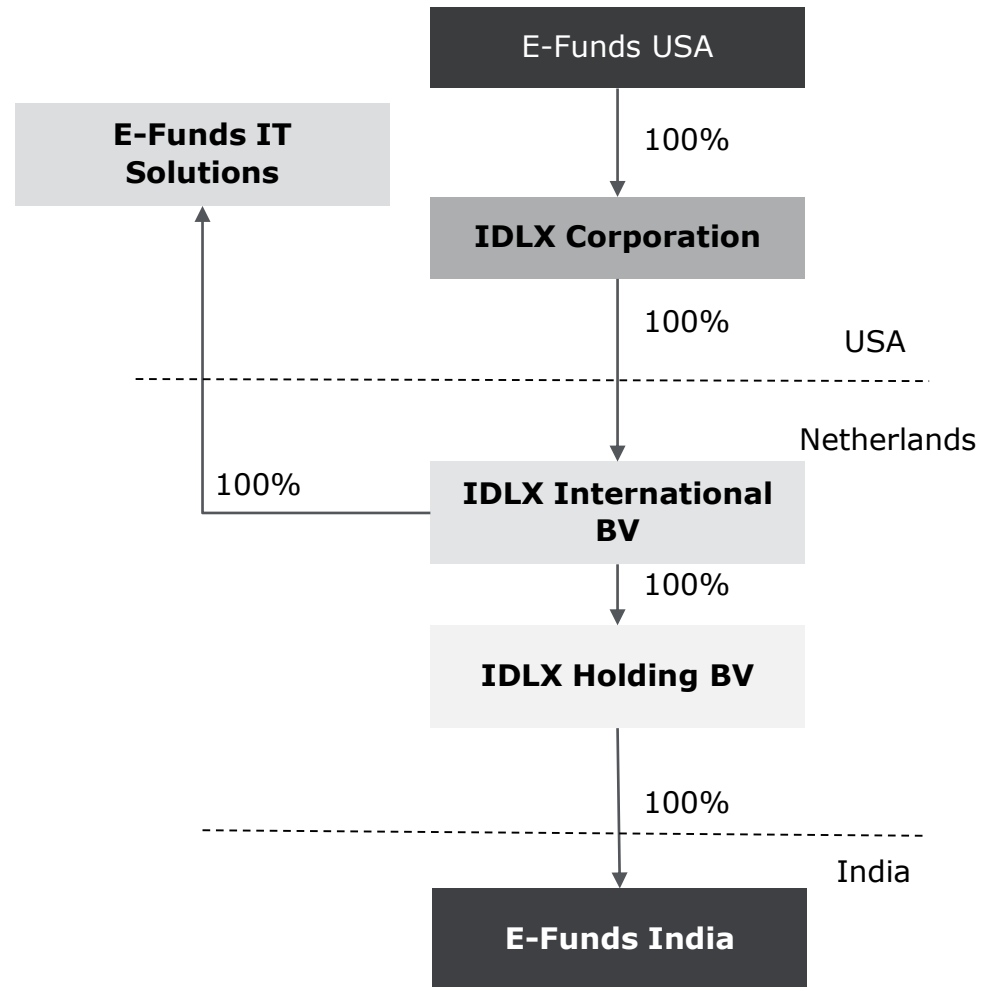
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Attribution – Only that portion of the income of FOWC which is attributable to the said PE would be treated as business income of FOWC

E-Funds IT Solution Inc.

E-Funds IT Solution Inc. Background

- E-funds Group is engaged in the business of electronic payment management, ATM management, decision support and risk management, and global outsourcing and professional services
- E-Funds Corporation (E-Funds USA) and its indirect subsidiary, E-Funds IT Solutions Group Inc. (E-Funds IT Solutions), entered into contracts with their customers outside India for providing various services/solutions
- Some of the work or activities were outsourced to E-Funds International India Private Limited (E-Funds India), an indirect subsidiary of E-Funds USA in India
- Two employees of E-Funds USA were also seconded to India in one of the years



E-Funds IT Solution Inc.

Key contentions of the parties

Fixed place PE

Revenue

- 40% employees in India
- Call centers and software development centers only in India
- E-Funds USA doing only marketing work
- American entity having complete control in regard to Indian entity's personnel
- Proprietary database and software provided by E-Funds USA
- President's office and sales team of E-Funds India servicing and reporting to overseas group entities
- Disposal test satisfied

E-Funds

- Disposal test not satisfied

Service PE

Revenue

- E-Funds India's employees qualify as "other personnel" of the US entities
 - As per India-US treaty, services should be provided through employees or other personnel
- Seconded employees also create service PE

E-Funds

- No services are provided by US companies in India
- Personnel engaged in India operations are employees of E-Funds India only

E-Funds IT Solution Inc.

