

# International Taxation - Business Profits

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# Overview on Articles of Tax Treaty

## Tax Treaty eligibility – Basic Provisions

- Article 1 – 'Scope' of tax treaty
- Article 3 – defines the term 'Person'
- Article 4 – lays down the 'Residence' test

Varies from treaty to treaty

# Overview on Articles of Tax Treaty

## Article 5 – Permanent Establishment ('PE')

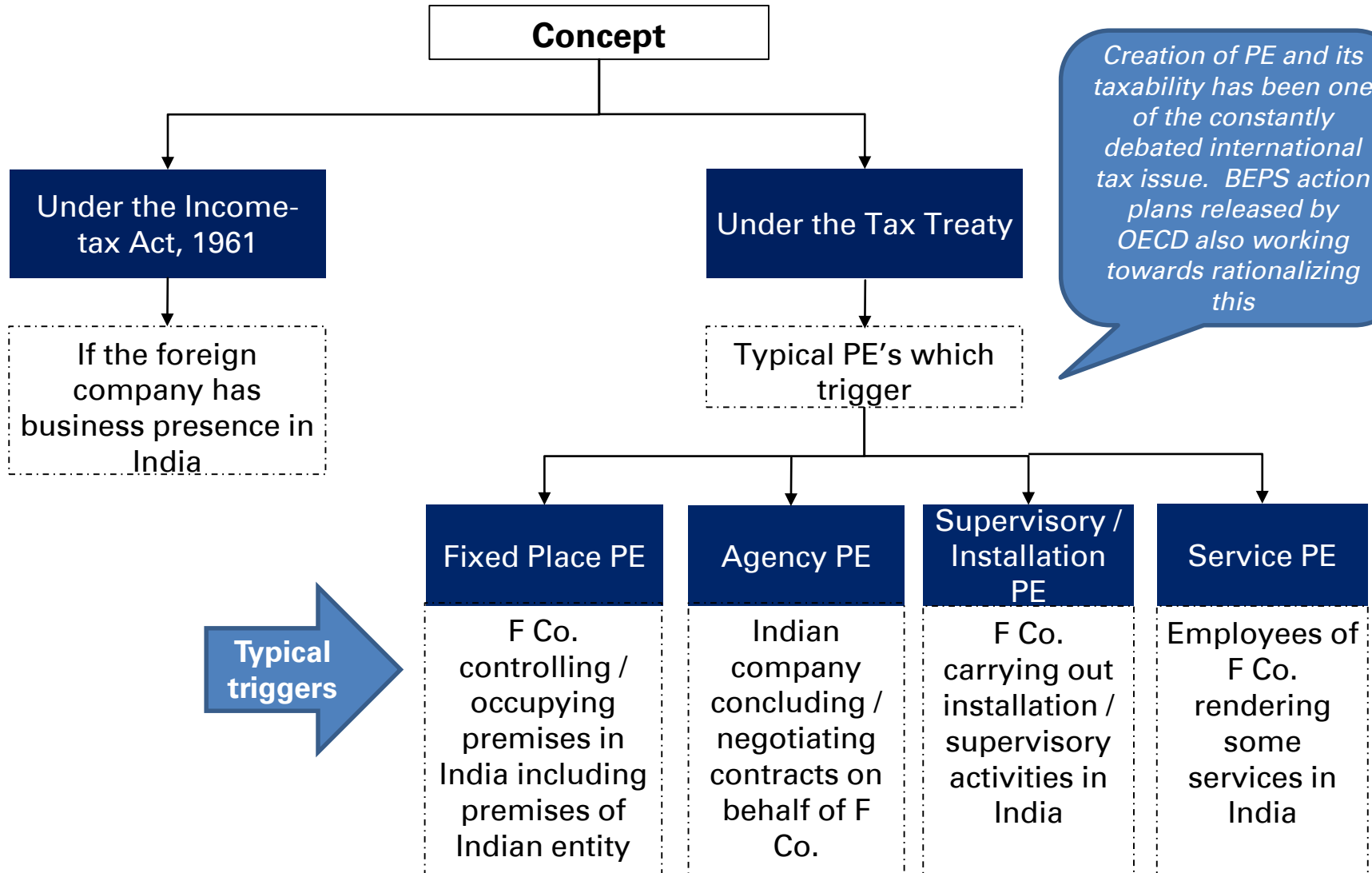
### Permanent Establishment

**Artificial entity created for taxing the income of a non-resident from business operations carried out by it in India.**

