

Cross Border Business Model Structuring – Ideas and Issues from a PE perspective

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Seminar on PE and Attribution of Profits to PE

WIRC, ICAI

5th July 2014

Introduction

- What is a PE?
 - Threshold for taxation of business income in India
 - Definition continuing since around a 100 years!
- Why is PE constitution an important aspect in business structuring?
- Substance is key to all restructurings
 - *“Every man is entitled if he can to order his affairs so that the tax attaching under the appropriate Acts is less than it otherwise would be.”*
 - Duke of Westminster v CIR
 - Anti-avoidance provisions
 - GAAR
 - BEPS
 - CFC
- Business Model Structuring available for whom?

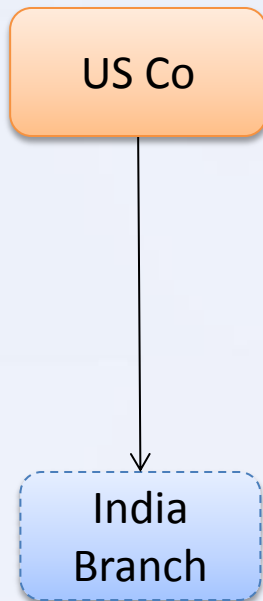
Permanent Establishment vs. Subsidiary

Permanent Establishment	Subsidiary
Projection of Foreign Enterprise on Indian soil for tax purposes	Distinct entity from that of Holding company, with separate tax liability
Tax at 40%	Tax at 30%
Repatriation of profits possible without any tax cost – effective tax rate of 40%	Repatriation of profits only after payment of DDT – effective tax rate of 40.5%
Credit of taxes paid in India available in home country	Taxes paid in India not available as credit
Global accounts exposed to Indian tax	Only local accounts to be submitted for tax purposes
Losses incurred in India available for set-off in home country	Losses incurred in India only available as set-off against profits in India, if any
Transfer Pricing provisions applicable	

Business Structuring – entry possibilities

- **FEMA**
 - Business possible without investment
 - Services
 - E-commerce
 - Business ‘within’ India
 - Can set up ‘place’ of business but only in certain ways
 - Liaison Office, Project Office, Branch, JV, Subsidiary
 - Business outside India
 - Investment only through ODI & LRS-ODI
 - FEMA applicable to overseas investments
- **Companies Act 2013** covers “foreign company”
 - having a ‘place of business’ in India
 - whether by itself or through an agent,
 - physically or through electronic mode; and
 - conducts any business activity in India in any other manner.

Case Study 1 – Presence in India



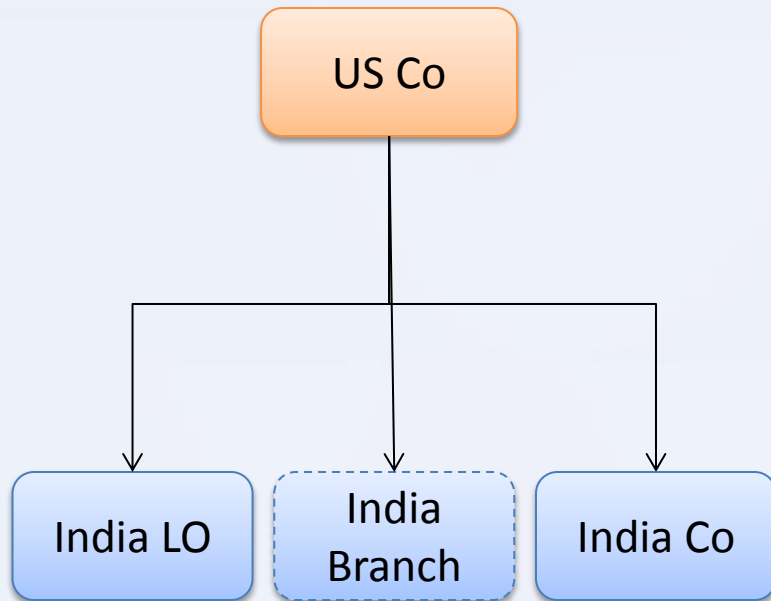
Facts:

- US Co intends to perform certain activities in India
- For performing such activities, the management of US Co has decided to set-up a branch in India
- The activities to be performed in India would be Support Services, Liaison Services and Follow-up services

Issue:

- Will the Indian branch constitute a PE of US Co?
- Will your answer change if US Co was to do core business activities through the branch?
- Alternate modes of presence in India

Case Study 1 – Presence in India



Constitution of PE

- No business activities in India through the branch
- Exclusion for Preparatory and Auxiliary
- If core business activities performed

Alternate Modes

- Liaison office – Limited activities
 - Columbia Sportswear Company
 - Jebon Corporation India
 - Brown & Sharpe Inc.
 - M Fabrikant and Sons
 - UAE Exchange - Delhi HC
- Subsidiary in India – Business activities
 - Mark-up – Transfer Pricing

Fixed Place PE – Indicative Dos and Don'ts

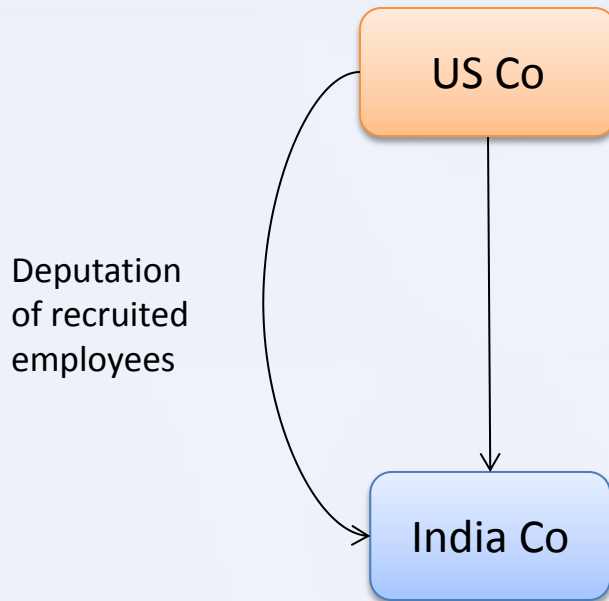
- Foreign company's employees who regularly visit India for business should not be issued business cards bearing the address or telephone numbers of India company
- No dedicated office/ office space should be provided to foreign company's employees on a prolonged basis
- No use of India Company 's stationery by foreign company's employees
- No dedicated phone, fax or email addresses to be provided to foreign company's employees
- No unrestricted access to India Company's office files, databases, etc. to foreign Company's employees
- A dedicated computer should not be provided to foreign Company's employees
- No reserved parking for foreign Company's employees
- No keys or entry cards for foreign Company's employees (they should be treated as visitors only)
- No listing of foreign Company's employees in Indian Company's employee listing/ directory
- No dedicated storage space at Indian Company's office for foreign Company's employees, unless such storage space is under the control of the building owner/lessee (and not under control of foreign Company). Allowing storage of physical items (e.g., computers, paperwork, etc.) should not be problematic
- No dedicated secretarial or administrative assistance at Indian Company's office foreign Company's employees
- No authority for foreign Company's employees to make changes to or alter any office space provided in Indian Company's office

LO – Indicative list of permitted activities

Based on various judicial precedents, following are the activities which if carried out by a Liaison office, should be regarded as preparatory and auxiliary activities and should not constitute a permanent establishment in India:

- Services like data processing, account reconciliation, etc
- Basic operations carried out by a foreign enterprise before its business actually commences, like:
 - Industry analysis;
 - Market survey;
 - Furnishing of information about the business of the foreign enterprise;
 - Ensuring technical presentations to potential users;
 - Development of market opportunities
- Providing a communications link between suppliers and customers;
- Collecting feedback from the prospective customer / consumers;
- Identifying Customers;
- Supply of information regarding customer requirements and specifications.