Key principles and takeaways

Fixed place PE

1

Mere having access to a place in India for the purpose of business not sufficient for creation of a fixed place PE – the non-resident should have right to use the place or have control thereupon

2

Close association between the entities or interactions/cross-transactions between them or dependence of Indian Co. on foreign parent/group company is not an appropriate test to determine the existence of a fixed place PE

3

Indian entity rendering support services which enable a foreign affiliate to render services to its clients abroad would not create fixed place PE of the foreign affiliate in India

Service PE

1

Primary condition for existence of a service PE is that the services should have been furnished within India

2

To constitute Service PE, it is important to evaluate the nature of services rendered by seconded employees as well as their reporting obligation

Payment of arm's length consideration to the Indian entity would extinguish any potential tax liability that may arise even if PE is established

Production Resource Group, In Re

Production Resource Group Background

Facts in Brief:

- Production Resource Group (PRG or the Applicant), a Belgium-based company, entered into a contract with the Organizing Committee of the Commonwealth Games, Delhi (OCCG), for providing on a turnkey basis, lighting and searchlight services during the opening and closing ceremonies of the Commonwealth Games Delhi, 2010
- Employees and equipment of PRG were in India for a period of 66 days, for carrying out preparatory, installation and dismantling activities
- The actual services were rendered only on 2 days –the opening and closing days of the ceremony

Issue before the AAR:

- Whether the payments received/to be received by the Applicant for rendering, lighting and searchlight services to OCCG under the Agreement dated 9th July, 2010 would be taxable in India under the provisions of the Act
- If the payments received by the Applicant for rendering lighting and searchlight services to OCCG, are taxable in India under the provisions of the Act, whether the same would not be taxable in India in view of the India-Belgium DTAA read together with the India-Portuguese Republic DTAA

Production Resource Group

Submission before AAR

- The consideration for the aforesaid services was not taxable as Fees for Technical Services (FTS), in the absence of the services being 'continuously rendered', as against a one-off project
- The services were also claimed to be standardized in nature, and hence, not taxable as FTS
- Based on the Most Favored Nation (MFN) clause in the India-Belgium DTAA, the requirement of 'make available', appearing in the India-Portugal DTAA, was sought to be imported. In the absence of services being made available, it was claimed that the services would not be taxable in India
- The consideration was also not taxable as business profits, in the absence of a Permanent Establishment (PE) in India. It was submitted that the conditions of place of business, power of disposition, permanence, location, business activity and business connection, were not cumulatively satisfied, for the existence of PE

Production Resource Group Ruling

- Based on a reading of the agreement between PRG and OCCG, the AAR held as follows:
 - ✓ PRG was provided with a 'lockable' space for storing its tools and equipment, inside the stadium. The very existence of a 'lockable' space implies access to and control over the space, to the existence of others. Based on the nature of business, it was held that this place was not merely for storage, but for carrying out the business itself
 - ✓ The fact that the space was within the stadium, i.e. where the revenue generating activity would take place, itself was a factor in establishing a PE
 - ✓ Coupled with the space, the lighting facilities created and erected by PRG, were also held to be a part of the 'place of business'
 - ✓ The contention of a transient presence was rejected on the basis that the establishment need not be permanent, and the context of the business would be relevant
 - ✓ An analogy was drawn to the Supreme Court decision in Formula One World Championship Limited (2017) 80 taxman.com 347, to state that the permanence was for as much time as the business required
 - ✓ The contention of PRG that services were provided only for 2 days, was rejected on the basis that this was a turnkey project, covering the entire duration of the Commonwealth Games and more.

Other key Indian rulings

Other key Indian rulings

Name	Country	Key principles	Key takeaways
ABB FZ – LLC (ITAT)	UAE	<ul style="list-style-type: none"> • For Service PE, physical presence of employees is not required • Satisfaction of conditions provided in Article 5(2) will create PE irrespective of whether general conditions of Article 5(1) cover such a situation or not 	<ul style="list-style-type: none"> • Ruling in line with India’s position on OECD Commentary
Shanghai Electric Group Co. Ltd (ITAT)	China	<ul style="list-style-type: none"> • Substance of contracts and intention of parties to be considered to evaluate whether supply and services are linked • Satisfaction of conditions provided in Article 5(2) will create PE irrespective of whether general conditions of Article 5(1) cover such a situation or not • Any income in respect of services rendered to an Indian project, similar to the services rendered by the PE, is also to be taxed in India, irrespective of the fact whether such services are rendered in India or outside India, through the PE or directly by the general enterprise 	<ul style="list-style-type: none"> • Arrangements involving offshore supply and onshore services may need a relook depending on the language of the respective treaty

