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Commissionaire Arrangement and Agency PE

Section 9 and Article 12 and 15 of MLI

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The Chamber of Tax Consultants
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Bengaluru

Kolkata

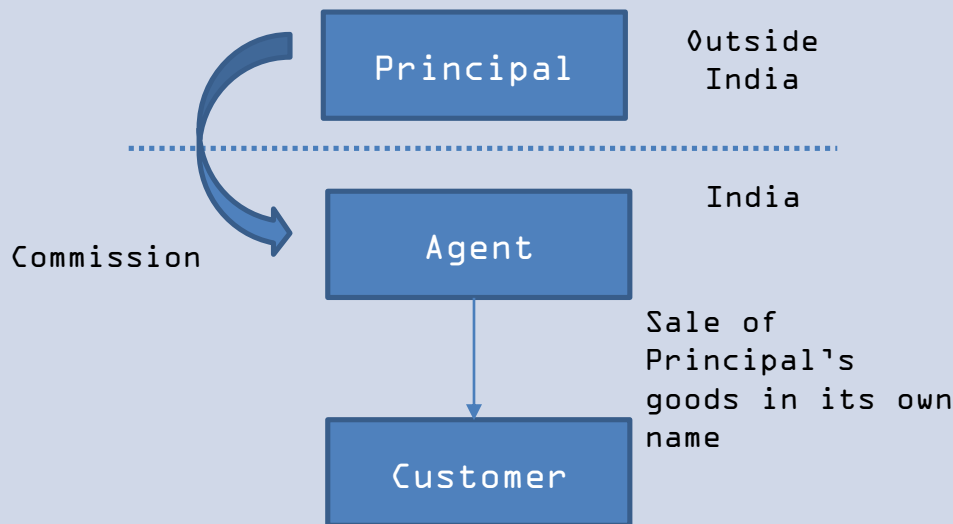
Mumbai

New Delhi



Article 12 | Context

Commissionaire Arrangement Art 5(5)



- Foreign enterprise is able to sell its products without having a Permanent Establishment ("PE")
- For tax purposes, no sale is attributed to Indian Agent
- Therefore, profits derived from such sales are not taxable in the source state
- Successful avoidance of Art 5(5): contracts concluded by the commissionaire are not binding in the hands of the foreign enterprise

PE definition changed

- To address techniques used to avoid existence of a PE
- To prevent use of certain common tax avoidance strategies (such as commissionaire arrangements)

Independent Agent Art 5(B)

- Though an 'independent agent' is closely related to the foreign enterprise on behalf of which it is acting, they are not granted a PE status.

Albeit in India, if an independent agent/broker acts for its foreign enterprise outside its ordinary course of business, it will constitute a 'business connection'

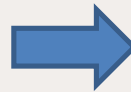


Article 12 | Provision to plug artificial avoidance of PE

Existing Provision

Agency PE shall be deemed to be established if a person other than an agent of independent status is acting in a Contracting State on behalf of an enterprise of other Contract State and:

- (a) he has and habitually exercises in first mentioned State an authority to conclude on behalf of the enterprise, unless his activities are in the nature of preparatory or auxiliary, which if exercised through a fixed place of business would not make that fixed place a PE; or
- (b) he 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
- (c) Habitually secures order in first mentioned state wholly or almost wholly for the enterprise



MLI Provision

Agency PE shall be deemed to be established if a person is acting in a Contracting State on behalf of an enterprise of other Contract State and

- (a) in doing so, habitually concludes contracts, or
- (b) Habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and**
- (c) these contracts are (i) in the name of the enterprise, or (ii) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use, or (iii) for the provision of services by that enterprise**



Article 12 | Exception

MLI provision as discussed in previous slide shall not apply where:

⑩ Person acting in a Contracting State on behalf of foreign entity carries on business in the first-mentioned State as an **independent agent** and acts in the ordinary course of business

⑩ Not an independent agent if he acts exclusively or almost exclusively on behalf of one or more enterprises to which it is **closely related**

Independent Agent

Closely related enterprise: Control test

- Based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises.