Case Study 2 - Manpower Company



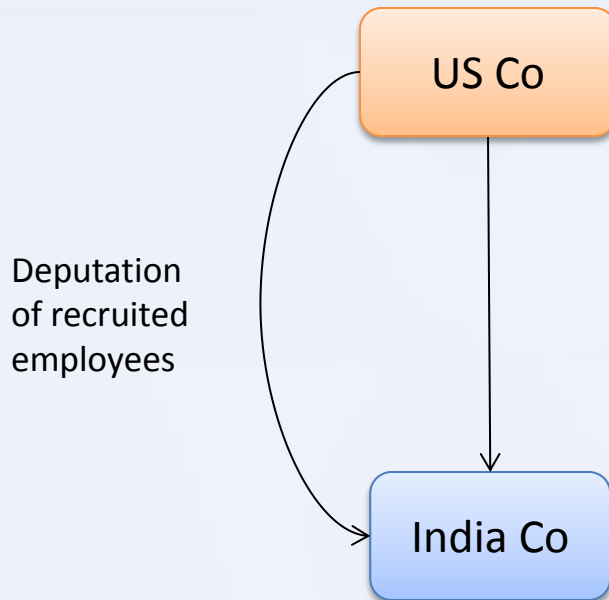
Facts:

- US Co. is a company engaged in the business of man power recruitment
- India Co approaches US Co in relation to recruitment of few employees
- Based on the requirement of India Co, US Co interviews employees in USA and then deputs employees to India

Issue:

- Will the employees recruited constitute a PE of the US Co?
- Can fees paid by India Co to US Co in respect of employees deputed be taxed in India?

Case Study 2 - Manpower Company



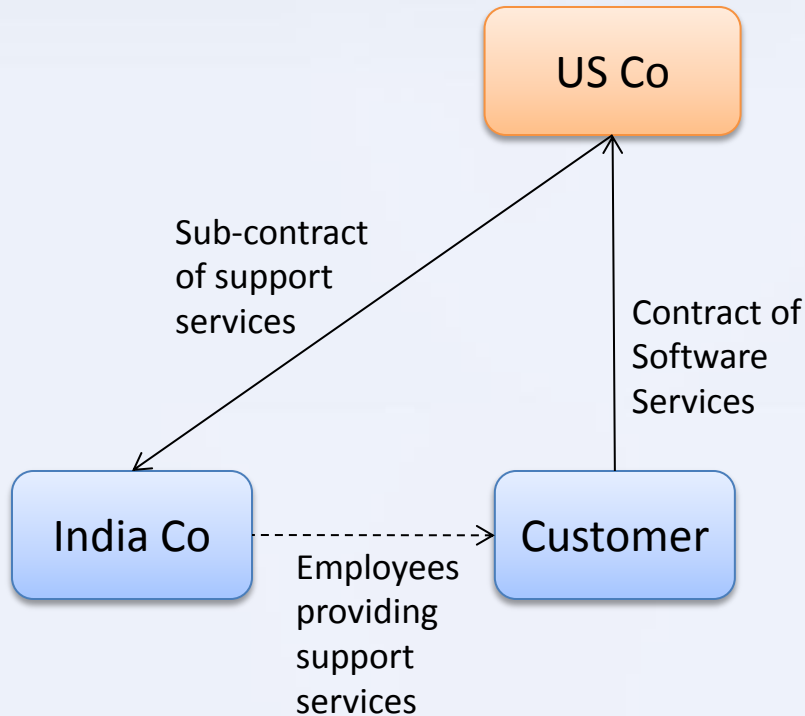
Constitution of PE

- Employees recruited
- Who is the economic employer
- US Co whether the employer of the deputed employees
- Provision of employees vs Provision of services through employees

Case Laws

- Tekmark Global Solutions LLC
- Tekniskil (Sendirian) Behard

Case Study 3(a) – Outsourcing Model



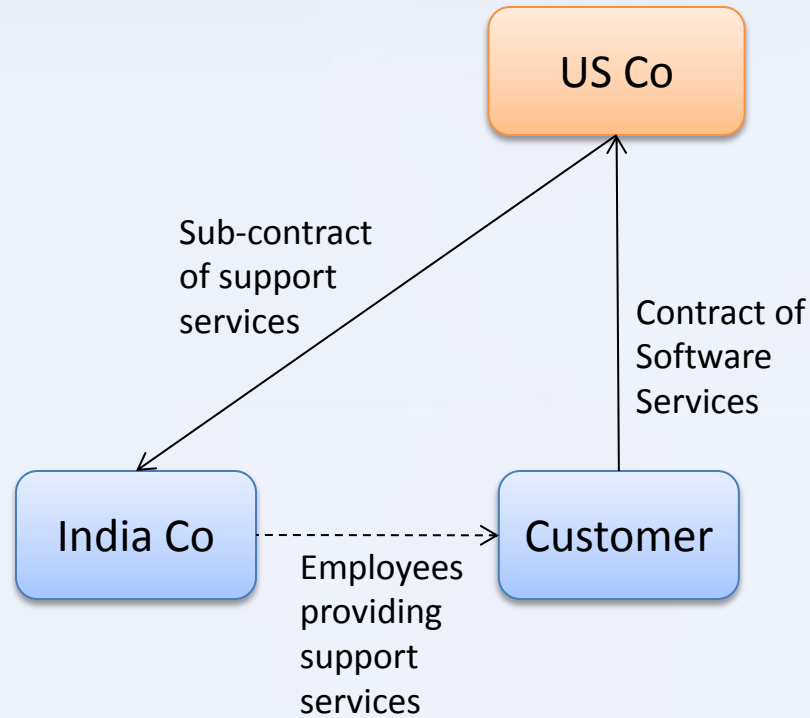
Facts:

- US Co. is a company engaged in the business of providing software services
- US Co gets a contract to provide these services to Customer in India
- US Co sub-contracts following support services to India Co:
 - Providing a communications link between US Co and customer;
 - Collecting feedback from the prospective customers;
 - Payment follow up services
- Employees of India Co render the above services in India to Customer

Issue:

- Will India Co constitute a PE of US Co in India
- Will the employees of India Co constitute a PE of the US Co?
- Will your answer change if the employees are working under direct supervision and control of US Co?