**Foreign enterprise constitutes a PE in case conditions provided in the tax treaty are satisfied.**

**Profits attributable to the PE are taxable in that country.**

# Overview on Articles of Tax Treaty

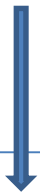


# Overview on Articles of Tax Treaty

## Article 7 – Business Profits

Residence State

**Enterprise**



Source State

**Constitution  
of PE**

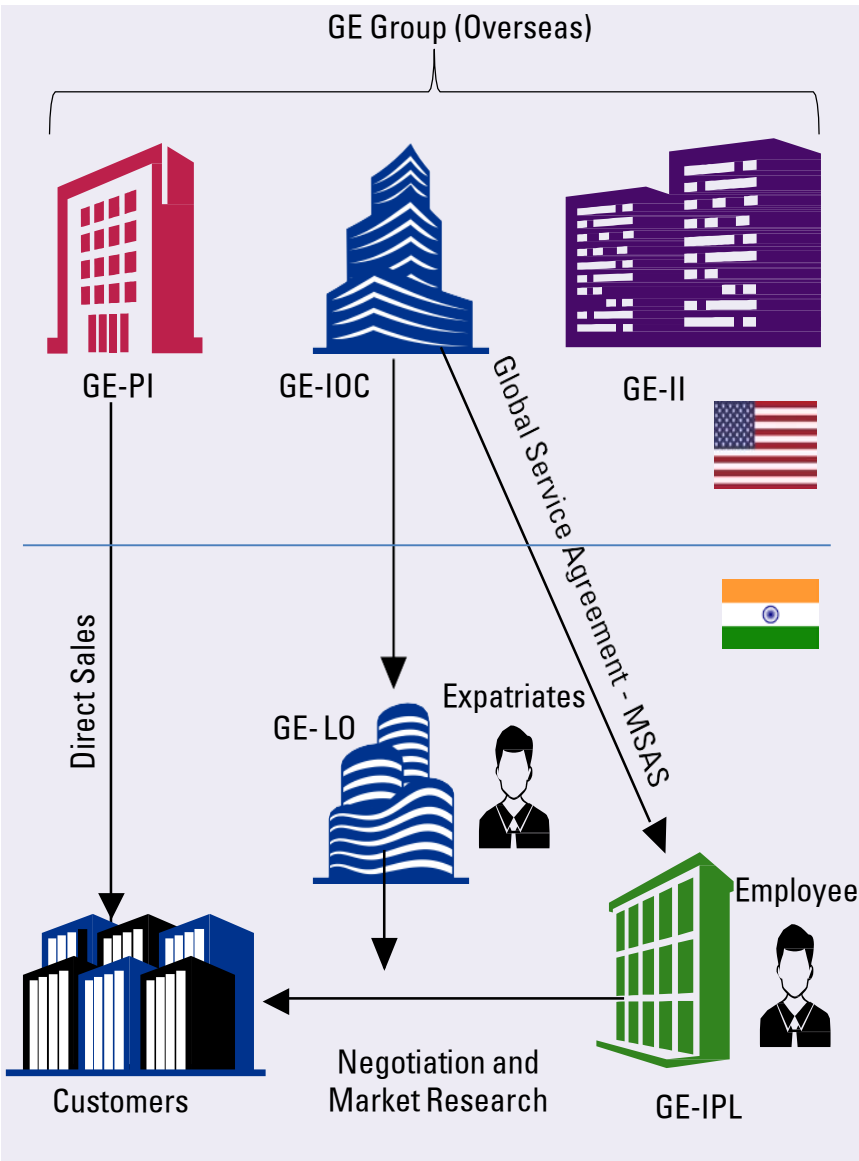


**Attribution  
of Income**

7(1)	<b>Charging Provision</b>
7(2)	Basis of Profit Attribution
7(3)	<b>Expense Deduction</b>
7(4)	Apportionment of Profit (if customary)
7(5)	<b>Consistency</b>
7(6)	Residual Article

GE Energy Parts Inc.  
(IT Appeal No 621 of 2017)  
(Delhi HC)

# GE Energy Parts Inc. - Facts



1. GE Energy Parts ('GE-PI')- Engaged in manufacture and offshore sale of highly sophisticated equipment.
2. General Electric International Operations Company Inc. ('GE-IOC') is related to GE-PI and has LO in India- for acting as communicating channel for GE-Group.
3. GE International Inc. ('GE-II') is a related entity, responsible for payroll of expats. GE-IOC has over 50 expats working for Indian operations.
4. GE India Industrial Pvt. Ltd. (GE-IPL) is an Indian entity and provides market support services (MSS) to GE Group.
5. GE-IPL enters into a global services agreement with GE-IOC for MSS and is remunerated on cost plus basis.
6. GE Group in US has expatriated its employees to India for carrying/ overlook the marketing activities.
7. Expats of GE group often use the premises of GE-IPL/ GE-LO.



