

Varying tax perceptions of the Permanent Establishment and the approach of judicial authorities towards them



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Option B : 5pm to 7.30pm

**Formula One World
Championship Ltd (FOWC)
(SC)**

Formula One World Championship Ltd (FOWC) (SC)

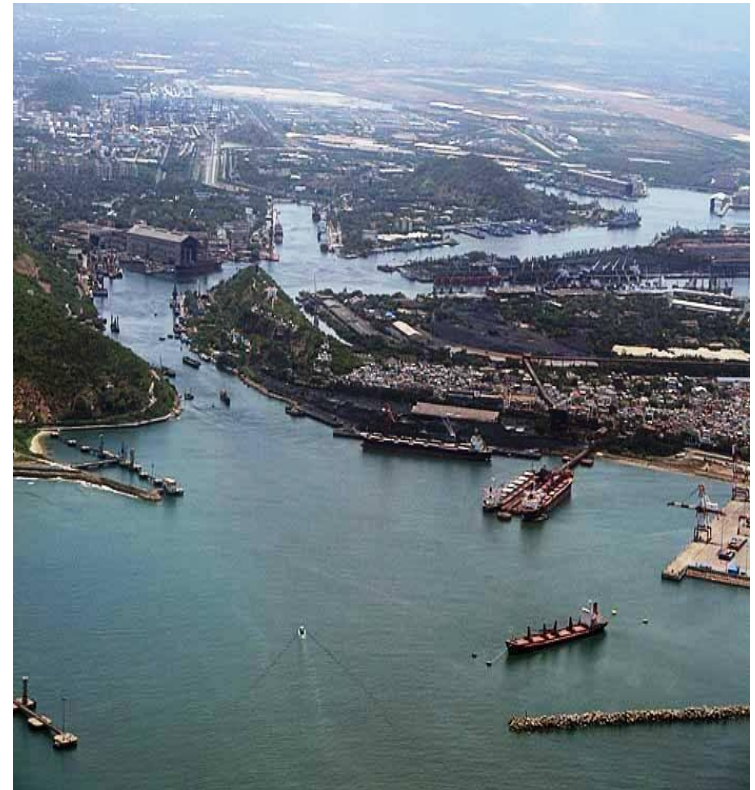
- Guidance from SC
 - **Disposal test** : Wholesome reading of agreements to identify party having real and dominant control
 - **Permanence test** : Permanence in fixed place could be relative having regard to nature of business
 - Observation related to **virtual projection**
- OECD Commentary
 - General threshold – six months
 - Exceptions
 - Where business can be carried out in short period
 - Recurrent activities



Virtual Projection & Permanent Establishment

PE as a Virtual Projection

“**50.** In our opinion, the words 'permanent establishment' postulate the ***existence of a substantial element*** of an enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country. It should be of such a nature that it would amount to a ***virtual projection*** of the foreign enterprise of one country into the soil of another country.”



Vishakhapptnam Port Trust [1983] 15 Taxman 72 (AP)

Virtual projection as a PE?

73. Hon'ble Andhra Pradesh High Court, in the landmark judgment in the case of *CIT v. Visakhapatnam Port Trust* [\[1983\] 144 ITR 146/15 Taxman 72](#), had observed as follows:

74. Clearly, therefore, even existence of a PE amounts to virtual projection of a business in the tax jurisdiction in which the PE is situated. When a business entity has a virtual projection in another tax jurisdiction, it would, in our humble understanding, essentially imply that such an entity is carrying on business in the jurisdiction in which such a PE is situated.

Qualcomm Incorporated v. ADIT
[2015] 56 taxmann.com 179 (Delhi - Trib.)