Case Study 3(a) – Outsourcing Model

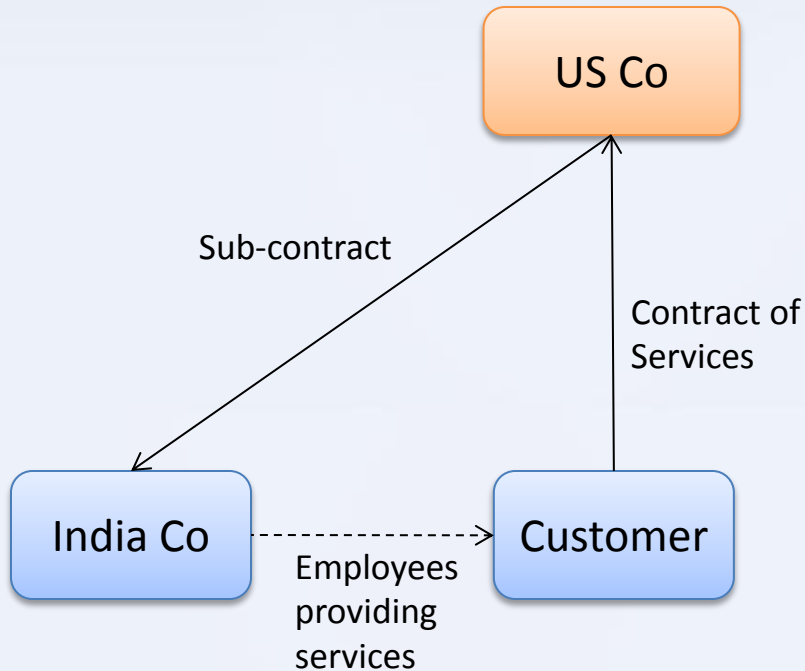


Constitution of PE

- Business activity test
- Right of Disposal test
- Preparatory and Auxiliary exclusion

- If employees provide services under supervision and control of US Co
 - Can recourse still be taken of Preparatory and Auxiliary exclusion?

Case Study 3(b) – Outsourcing Model



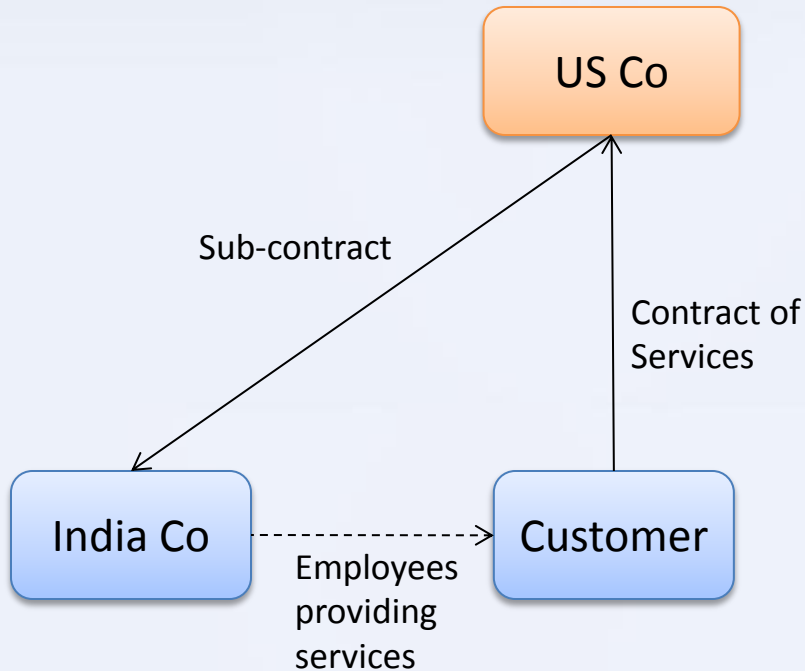
Facts:

- US Co. is a company engaged in the business of providing consultancy services
- US Co gets a contract to provide consultancy services to Customer
- US Co sub-contracts with an India Co for provision of the said services to Customer
- Employees of India Co render the requisite services in India to Customer

Issue:

- Will the employees of India Co constitute a PE of the US Co?
- Will your answer change if the employees are working on direct supervision and control of US Co?

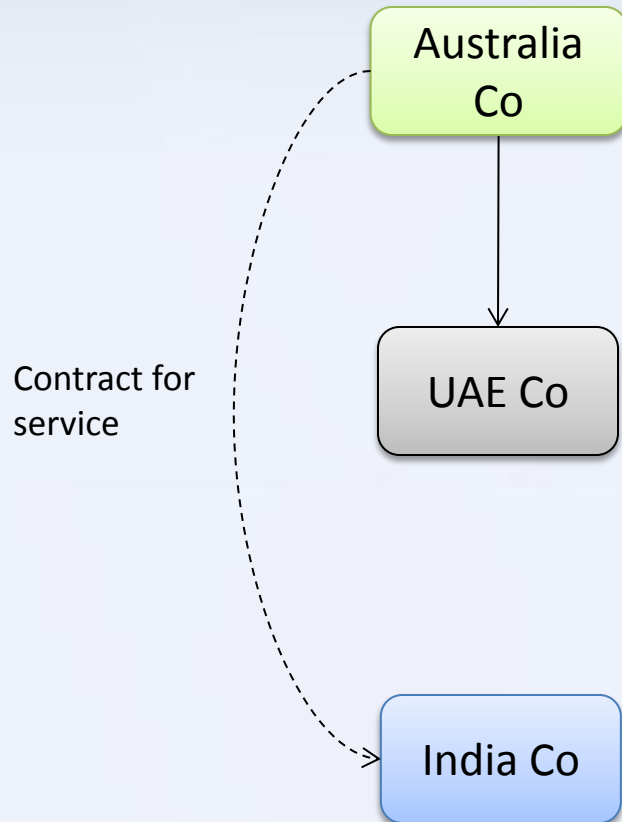
Case Study 3(b) – Outsourcing Model



Constitution of PE

- Employees or Other Personnel
- Meaning of 'Other Personnel'
- Working at the instruction of US Co
- Lucent Technologies
- OECD Commentary to Article 5 - Para 10
- Force of Attraction – select treaties

Case Study 4 – Service PE (Threshold Limit)



Facts:

- Australia Co. is a company engaged in the business of providing consultancy services
- Australia Co gets a contract to provide consultancy services to India Co
- For providing the services, Australia Co is likely to depute employees to India for 160 days

Issue:

- Will the employees deputed to India constitute a PE of the Australia Co?
- Can the transaction be structured better?