# GE Energy Parts Inc. - Issues Under Consideration



**Indian office  
constitutes Fixed  
Place PE?**



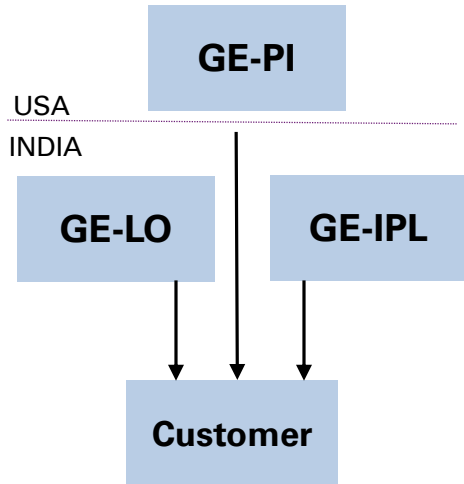
**Attribution of Profits**



**Dependent Agent PE**

**Participation = Conclusion?**

# GE Energy Parts Inc.



## Demonstration by revenue authorities that expats were not limited to preparatory and auxiliary activities – Basis survey documents

1. **Pre-Qualification stage** – Expats/ Employees identify business opportunities / leads. Also, furnishes details of market trends, policy changes, etc.
2. **Bid/No-Bid**  
Assessee – On identifying business opportunity, GE overseas decides to pursue the opportunity and develops the proposal.  
Revenue – Some proposal development are jointly run by GE overseas and GEIPL.

### 3. Bid Approval and Negotiation

Assessee – GE overseas negotiates with end customer, address their queries, provide clarifications.  
Revenue – Active participation of GEIPL in finalizing MOU with end customer, GEIPL also reviews and revises offer based on discussions, responds to the queries of end customers.

### 4. Final Contract and Approval

Assessee – Based on negotiation process, GE overseas signs the contract.  
Revenue – Material changes brought by expats / GEIPL before finalization and execution.

Submissions in contradiction with survey documents

## Stages of Sales Activities

### 1 Pre-qualification

### 2 Bid / no bid

### 3 Bid Approval

### 4 Final contract and approval

# GE Energy Parts Inc.

## Marketing activities are not preparatory and auxiliary

- Mere fact that the contract were formally signed outside India does not undermine the core activity.
- Without marketing activities, GE group could not have earned USD 1 billion.

## Agency PE

- LinkedIn / emails used to demonstrate participation = conclusion.
- Authority to conclude does not mean it has to be core in nature. Rather, participation in the phase of conclusion would also fall within the concept of conclusion of contract.

## Key Highlights of the Judgement

## Agency PE

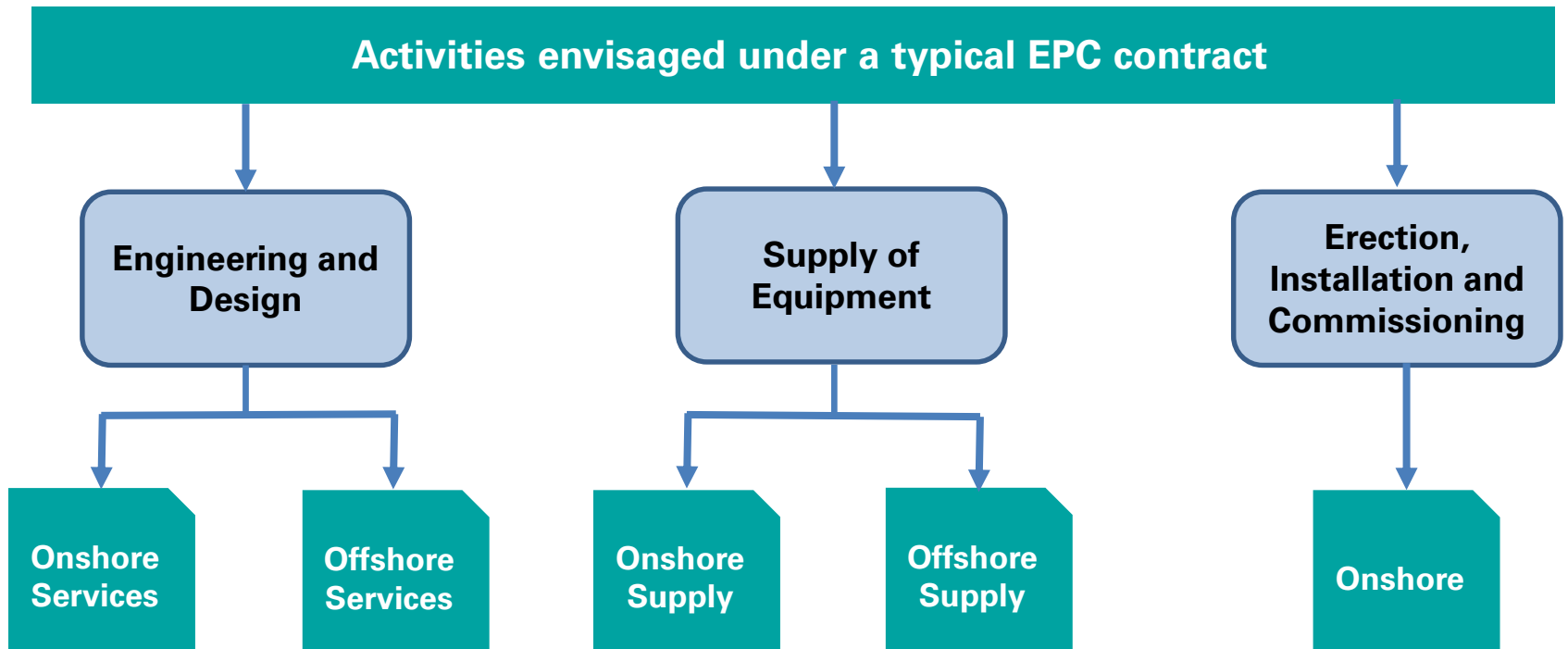
- Use of premises by expats-satisfies disposal test.
- Despite tech business, marketing is core business activity and not preparatory / auxiliary.