**Virtual projection as
a standalone /
additional test for
PE?**

Virtual projection

- **76.** *We are of the opinion that the test laid down by the Andhra Pradesh High Court in Visakhapatnam Port Trust case fully stands satisfied. Not only the Buddh International Circuit is a fixed place where the commercial/economic activity of conducting F-1 Championship was carried out, one could clearly discern that it was a virtual projection of the foreign enterprise, namely, Formula-1 (i.e. FOWC) on the soil of this country.*

[Formula One World Championship Ltd. v. CIT [2017] 80 taxmann.com 347 (SC)]



**Virtual projection as
an additional test for
PE?**

Virtual projection

- Basic rule PE test are not necessarily the test to determine whether there is a “virtual projection or not”. Where the transactions are not at arm’s length, when “virtual projection” can be held de hors the fixed place PE test, it would be treated as a PE
- **Nokia round 1 SB**
- Interprets Formula One as providing “the fixed place acts as a virtual projection of the foreign enterprise
- **Nokia [2018] 94 taxmann.com 111 (Del trib)(SB)**
- **Round 2 SB – Majority**
- It cannot be a case that even when all the preconditions of the basic rule PE are satisfied, there is no basic rule PE because there is no virtual projection.
- **Nokia [2018] 94 taxmann.com 111 (Del trib)(SB)**
- **Round 2 SB – Minority**

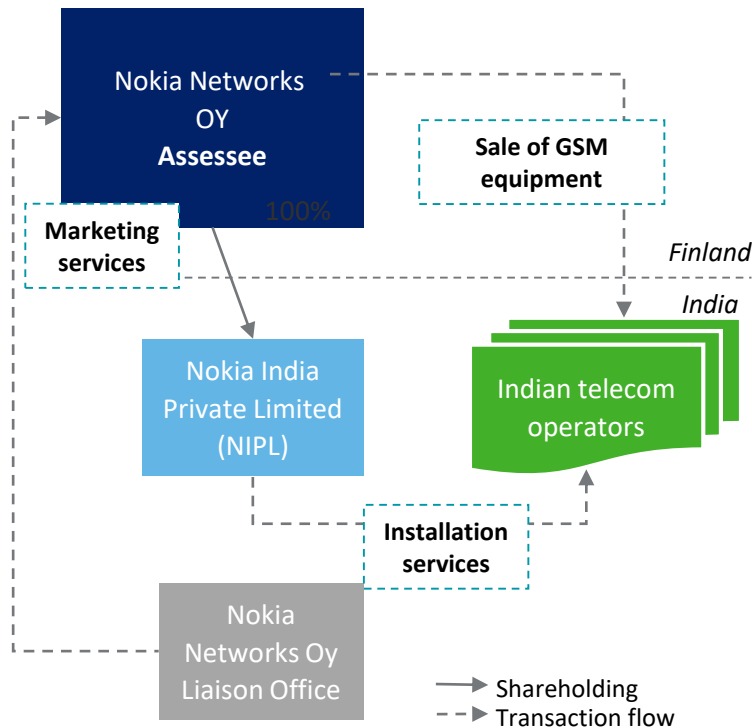
India Observations on OECD Commentary

Paragraph of OECD Commentary	India position
Para 27 – Satellite’s footprints [2010]	Source state contributes its customer base and provides infrastructure for reception of the satellite telecast. A satellite’s footprint falls both in the international and national space. The footprint has a fixed location, has a value and can be used for commercial purposes. Accordingly, it can be treated as fixed place of business in space in the jurisdiction of source country
Para 123 – Website [2008, 2017]	Website could constitute PE when it leads to significant economic presence of the enterprise

Nokia Networks OY v. JCIT
[2018] 94 taxmann.com 111
(Delhi - Trib.) (SB)
Alter Ego

Nokia Networks OY v. JCIT

[2018] 94 taxmann.com 111 (Delhi - Trib.) (SB)



- AY 1997-98 and 1998-99
- Nokia, Finland tax resident, engaged in manufacture of advanced telecommunication systems and equipment (GSM equipment)
- Indian LO (1993), advertising activity
- Nokia sold equipment manufactured in Finland, to Indian telecom operators, on a principal-to-principal basis and also entered into installation contracts
- Subsidiary Nokia India Pvt. Ltd. (NIPL) was established in 1995. Thereafter, installation activities (including existing contracts) were carried out by NIPL
- Nokia's undertaking on the performance of NIPL and retention of 51% ownership (customer consent for transfer)
- Seconded employees.