- if one possesses directly or indirectly >50% of the **beneficial interest / aggregate vote and value of shares / beneficial equity interest** in the other

- if another person possesses directly or indirectly >50% of the beneficial interest / aggregate vote and value of shares / beneficial equity interest in the company) in the person and the enterprise.

Closely related enterprise: Holding test

What if activities undertaken are preparatory or auxiliary?



India's action vis-à-vis Article 12

India has signed Multilateral Instrument (MLI) for implementing BEPS actions. The MLI contains the following articles dealing with PE

MLI Articles	Particulars	India's Position
12	Artificial avoidance of PE status through commissionaire arrangements and similar strategies	Adopted
13	Artificial avoidance of PE status through the specific activity exemptions	Adopted

- Significant treaty partners of India who have reserved the right for article 12 of the MLI to not apply to their tax treaties: Canada, Cyprus, Luxembourg, Singapore and the UK
- US is not a signatory to MLI: no effect on the India US treaty
- India's treaty with China, Germany and Mauritius have not been listed as a covered tax agreement for MLI purposes: hence the agency PE articles under these treaties is not affected by the MLI
- India's treaty partners who have adopted Article 12 of the MLI and their treaty with India is listed as covered tax agreement include France, Japan and the Netherlands



Amendment to Explanation 2 to section 9(1)(i)

The 'Business connection' concept under Indian tax law is akin to but wider than PE concept under treaties

In consonance with Action Plan 7, India has expanded scope of 'business connection' w.e.f FY 2018



Person acting or carrying out business activity in India on behalf of a foreign entity



has and habitually exercises in India an authority to conclude contracts or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by foreign entity



Contracts are in the name of foreign entity or for transfer of the ownership of or for granting of right to use property owned by that foreign entity or that foreign entity has the right to use or for the provision of service by the foreign entity

Exception: Activities in the ordinary course of business of an 'independent agent' do not constitute 'business connection'



Article 12 vs Explanation 2 to section 9(1)(i)

Provisions that trigger Agency PE	Article 12	Explanation 2 to section 9(1)(i)
Person acting or carrying out business activity in a contracting state on behalf of a foreign entity	✓	✓
Habitually concludes contracts or	✓	✓
Habitually plays the principal role leading to conclusion of contracts	✓	✓
Such contracts are routinely concluded without material modification by the foreign entity	✓	✗
Contracts are in the name of foreign entity or for transfer of the ownership of or for granting of right to use property owned by that enterprise or that enterprise has the right to use or for the provision of service by the foreign entity	✓	✓



Substance over form concept

Substance over form

Signing of contract outside India not relevant if substance test met

Contracts cover the ones relating to operations which constitute the business proper of the foreign entity

Extent and frequency of activity necessary to determine if agent acts habitually on behalf of the foreign entity

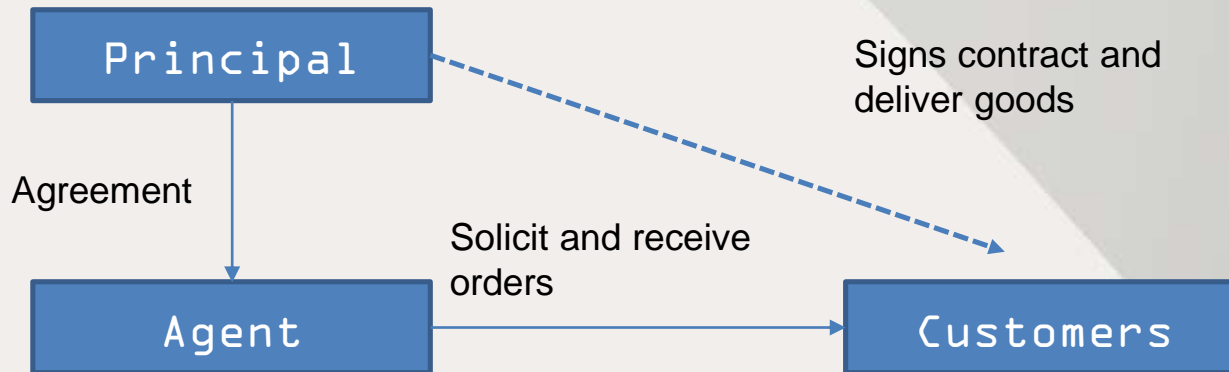
Agent not independent if its activities subject to detailed instructions / control of foreign entity