Case Study 4 – Service PE (Threshold Limit)

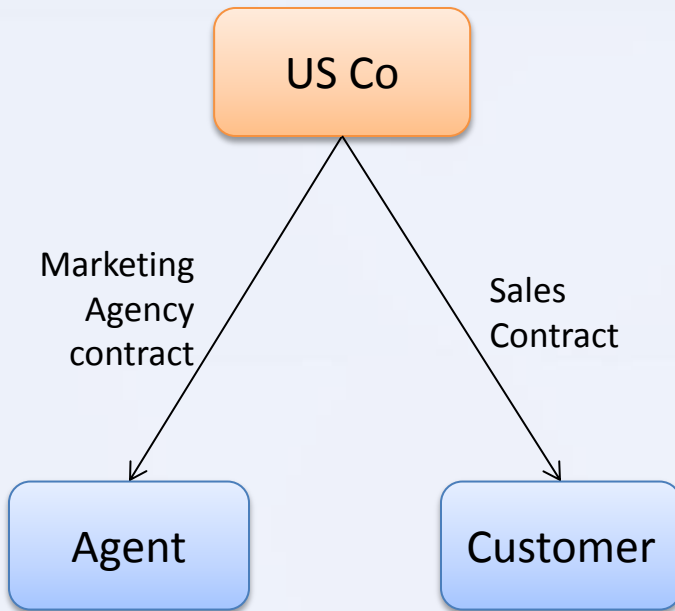
Treaty	Exclusion for FTS	No of days	
		AE	Non-AE
Australia	Yes	One day	90 days
Botswana	No	183 days	
Canada	Yes	One day	90 days
China	Yes	183 days	
Iceland	No	90 days	
Namibia	Yes	six months	
Nepal	No	183 days	
Norway	No	six months	
Saudi Arabia	No	182 days	
Singapore	Yes	30 days	90 days
Sri Lanka	No	183 days	
Swiss Confederation	Yes	30 days	90 days
Syrian Arab Republic	No	183 days	
Thailand	No	183 days	
UAE	No	9 months	
UK	Yes	30 days	90 days
USA	Yes	One day	90 days

Service PE - Indicative Dos and Don'ts

Points to bear in mind before planning a secondment structure

- Authority to terminate not only the secondment, but the employment should lie with the host entity
- Employee should be transferred on the payroll of the host entity
- Work under supervision and control of host entity
- Salary to be paid by host entity. Second alternative - Salary costs to be recharged to host entity
- Reporting to Host entity
- Home entity not to have lien over employees / or re-employ after termination of secondment
- Employee to have no lien over foreign employment
- The above clauses should be included in the following three important documents in an appropriate manner:
 - Deputation letter between the assignee and the home country
 - Inter company agreement between the two companies
 - India employment letter between the assignee and the host country

Case Study 5 – Marketing Agent



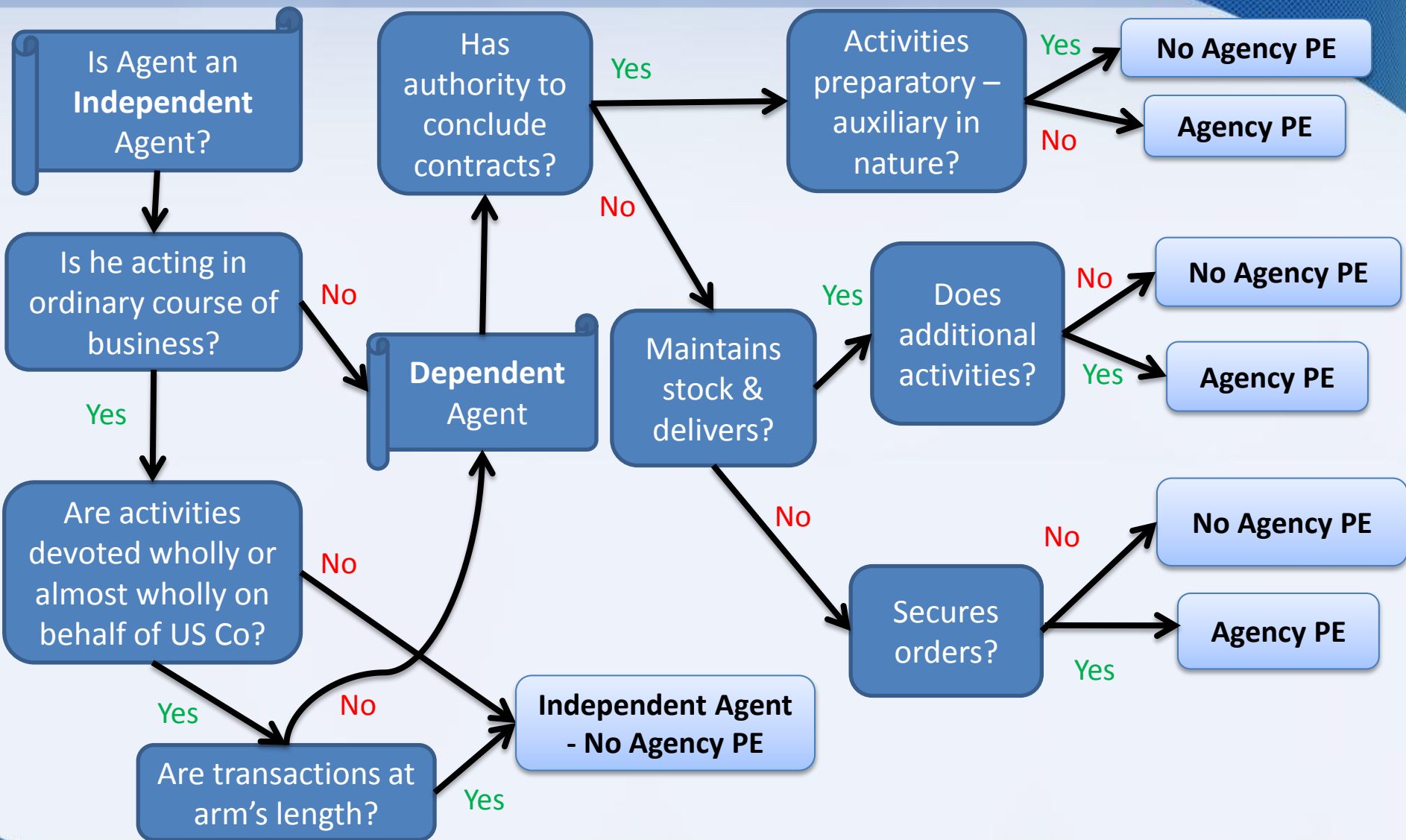
Facts:

- US Co in business of manufacture and sale of industrial machines
- US Co appoints Independent Marketing Agent in India
- The activities performed in India by Agent are:
 - Soliciting customers in India
 - Marketing US Co. in India
 - Negotiating on behalf of US Co. in India
 - Passing on offers of US Co. to Customer and responses by Customer on offers to US Co.
- Contract between US Co. and Customer concluded by US Co.
- US Co. delivers goods to Customer

Issue:

- Will the marketing agent constitute a PE of US Co in India?

Case Study 5 – Does US Co have Agency PE?