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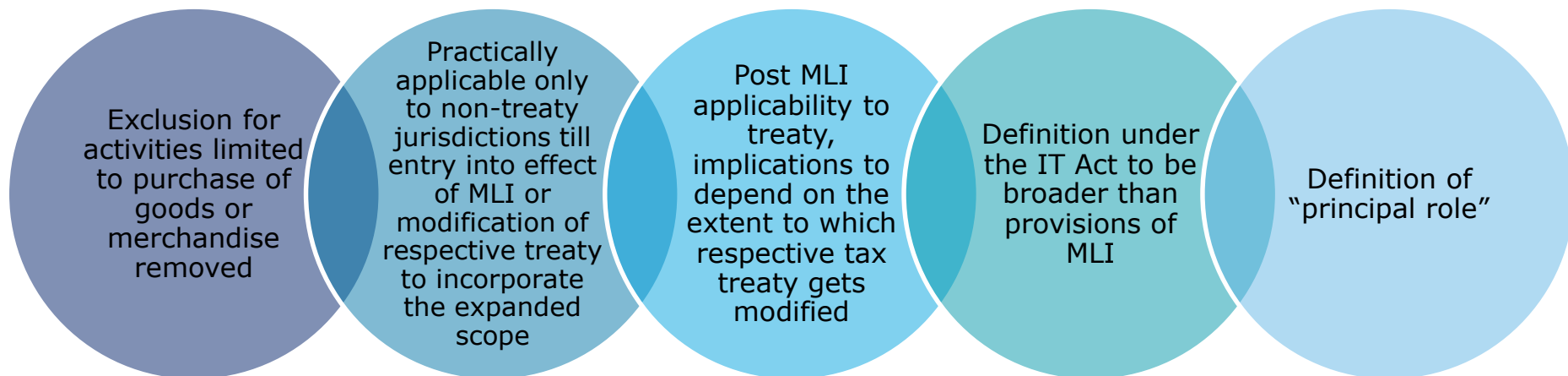
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Business connection widened to include agency contracts

Definition of the term business connection widened to include agency contracts

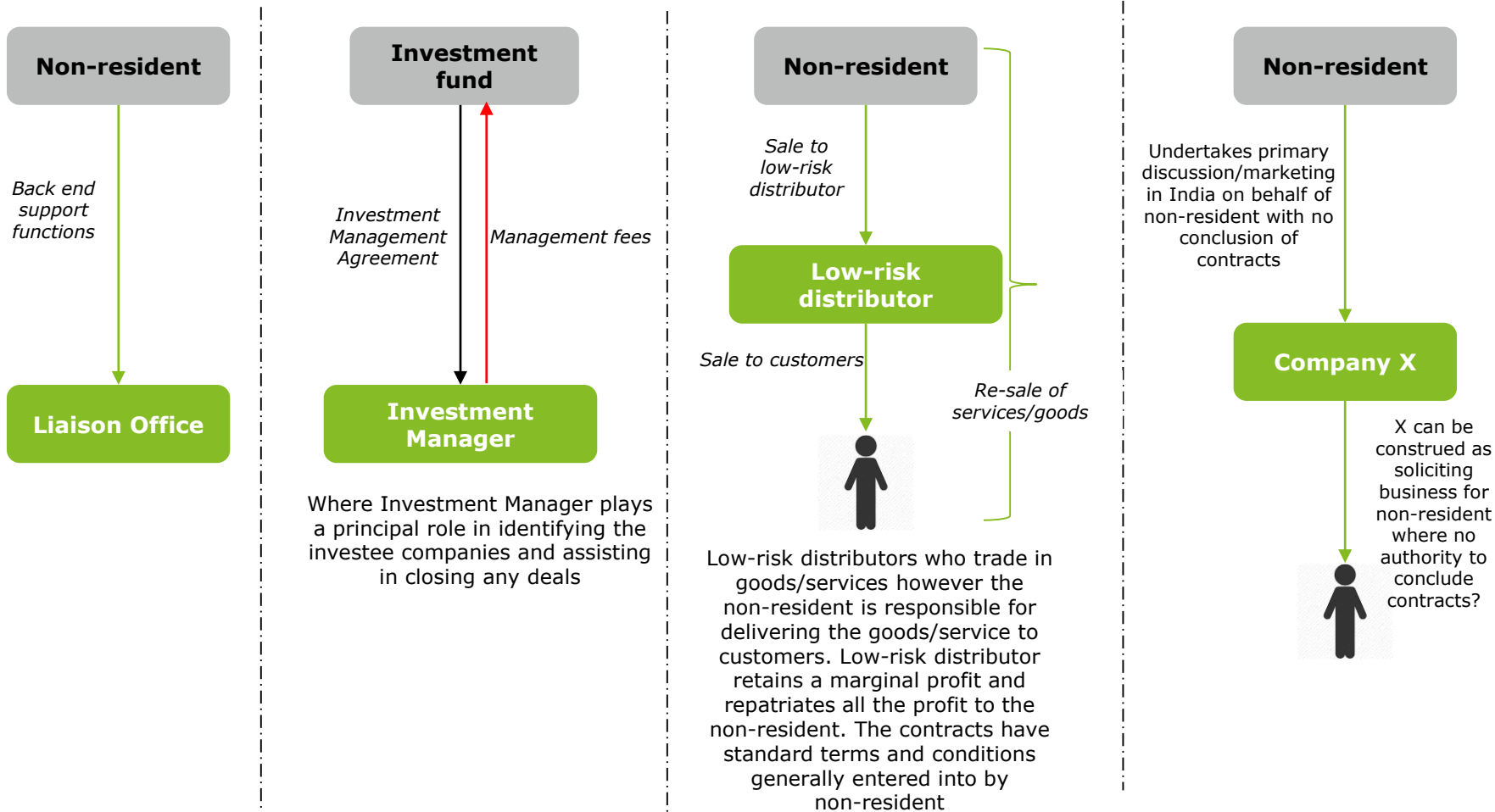
“Business connection” to now include any business activity carried through a person who, acting on behalf of the non-resident, habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the non-resident and the contracts are