Independent if foreign entity relies on special skill and knowledge of the agent

Person closely related to enterprise to be distinguished from the concept of associated enterprise (though overlap, not equivalent)



Illustration I Agency model



- Agent solicits and receives order from the customers;
- Agent communicates to the warehouse of the Principal;
- Principal on receipt of the communication routinely approves the transaction and goods are delivered to the customer

Habitually plays principal role leading to conclusion of contract



Contract in name of Principal



Independent agent



Preparatory or auxiliary



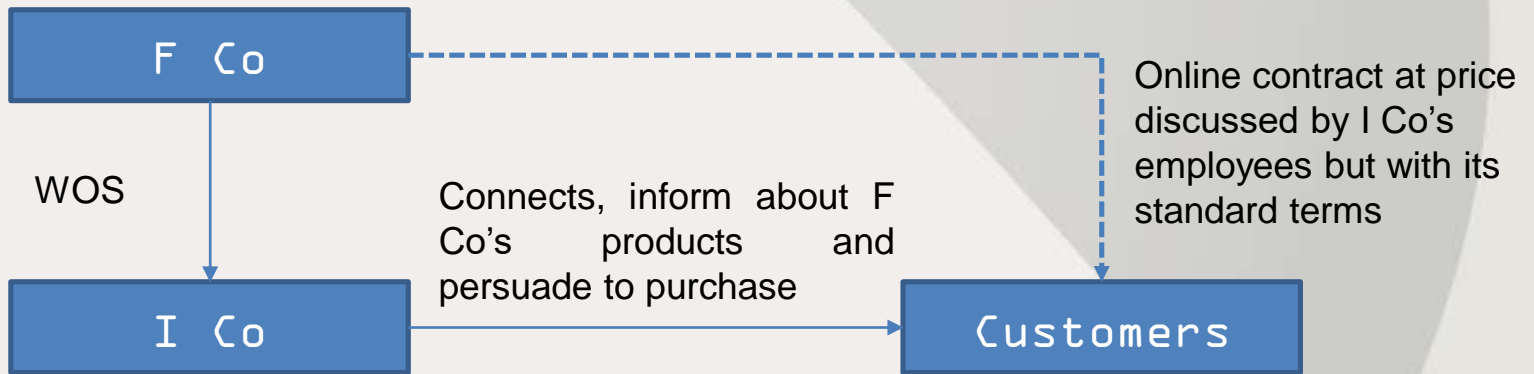
Agency PE?



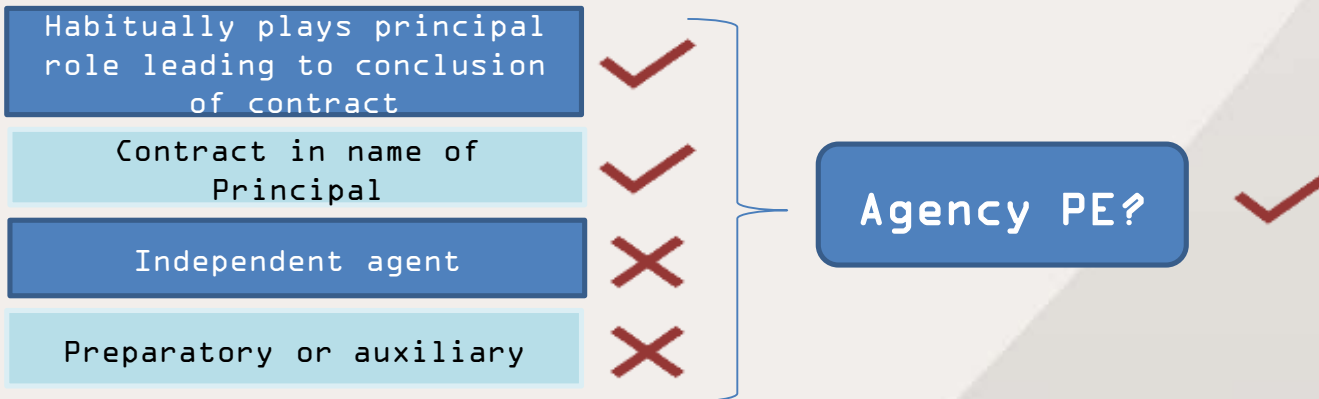
What if Agent merely promotes and markets goods or services of Principal which does not directly result in conclusion of contract?