## Attribution

- Factual matrix checked by ITAT to determine attribution rate doesnot require reconsideration in light of other decisions.
- TPO analysis of ALP transactions of Indian subsidiary doesnot mean transaction with deemed PE is at ALP.

# EPC Contracts

# Key Components of an EPC Contract



# EPC Contracts

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A vertical light blue scroll-like graphic with rounded corners and a shadow. The text 'AOP Overview' is centered within it.

## AOP Overview

**AOP is a distinct taxable entity separate from its members, not having any legal presence.**

**Constitution of AOP between two or more persons depends upon arrangement between them, other factors and extent of collaboration between them.**

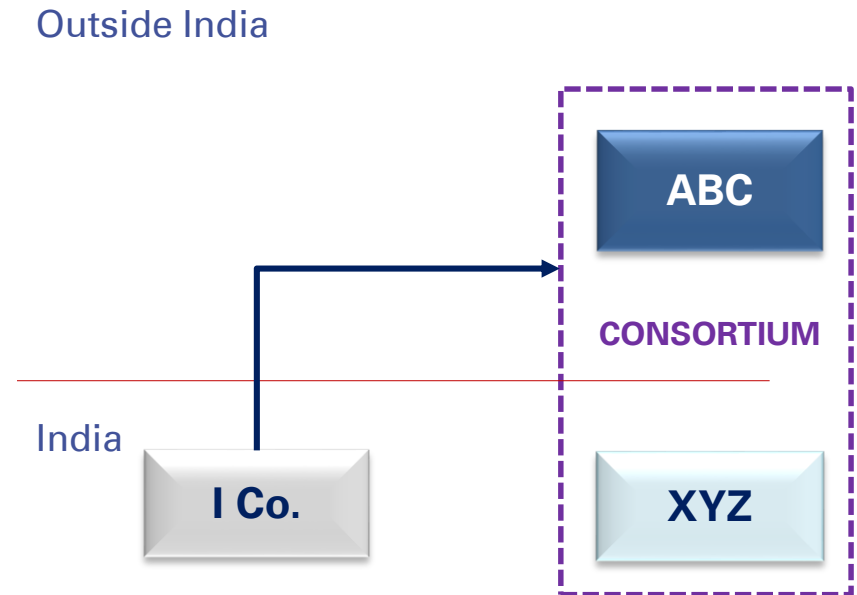
**AOP is a person resident in India unless its control and management is wholly situated outside India.**

**Very common for tax authorities to conclude that an arrangement is an AOP.**

# EPC Contracts - Consortium

## MECHANICS

- Consortium of ABC and XYZ bid for a project in India.
- Single contract is awarded to the consortium.