Nokia Networks OY v. JCIT

[2018] 94 taxmann.com 111 (Delhi - Trib.) (SB)

Findings – Majority view

- No fixed place PE
- Disposal test is paramount – Formula One (SC)
- Observations on virtual projection
- Fixed place PE does not get established by making reference to provision of telephone, fax and car facility to visiting employees
- Subsidiary cannot be reckoned to constitute PE, merely because it is controlled by Nokia

Findings – Minority view

- When a subsidiary company is merely an alter ego, or virtual projection of its parent company, in the sense that it has no significant activities of its own or on behalf of persons other than the non-resident parent company, it must be treated as a PE of the parent company in India

Features of 'alter ego' conclusion

- For all the contracts signed by I Co with the third parties for installation, the equipment / machines were sold by the parent F Co. Without installation support the contract may not happen
- I Co shown as having significant experience, although recently incorporated
- Key employees of I Co were all employees of the F Co seconded to India.
- Performance guarantee given by F Co to the customers of I Co. for installation work
- 51% ownership to be continues
- No consideration given by I Co to F Co for the performance guarantee given by the F Co.
- Any notice sent by the I Co's client to I Co was also required to be sent by such client to the F Co.
- F Co was required to compensate I Co at cost plus 5% and the contract between the two provided for quarterly billing. Invoices were not raised regularly. The delay in raising invoice meant that return on the cost incurred by I Co was not at arm's length and did not even cover the time value of the cost incurred by I Co.
- Installation services rendered to the Indian customers by I Co resulted in huge losses for I Co – F Co artificially allocated lesser amount of the total consideration for the activities to be performed by I Co
- Incorporation of I Co. was a device to artificially block creation of a PE
- No consideration charged for support services

Associated PE / Direct PE	Unassociated PE / Indirect PE	Construction related PE
Establishment forms part of the same entity <ul style="list-style-type: none"> • Branch • office 	Establishment does not form part of the same entity <ul style="list-style-type: none"> • An agent • Alter ego subsidiary without significant independent activity of its own 	
Disposal test must be satisfied	Disposal test need not be satisfied	
	Alter ego subsidiary PE not under Article 5(5) but under Article 5(1)	

**MasterCard Asia Pacific Pte.
Ltd., In re. [2018] 94
taxmann.com 195 (AAR - New
Delhi)**

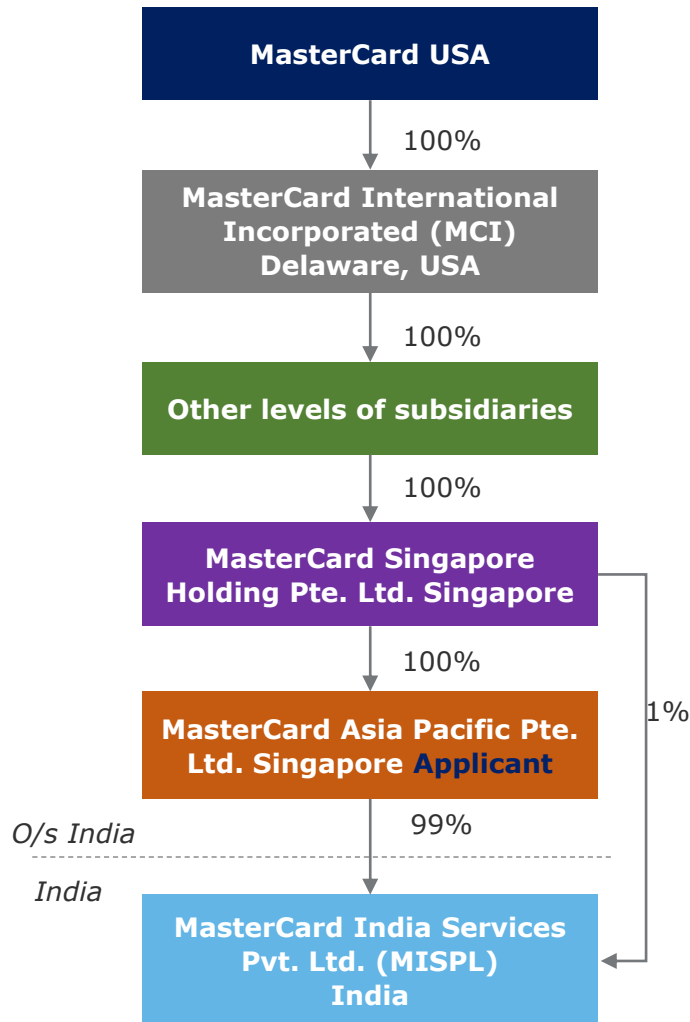
*PE through multiple factors including system and
network*