Illustration II Group company model



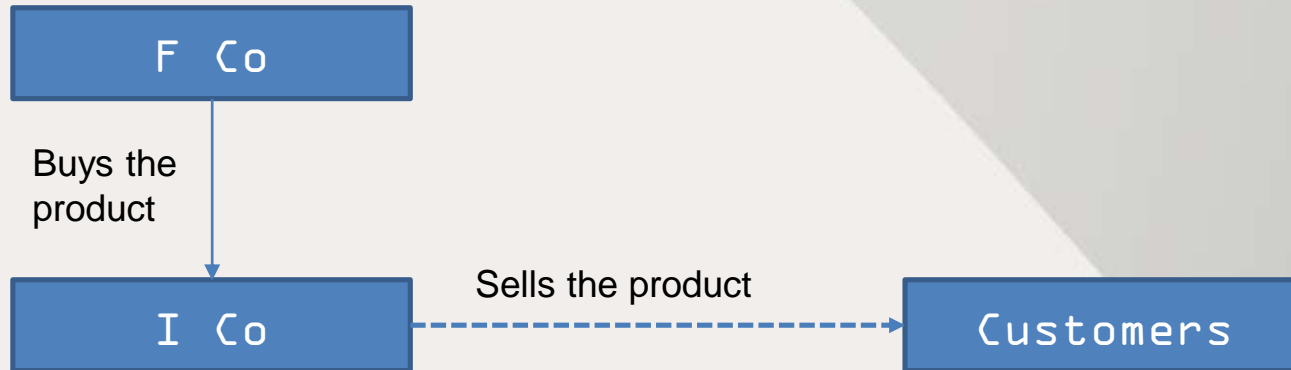
- I Co's employees send emails, make telephone calls to, or visit large organizations in order to convince them to buy F Co's products and services;
- I Co's employees indicates the price payable for the given quantity;
- I Co's employees indicates of contract to be concluded with F Co online
- F Co concludes contract as per quantity and price discussed by I Co's employee



No power with I Co's employees to vary the terms of the contract : Conclusion?



Illustration III Distributor model



- I Co buys the products from F Co and sells / distributes the same to the customers
- Contract is entered between I Co and customers directly