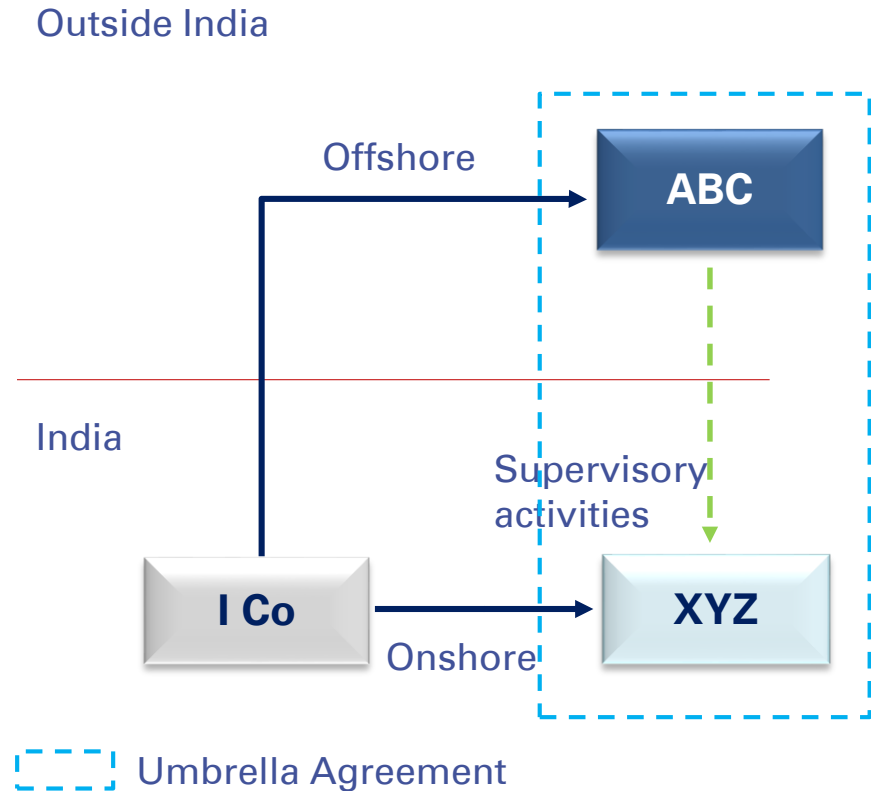


**What will be the implications in the hands of Consortium?**

# EPC Contracts - Split

## MECHANICS

- I Co. awards two separate contracts for offshore and onshore activities to ABC and XYZ respectively.
- ABC separately enters into a supervisory agreement to oversee work to be done by XYZ India.
- ABC and XYZ enter into an umbrella agreement.



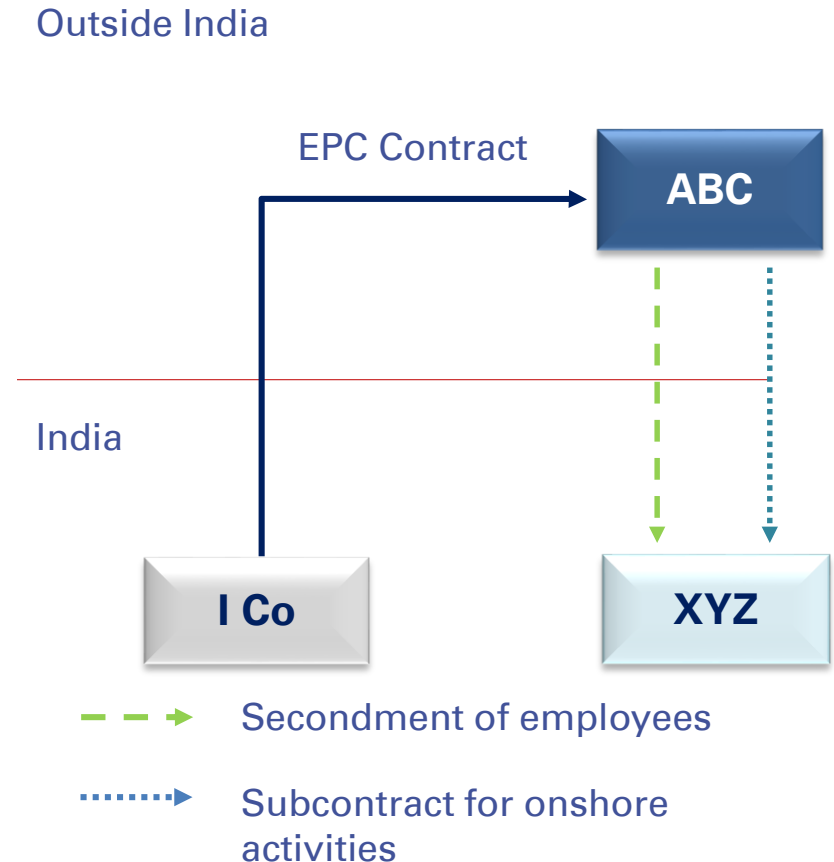
**What will be the implications in the hands of ABC?**



# EPC Contracts - Secondment

## MECHANICS

- I Co. enters into an EPC Contract with ABC.
- ABC sub contracts onshore related scope to XYZ.
- ABC second its employees to XYZ.



What will be the implications on secondment arrangement?