Agency PE – Indicative Dos and Don'ts

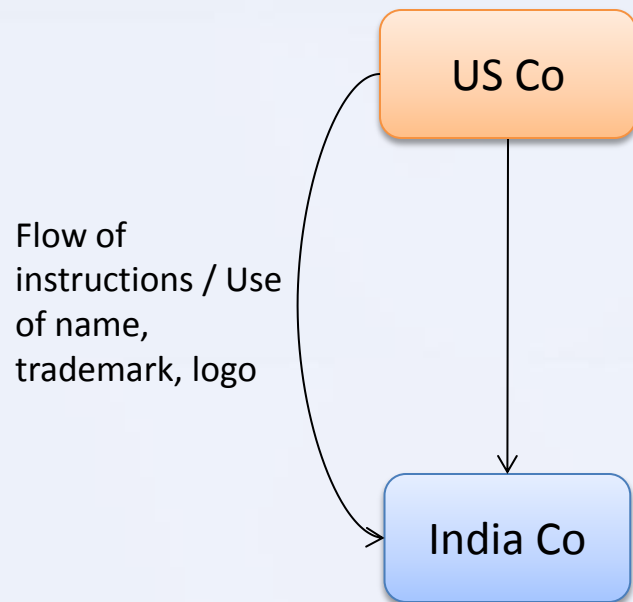
Dos

- Identify potential clients
- Assist in negotiations but not bind foreign Company in any way (ideally this activity should be restricted to the extent possible in view of the aggressive positions being taken by tax authorities)
- Assistance with review of agreements to be entered into with end customer

Don'ts

- Enter into a binding contract with the end customer
- Habitual maintenance of stock of goods & regular delivery thereof
- Negotiate the final terms of the contract
- Sign any contract or any similar document indicating an ability to bind the foreign enterprise
- Habitually secures orders – not present in all treaties

Case Study 6(a) – Service Company



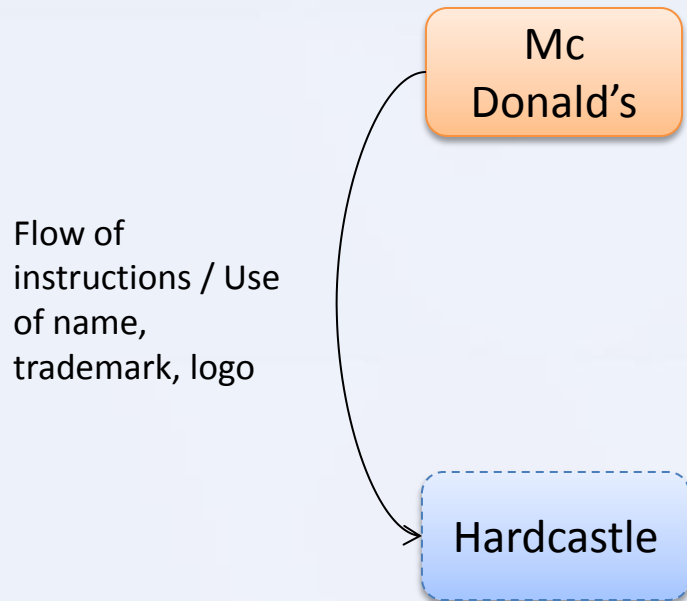
Facts:

- US Co intends to render services to Indian customers
- For rendering such services, the management of US Co has decided to set-up a subsidiary in India
- The Indian company will use the trade name, brand, logo, etc. of the US Co
- Indian company will work on the instructions of US Co. A detailed list of guidelines will be provided by US Co as to the manner in which the services are to be performed by India Co
- The contracts signed and invoices raised by India Co would bear the name, brand, logo of US Co.

Issue:

- Will India Co would constitute a PE of US Co?

Case Study 6(b) – Service Company



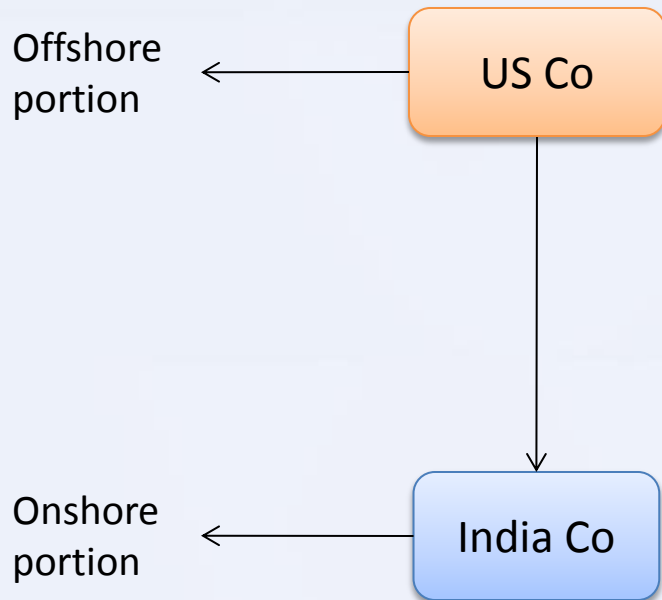
Facts:

- Mc Donald's intends to sell its food products to Indian customers
- For doing so, it has decided to set-up franchises in India
- The Indian franchises will use the trade name, brand, logo, etc. of Mc Donald's
- Indian franchises will work on the instructions of Mc Donald's. A detailed list of guidelines will be provided by Mc Donald's as to the manner in which the services are to be performed by Franchise
- The invoices raised by Franchisee would be on Hardcastle's letterhead as Franchisee of Mc Donald's - bearing the name, brand, logo of Mc Donald's

Issue:

- Will Franchise would constitute a PE of Mc Donald's?

Case Study 7 – EPC (Splitting of Contracts)



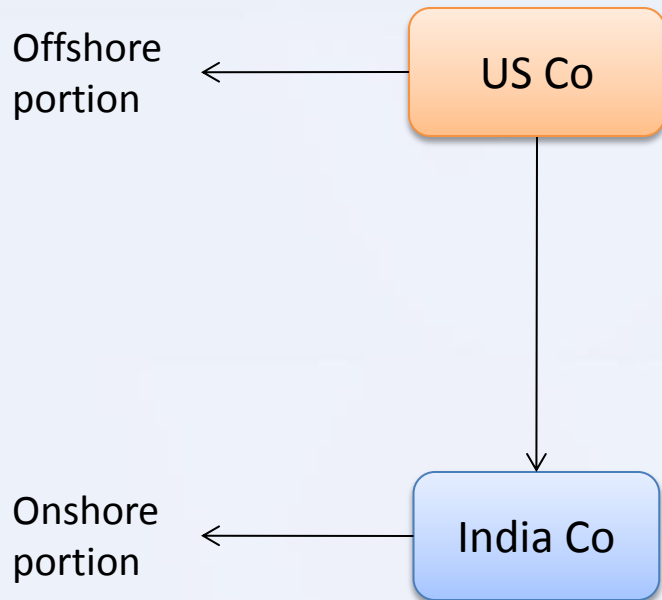
Facts:

- US Co bids for an EPC contract where in it has to undertake offshore supply of equipments, offshore services in the nature of design and engineering, onshore supply of spares and installation and commissioning of the equipments
- While executing the contracts, it signs a contract for offshore portion and makes its Indian subsidiary sign the contract for onshore portion

Issue:

- What are the tax issues that will be faced by US Co in India?