MasterCard Asia Pacific Pte. Ltd., In re.

[2018] 94 taxmann.com 195 (AAR - New Delhi)

Facts

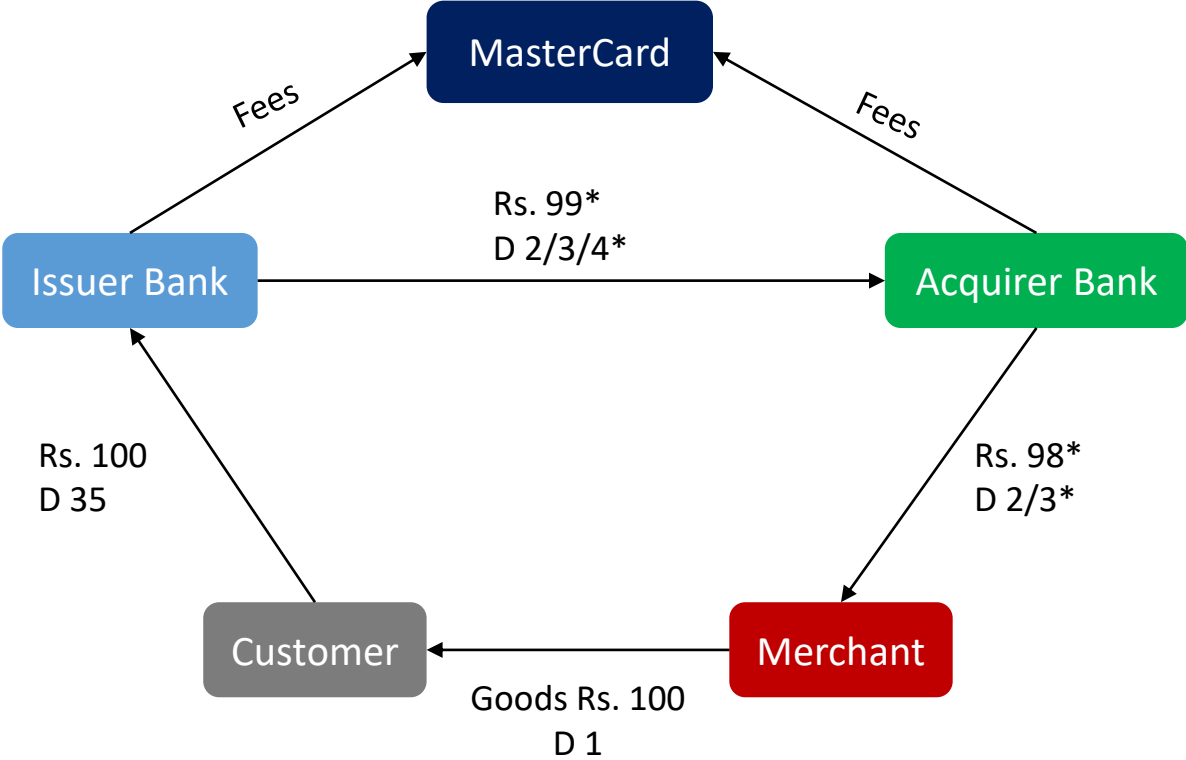
- Applicant is a group company of MasterCard. Applicant is the regional headquarter for Asia-Pacific region
- Applicant enters into Master License Agreements (MLA) with various customers in the Asia-Pacific region, including India. These customers are mainly banks and other financial institutions.
- The main business of the applicant consists of authorization, clearance and settlement of transactions between its customers for which it charges a fee.
- Activities :
 - Authorization
 - Clearance
 - Settlement