# EPC Contracts - Secondment

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## Employee Secondment (Points for Consideration)

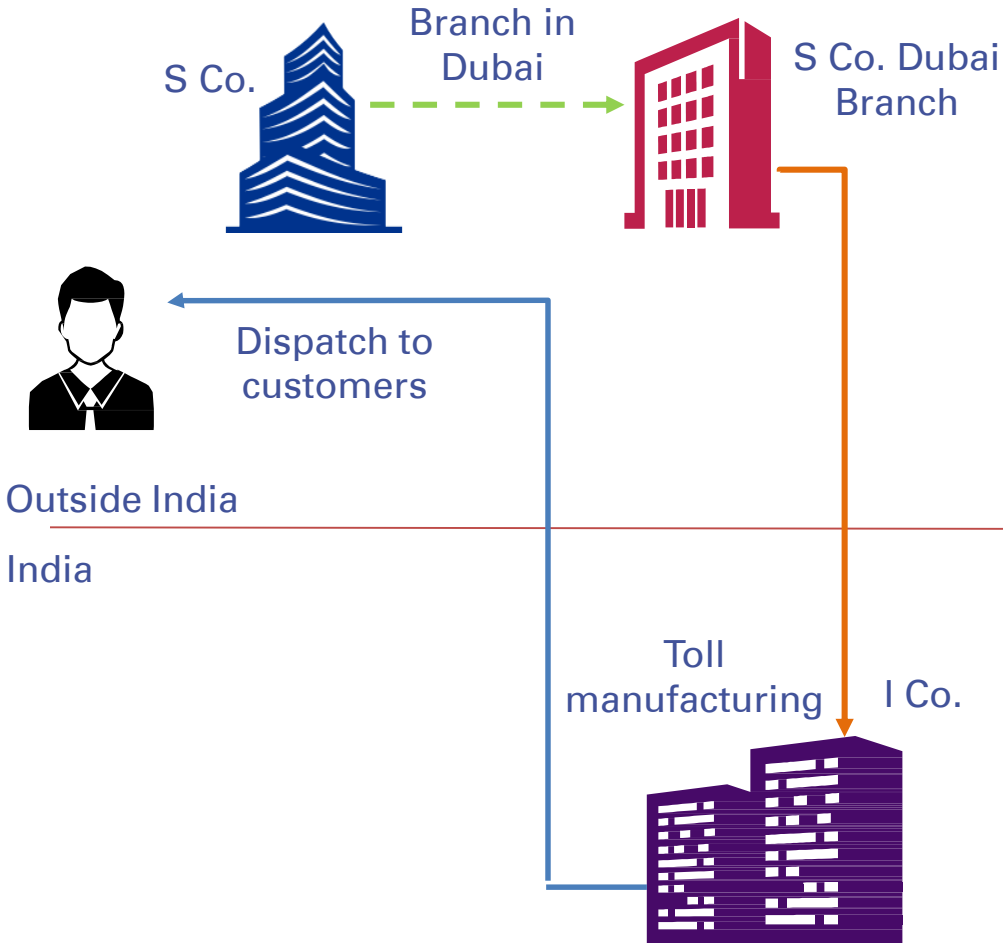
**Presence of employees of foreign entity in India may create a PE of that entity in India.**