Case Study 7 – EPC (Splitting of Contracts)



Splitting of Contracts:

- Ishikawajima SC decision
- Vodafone
- Series AAR Rulings
- Dongfang – Kolkata ITAT
- Linde AG – Delhi HC

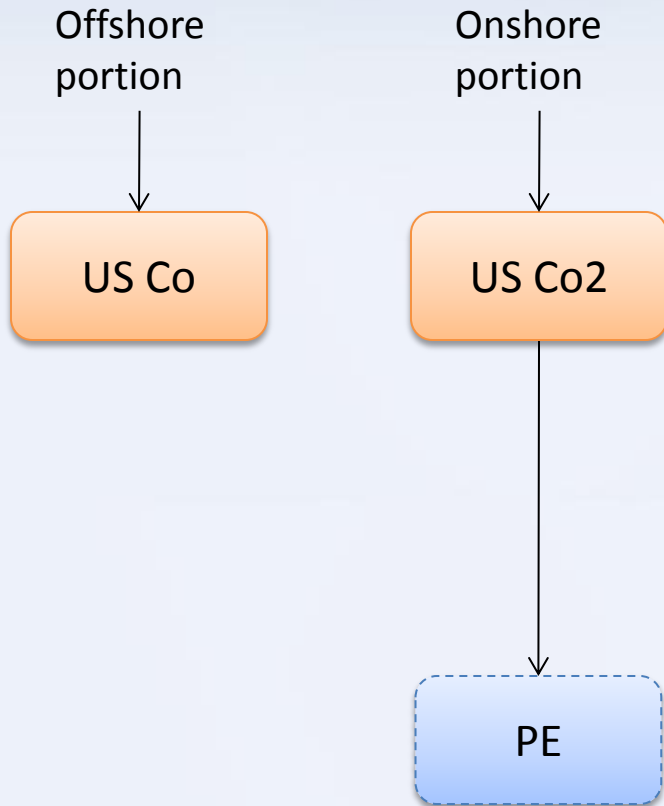
Constitution of PE:

- Even if contracts are split can India Co be regarded as PE of US Co.
 - Nortel Networks

Issue:

- What are the tax issues that will be faced by US Co in India?

Case Study 8(a) – EPC (Splitting of Contracts)



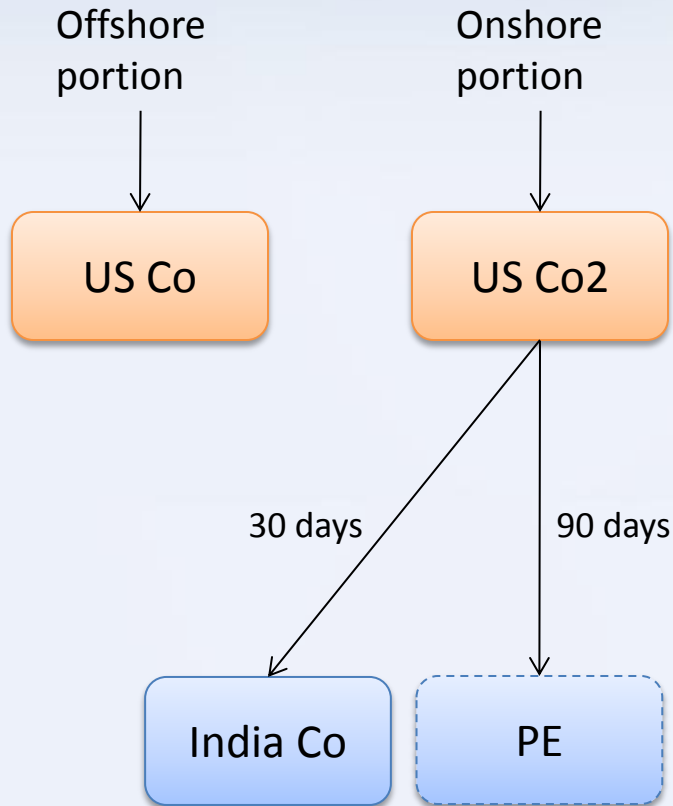
Facts:

- US Co bids for an EPC contract where in it has to undertake offshore supply of equipments, offshore services in the nature of design and engineering, onshore supply of spares and installation and commissioning of the equipments
- While executing the contracts, it signs a contract for offshore portion and makes its affiliate US Co2 sign the contract for onshore portion

Issue:

- What are the tax issues that will be faced by US Co in India?

Case Study 8(b) – EPC (Splitting of Contracts)



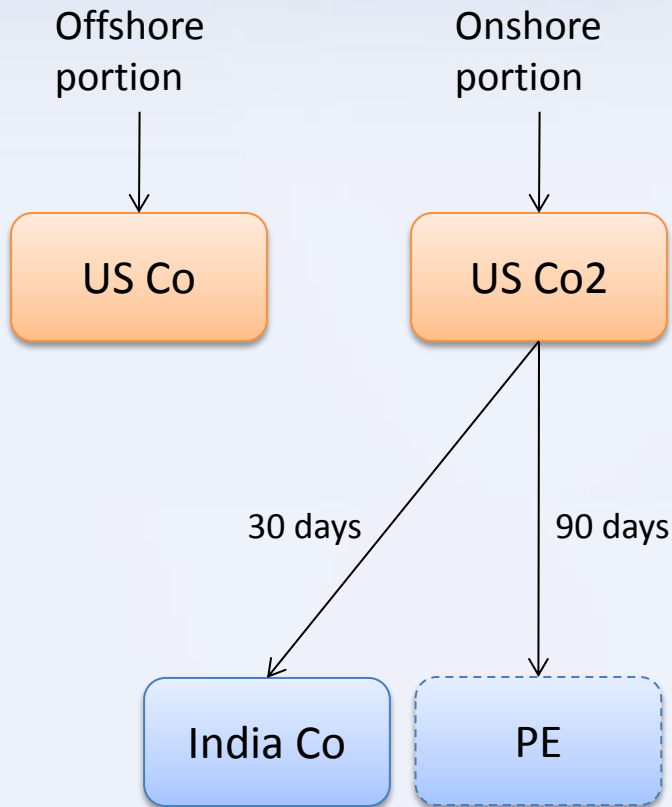
Facts:

- US Co bids for an EPC contract where in it has to undertake
 - offshore supply of equipments,
 - offshore services in the nature of design and engineering,
 - onshore supply of spares and
 - installation and commissioning of the equipments
- While executing the contracts, it signs a contract for offshore portion and makes its affiliate US Co2 sign the contract for onshore portion
- US Co2 in turn assigns part of onshore contract to its subsidiary - India Co –
- Balance portion of onshore contract executed by Installation PE

Issue:

- What are the tax issues that will be faced by US Co in India?