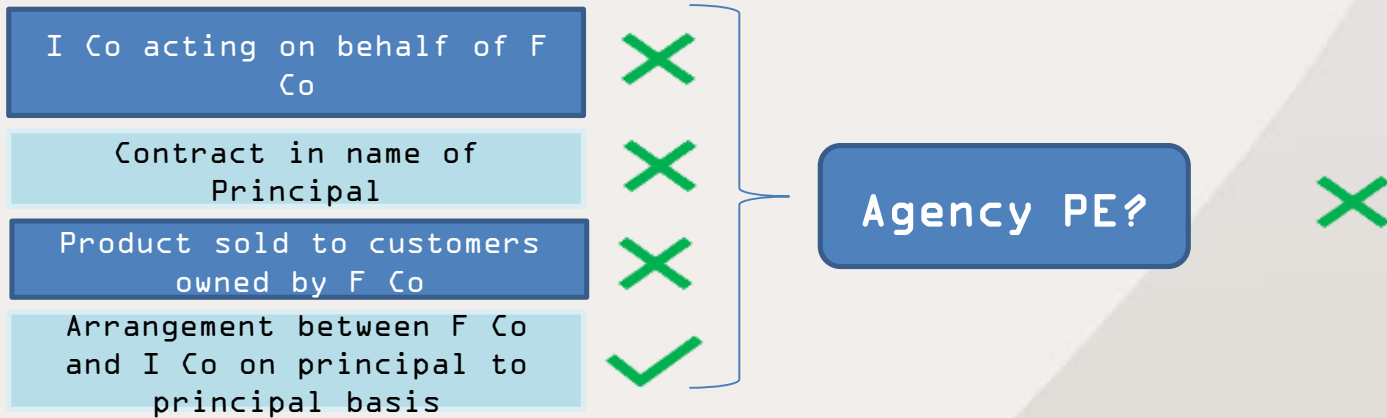
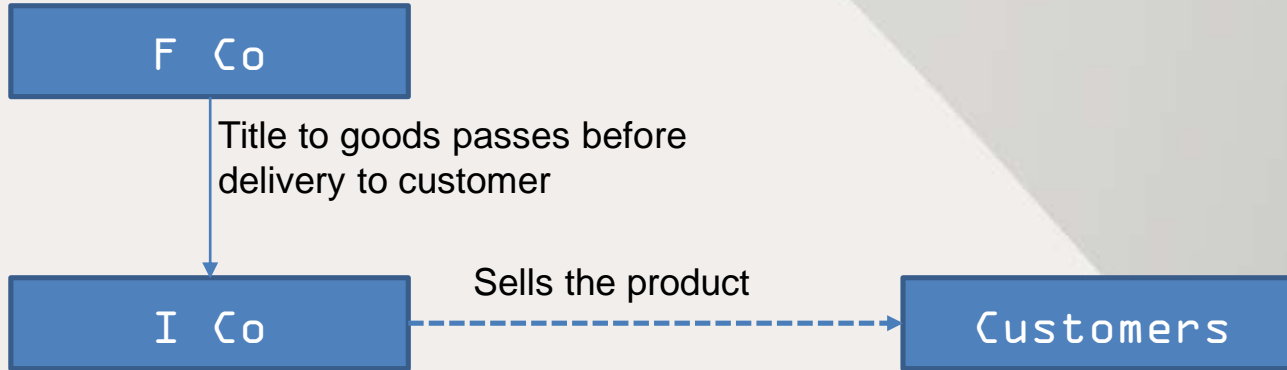
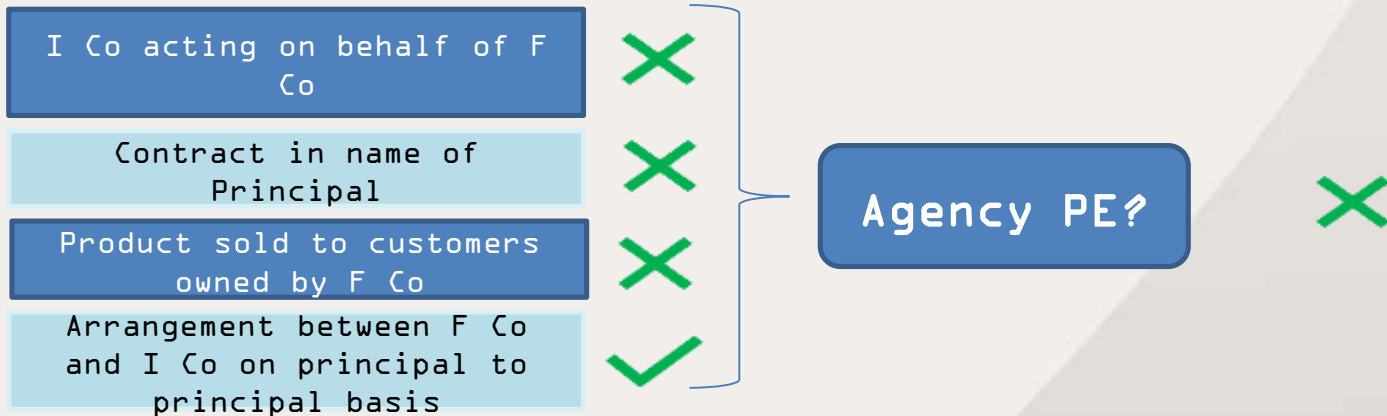




Illustration IV Low risk distributor



- I Co's is a low risk distributor for the products of F Co;
- F Co assumes the business risk and inventory risk of I Co;
- Typically, title to the goods passes to I Co just before delivery to end customer





Recent judicial rulings

Nokia Networks OY ("Nokia") [2018] 194 TTJ 137 (Delhi - Trib.) (SB)

Facts:

- Nokia manufactured telecommunication system and equipment which were sold to Indian telecommunication operators under independent buyer-seller arrangement.
- The installation activities qua this transaction were undertaken by Nokia India Private Limited ("NIPL") Indian subsidiary of Nokia, under an independent arrangement between NIPL and the customers.
- Nokia and NIPL entered into marketing and technical support agreements in respect of the projects installed with no correlation to the supply contract

Held: Agency PE not established as

- Supply of offshore equipment has been done by Nokia outside India
- No activity relating to off-shore supply has been performed in India
- NIPL has not negotiated or concluded any contract of supply of equipment on behalf of Nokia which binds Nokia
- Marketing agreement is an independent agreement bearing no relation with supply of equipment by Nokia and for which NIPL is remunerated at arm's length
- NIPL does not habitually exercises any authority to conclude contract

Situation post MLI provision

- NIPL is not performing activity in India on behalf of Nokia;
- No contract is entered by NIPL in name of Nokia;
- Arrangement between NIPL and customers is on 'principal to principal' basis;
- NIPL does not play any role resulting in conclusion of contracts between Nokia and its customers;
- If the marketing services are undertaken frequently on behalf of Nokia and results into conclusion of business contract between Nokia and customers, Agency PE could be triggered



Recent judicial rulings

MasterCard Asia Pacific Pte. Ltd ("MasterCard") [2018] 406 ITR 43 (AAR - NewDelhi)

Facts:

- MasterCard India Services Private Limited ("MISPL"), a subsidiary provides proposal to the Indian banks that are prepared, validated and approved by the Mastercard
- The proposals contain rates at which Mastercard proposes to provide services to the customer banks.
- If customer does not agree with the proposed terms and makes a counter proposal, the same is uploaded on the portal of Mastercard outside India by the employees of MISPL.
- It is upto Mastercard operating from outside India to accept the counter proposal of the customer or reject the same.
- For the new customers there is constant interaction between Mastercard and MISPL. This process clearly establishes that orders or agreements are routed through MISPL though the finalization of contract is Mastercard in Singapore

Held: Agency PE is established as

- MISPL works only for Mastercard and no service rendered to third parties
- MISPL is legally and economically dependent on Mastercard and gets instructions from Mastercard
- MISPL may not satisfy the requirement of "concluding contract" but it satisfies the requirement of "procuring order"

Situation post MLI provision

- MISPL is not performing activity in India on behalf of Mastercard;
- Contract entered in the name of Mastercard;
- MISPL habitually plays principal role res resulting in conclusion of contracts between Mastercard and its customers;
- It appears that the proposal is prepared by Mastercard and even in case of counter-proposal by the bank, the same is at the discretion of Mastercard to accept or reject the same. This aspect would have significant impact under new provisions



Recent judicial rulings

Daikin Industries Ltd ("Daikin Japan") [2018] 171 ITD 301 (Delhi - Trib.)

Facts:

- Daikin Japan sold air-conditioners to its subsidiary Daikin Air-conditioning India Pvt Ltd ("DAIPL") as well as direct sales to third parties in India
- In absence of Daikin Japan submitting any cogent evidence of it being directly undertaking marketing activities in respect of sales in India, Assessing Officer held that such activities were, in fact, done by DAIPL simultaneous with making sales in respect of their own distribution activity and DAIPL was held as a Dependent Agent Permanent Establishment of Daikin Japan