**If such presence is created, offshore supply and services may get taxed in India.**

**Taxability of payments under Secondment – Whether contract of service or contract for service.**

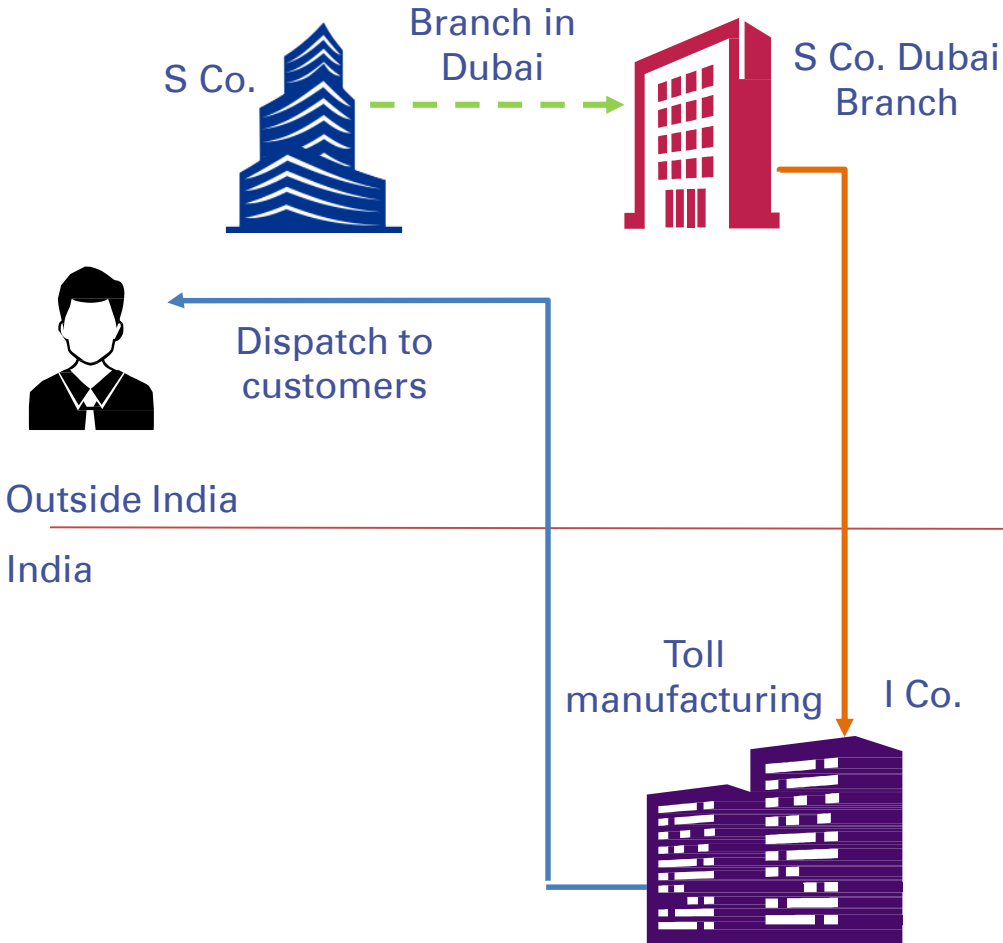
# Branch Activities in India

# Branch Activities in India



- Switzerland based company ('S Co.!) is in the business of manufacturing and sale of pharmaceutical products.
- S Co. has a branch in Dubai.
- Dubai branch appoints I Co. for undertaking toll manufacturing of products.
- I Co. shall manufacture and directly dispatch the products to Dubai branch customers in USA and UK.
- Title to goods passes outside India and ownership of goods at all times lies with the Dubai branch.
- I Co. is remunerated at cost plus margin basis.

# Branch Activities in India



## Questions

**1) Tax implication of Dubai branch in India?** →

**2) Tax implication of S Co. in India?** →

# Branch Activities in India

## India UAE DTAA

### Article 3 – General Definitions Definition of the term ‘Person’

1(a).....

(b) .....

(c) .....

(d) .....

*(e) the term "person" includes an individual, a company, and any other entity which is treated as a taxable unit under the taxation laws in force in the respective Contracting State.*



# Branch Activities in India

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## India Swiss Confederation DTAA

### Article 5 – Permanent Establishment

*1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of the enterprises is wholly or partly carried on.*

# Branch Activities in India

## India Swiss Confederation DTAA

### Article 5 – Permanent Establishment

3. The term "permanent establishment" shall not be deemed 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 for collecting information, for the enterprise;
  - (e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade or business of the enterprise;
  - (f) the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (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.



# Branch Activities in India

## India Swiss Confederation DTAA

### Article 5 – Permanent Establishment

*5. A person acting in a Contracting State for or on behalf of an enterprise of the other Contracting State ...other than an agent of an independent status to whom paragraph 6 applies... shall be deemed to be a permanent establishment of that enterprise in the first-mentioned State if :*

- i. he has and habitually exercises in that State, an authority to negotiate and enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise; or*
- ii. he habitually maintains in the first-mentioned Contracting State a stock of goods or merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or*
- iii. in so acting, he manufactures or processes in that State for the enterprise goods or merchandise belonging to the enterprise, provided that this provision shall apply only in relation to the goods or merchandise so manufactured or processed.*

# Branch Activities in India

## India Swiss Confederation DTAA

### Article 5 – Permanent Establishment

*6. 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. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it, he would not be considered an agent of an independent status within the meaning of this paragraph.*

# Equalisation Levy

# Equalisation Levy - Overview

## Chargeability

Equalization Levy ('EL') to be deducted at the rate of 6% on amounts paid or payable to a non-resident, not having a PE in India for specified services.

## Specified Services

- Online advertisement; or
- Any provision for digital advertising space; or
- Any other facility or service for the purpose of online advertisement; or
- Any other service as may be notified by the Central Government.

## Payer

- Any person resident in India carrying on business or profession in India, or
- A non-resident having a PE in India.

## Exclusions

- Recipient i.e. the non resident has a PE in India and such income is effectively connected to the PE.
- Income does not exceed Rs. 100,000
- Payment is not for carrying out business or profession i.e. Equalization Levy would apply only on B2B transaction.