Case Study 8(b) – EPC (Splitting of Contracts)



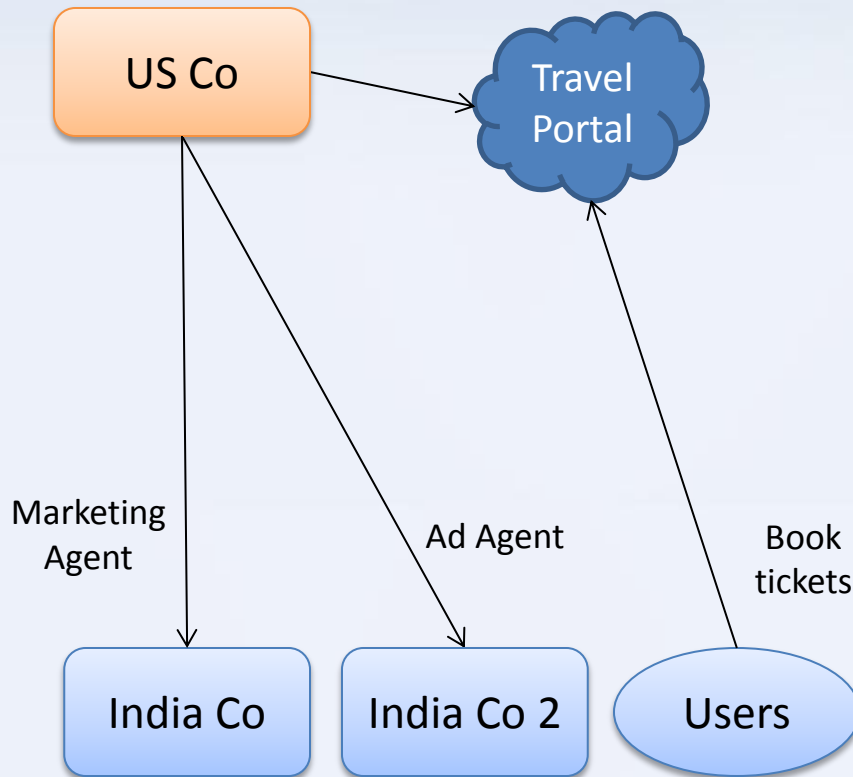
Constitution of PE:

- US Co has no business activity in India - no PE
- US Co 2 has subsidiary in India
 - Independently managed
 - Only supervisory activities by US Co2
 - Deputed employees salary cross charged to US Co2
 - No subsidiary PE
 - Efunds
- Installation PE executing major portion of onshore activities
 - Falls out of Installation PE definition as number of days less than 120

To Consider:

- PE of 'enterprise' not of a single tax payer
- Philip Morris – Italian SC
- AOP exposure

Case Study 9 – E-commerce



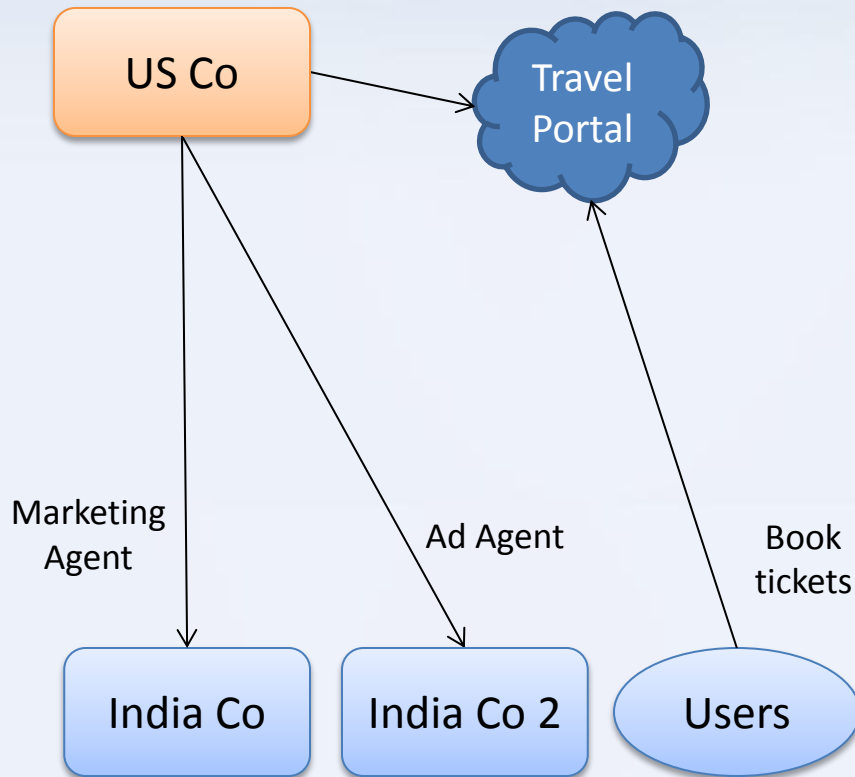
Facts:

- US Co provides online portal for travel services
- Portal hosted on cloud services managed by independent service provider
- Portal targeted for Indian users
- Accessed by Indian users from India for concluding transactions
- US Co appoints India Co. as Agent for marketing portal
- US Co appoints India Co 2 as Agent for soliciting customers for targeted ads at Indian users on travel portal

Issue:

- What are the tax issues that will be faced by US Co in India?

Case Study 9 – E-commerce



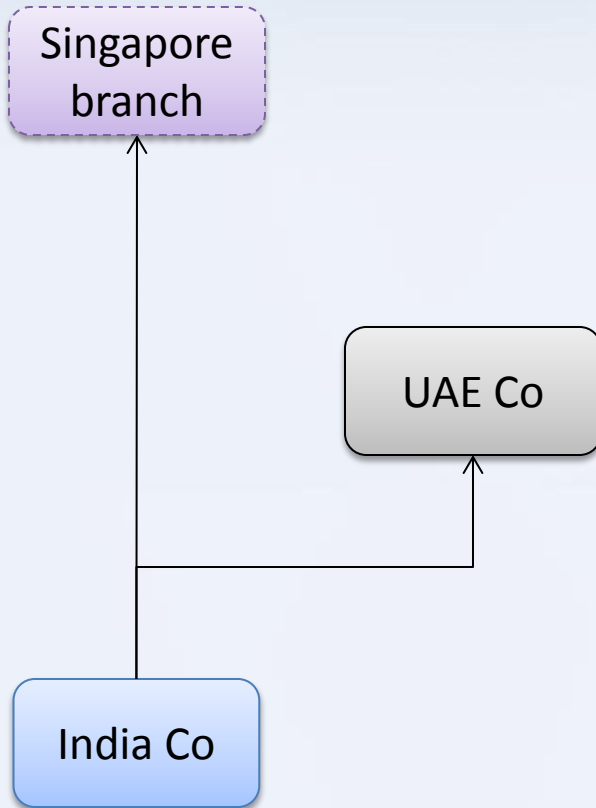
Constitution of PE:

- Virtual business activity
- PE definition based on Fixed Place
 - No Server, no fixed place in India

To consider:

- eBay International AG
- Right Florists Pvt Ltd
- Google's tax issues in UK and USA
- BEPS Action 1 – Digital Economy

Case Study 10 – Outbound I Obligatory PE



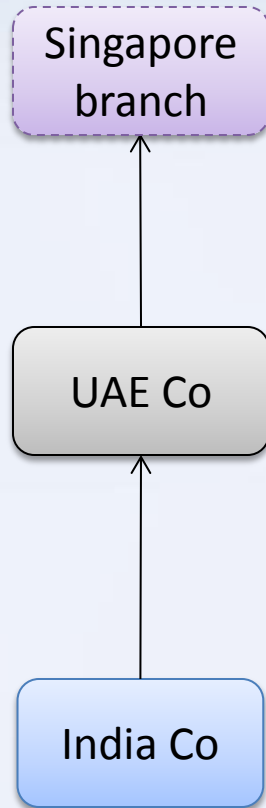
Facts:

- India Co has a wholly owned subsidiary in UAE
- India Co intends to undertake business activities in Singapore
- For the purposes of undertaking the said business activities, it has to set-up a branch in Singapore
- It carries out its entire Singapore business through this branch in Singapore

Issue:

- Can this transaction be structured better?