Held: Agency PE is established as

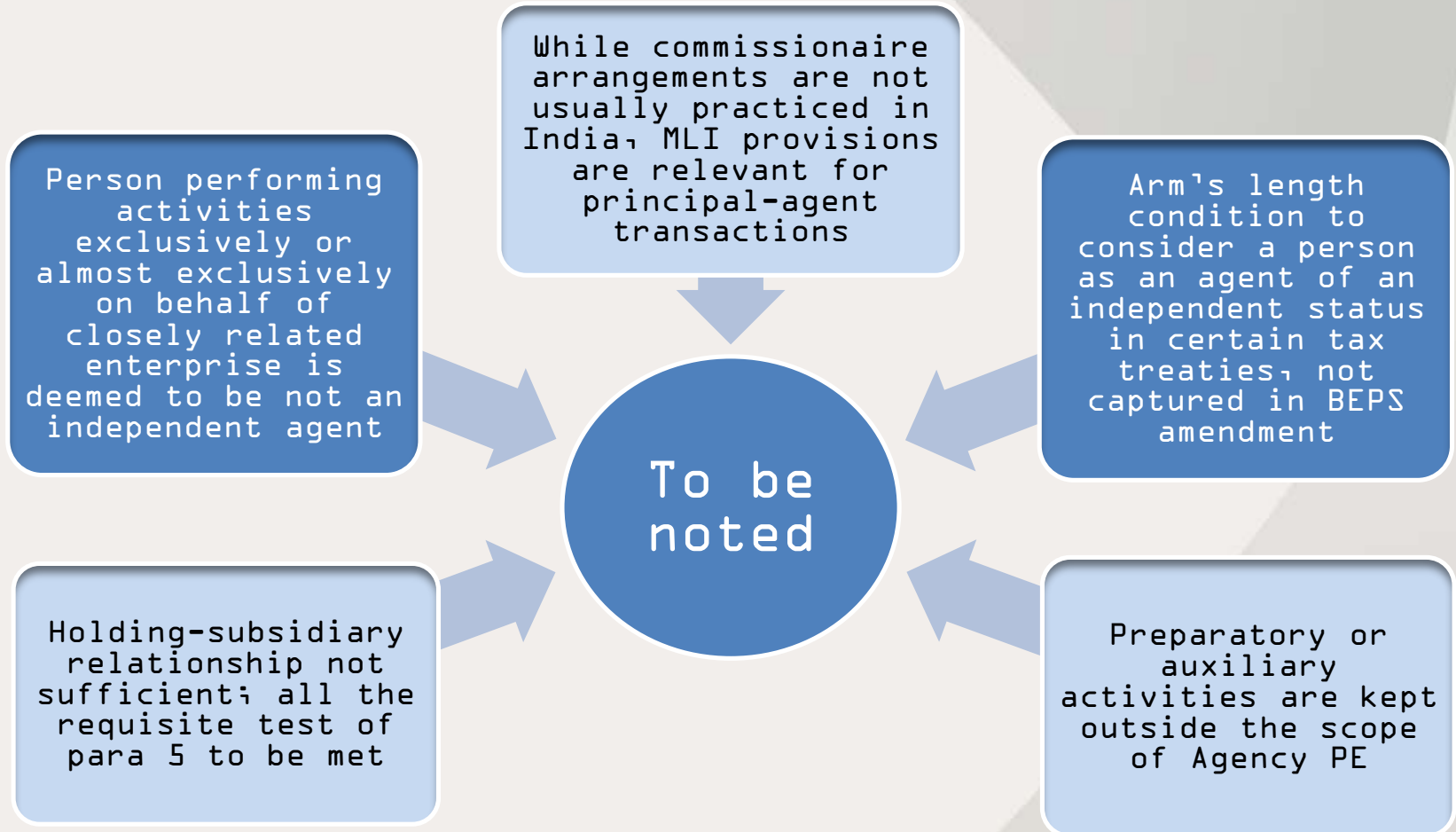
- In absence of evidence, it was observed that entire activity starting from identifying customers, approaching them, negotiating prices with them and finalization of products and prices were done by DAIPL in India not only for the products sold directly by them as distributor, but also for which Daikin Japan is claiming to have made direct sales
- Albeit no authority apparently vested in DAIPL to finalize the contracts of direct sales in India, but the activities of negotiating and finalizing the contracts etc., constituting substance of any sale transaction, were indeed performed by DAIPL
- The mere fact that the Daikin Japan was formally signing the contracts of sale does not, in any manner, alter the position.
- DAIPL was habitually exercising authority in India to conclude contracts on behalf of Daikin Japan,

Situation post MLI provision

- DAIPL is performing activity in India on behalf of Daikin Japan;
- DAIPL habitually plays principal role resulting in conclusion of contracts between Daikin Japan and its customers;
- The facts show that DAIPL was habitually playing principal role of negotiation and finalisation of the terms of the contract with the customers which were formally entered into by Daikin Japan and hence, it satisfies the test for forming an Agency PE



Key takeaways





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