# Equalisation Levy - Some thoughts

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## Subsequent Constitution of PE

Constitution of PE in India has always been a litigative issue. In case PE is alleged at assessment stage, whether EL would be adjusted with future tax liability of income or would it be refunded to payers?

## Uncertainty on scope of "other"

Whether the scope of "other facilities/services" includes only virtual/online services or extends to the ancillary or incidental services (other than online) as well?

## Taxation of Composite Contracts

In a scenario where advertisement is a part of the contract with lump sum consideration – How will EL be charged?

# Force of Attraction

# Force of Attraction - Overview

## Article 7 Para 1 of the UN Model Convention

“The profits of an enterprise of a Contracting State shall be taxable only in that State unless the

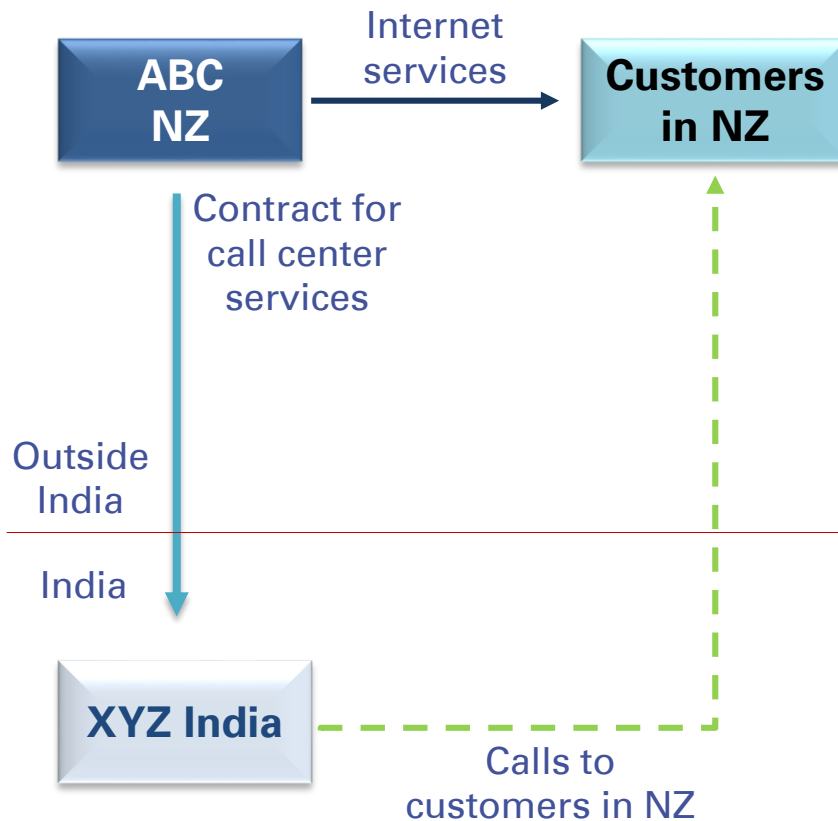
..... may be taxed in the other State but only so much of them as is attributable to

- (a) that permanent establishment;
- (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.”

**‘Force of attraction’ rule not present in OECD Model Convention**

# Force of Attraction - Case Study

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- ABC NZ is engaged in the business of rendering internet services to customers in New Zealand.
- ABC has engaged third party service provider in India for sales support / call center activities for customers based in New Zealand.
- ABC NZ also renders cellular services to its customers in New Zealand. However entire back office operations pertaining to cellular services, are done in India by another third party.



# Force of Attraction

## Role of XYZ in India

- Outbound calls to prospective customers from a list of leads provided by ABC NZ.
- Explain features / products and offer discounts.
- Pre-determined price range provided to XYZ India employees basis which they can roll out offers to customers. Additional discounts can be offered post approval from manager of XYZ.
- If customers agree, XYZ India shall perform checks. Once approved, confirmation email goes to customers in New Zealand. If no approval is received, the application is rejected.

# Force of Attraction

## Issues under Consideration

Whether XYZ India constitutes dependent agent PE in India?

If Yes, whether income from cellular service is also attributable to PE on account of force of attraction provision in DTAA?

# Force of Attraction

## Points for Consideration while determining PE

- Do employees of XYZ India have authority to conclude contracts on behalf of ABC NZ?
- Is XYZ India, an independent agent?
- Will adequate remuneration solve the issue?

## Force of attraction

### India – New Zealand DTAA: Article 7 – Business Profits

1. *The profits of an enterprise of a Contracting 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 enterprise may be taxed in the other State but only so much of them as is attributable to (a) that permanent establishment or, (b) sales in that other State of goods or merchandise of the same or similar kind as those sold through that permanent establishment.*

# Thank you

The information contained herein is of general nature and is not intended to address the circumstances of any particular individual or entity. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.