Case Study 10 – Outbound I Obligatory PE



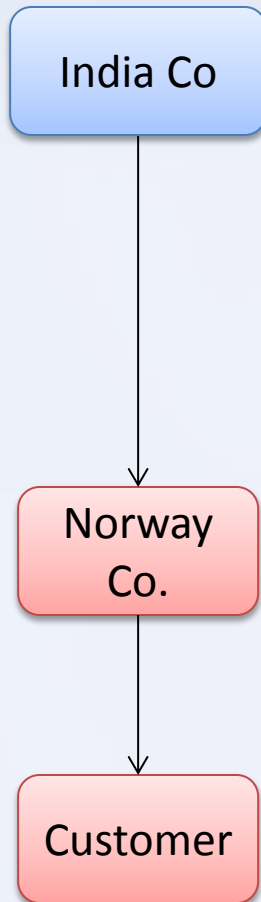
Use of UAE Co

- Branch of UAE Co
- PE of UAE Co in Singapore
- Taxability in India of income earned by Singapore branch

Issues to be kept in mind

- Control and management of UAE Co
- Substance test to be satisfied
- GAAR provisions

Case Study 11 – Commissionaire Model



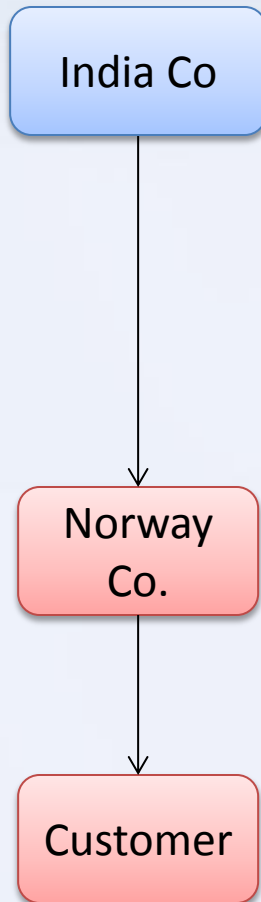
Facts:

- Norway Co. is Dependent Agent of India Co.
- India Co. acts as 'secret' principal
 - Possible under Civil law jurisdictions
 - Contract between customer and agent, though agent represents principal
 - Customer does not know the Principal exists

Issue:

- Will the Norway Dependent Agent constitute a PE of India Co.?

Case Study 11 – Commissionaire Model



Constitution of PE

- India Co. not bound by actions of Norway Co.
- No constitution of Dependent Agent PE in Norway of India Co.

In Favour

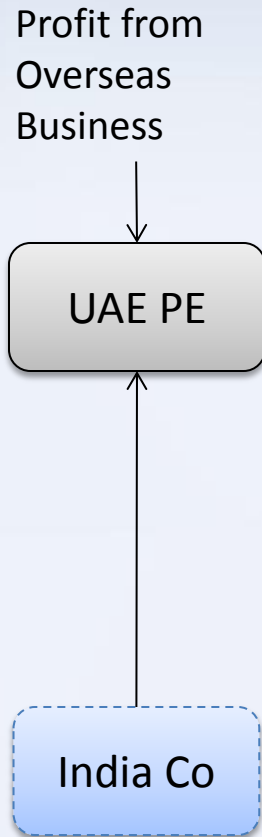
- Dell - Norway – 2011
- Zimmer – France - 2010
- Boston Scientific S.p.a. - 2012

Against

- Dell - Spain – 2012
- Roche Vitamins – Spain - 2012
- BEPS Action 7 specifically targets commissionaire model

Legalistic vs Substantialist Interpretation

Case Study 12 – Outbound PE



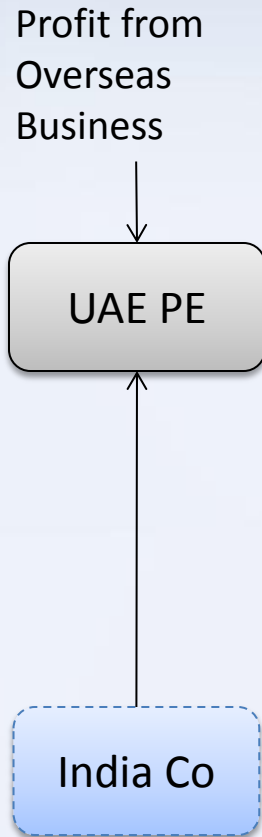
Facts:

- India Co has a branch set up in UAE
- It carries out its entire overseas business through this branch
- India Co wishes to claim that profits earned through and attributable to UAE branch should not be liable to tax in India

Issue:

- Is the claim made by India Co correct?

Case Study 12 – Outbound PE



Credit Method

- Credit Method vs Exemption Method
- India DTAA's follow which method
- Taxability in India

Judicial Backdrop

- PVAL Kuladangan Chettiar's case
- Patni Computers (Pune ITAT)
- Notification under section 90
- Protocol under Malaysia DTAA
- Sivagami - 2014

Buyer's Perspective – Issues to be kept in mind

- Payments made by Indian tax payers for services/goods provided by NR
- Withholding taxes to be deducted in case of PE
 - Based on tax officer's certificate
- Undertaking essential from payee
- Checking of conduct and correspondence
 - Negotiations and conclusion of contract by whom?
 - Website details?
 - NR employee's visiting cards, etc.
- If no PE, no income chargeable to tax
 - No tax required to be deducted at source, even if no PAN
 - Section 206AA does not apply

Thank You

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India-US DTAA – Agency PE Article 5(4)

- Notwithstanding the provisions of paragraphs 1 and 2, where a person -- other than an agent of an independent status to whom paragraph 5 applies -- is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first-mentioned State if:
 - (a) he has an habitually exercises in the first-mentioned State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 3 which, if exercised through a fixed place of business, would not make that fixed place of business a permanent establishment under the provisions of that paragraph;
 - (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 merchandise on behalf of the enterprise, and some additional activities conducted in that State on behalf of the enterprise have contributed to the sale of the goods or merchandise; or
 - (c) he habitually secures orders in the first-mentioned State, wholly or almost wholly for the enterprise.