- 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.



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What will be the impact?

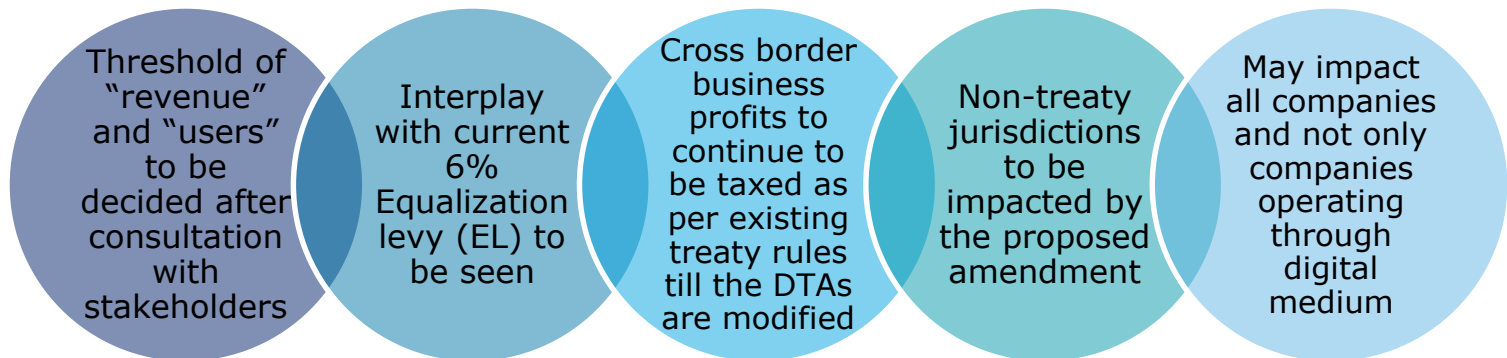


India Budget 2018

Business connection widened to include significant economic presence

Definition of business connection widened to include nexus based taxation through significant economic presence

- Definition of “business connection” widened to include “significant economic presence” in India. “Significant economic presence” to mean
 - Transaction in respect of 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 transactions during the previous year exceeds the prescribed threshold; or
 - systematic and continuous soliciting of business activities or engaging in interaction with the prescribed number of users in India through digital means
- Transactions/activities to 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, or the agreement for such transactions or activities is entered in India



Consequences of PE

Consequences of PE

Why is it important to analyze PE?

- Higher tax rate of 40% (plus applicable surcharge and cess) to apply on profits attributable to PE in India
- Computation of profits attributable to the PE subject to the Indian domestic tax law provisions
 - Restrictions relating to disallowance of expenditure for withholding tax default would be applicable, allowance of certain expenses on payment basis, deduction of head office expenditure, etc. to apply
- Various compliances such as Permanent Account Number, Tax Deduction account number may be required to be obtained
- Filing of corporate tax returns in India (even if there is no PE, tax return filing obligation exist)
- Compliance with the withholding tax provisions (withholding tax from payments, filing tax withholding returns, etc.) may be attracted
- Customers would withhold tax at a higher rate – obtain lower withholding tax order
- Impact on short stay exemption for employees – personal taxation of employees may be impacted
- Maintenance of books of account and having the same audited in accordance with the Indian domestic tax law
- Compliances under indirect tax laws and corporate law to be considered

Way forward

Way Forward

- PE determination and attribution – An important exercise
- Dynamic of PE are changing
- Need to look at the recent judicial precedents and relevant tax treaty
- In case there is a PE, advisable to obtain a lower withholding order and a CA certificate shall not be issued

Questions