Difficulty in facts

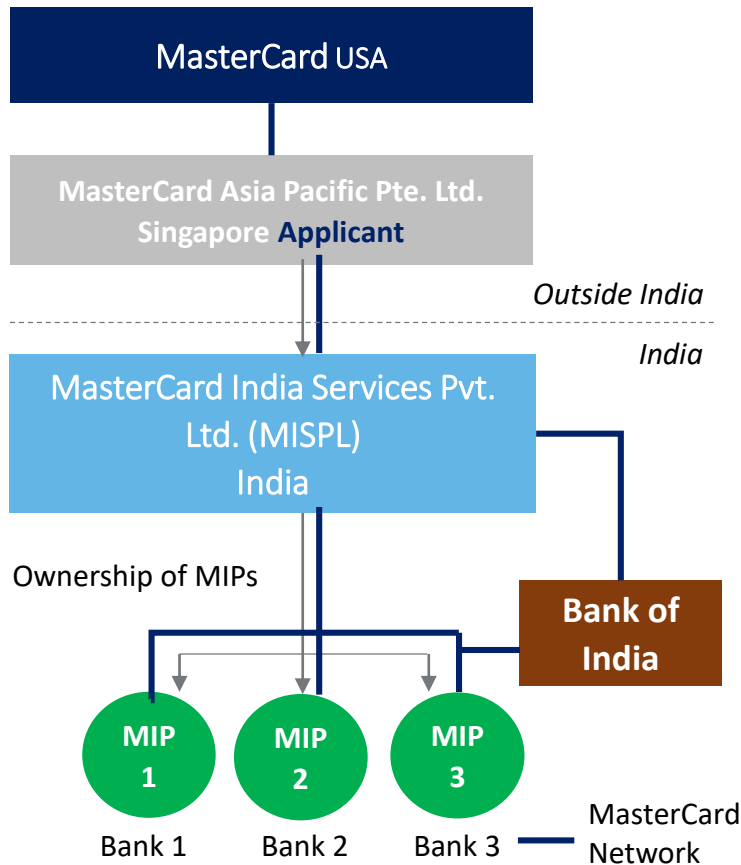
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* Days and amounts are only indicative

On fixed place PE through MasterCard Interface Processors (MIPs)



- MIPs constitute a fixed place since there is no condition of attachment to ground
- Permanency test is also satisfied.
- MIP activities not preparatory.
- Legal ownership of MIPs with MISPL
- The MIPs are controlled by the applicant through agreement with customer banks. There is no agreement between MISPL and the customer banks
- All risk mitigation functions are performed by the applicant and all decisions with respect to MIPs are taken by it (like repairs, upgradation).
- The software inside MIPs is also admitted to be owned by the applicant and is upgraded by third parties on behalf of the applicant.

On fixed place PE through MasterCard Network

- MasterCard Network in India consists of MIPs owned by Indian subsidiary, transmission tower, leased lines, fiber optic cable, nodes and internet- owned by third party service provider, and application software - Master Connect and Master Card File express, owned by the applicant.
- Finding of the AAR on Network
 - Passes disposal test as one of the MasterCard US entity is responsible for maintenance of worldwide network remotely from the USA.
 - Application software are owned by the Applicant and controlled by them and are therefore at the disposal of the Applicant.
 - The part of network provided by third party service provider in India is also at the disposal of the Applicant. It was admitted that the network in India is secured by MasterCard to prevent fraud and to enhance security.
 - The MasterCard network in India creates a fixed place PE.
- While the AAR has held the “network” to be resulting in Article 5(1) PE, most part of the discussion is in the context of usage of software in India and the AAR has placed reliance on the previous rulings of the Delhi Tribunal in the case of **Galileo** and **Amadeus**.
- The reason given for third party network resulting in PE is minimal. ¹⁹

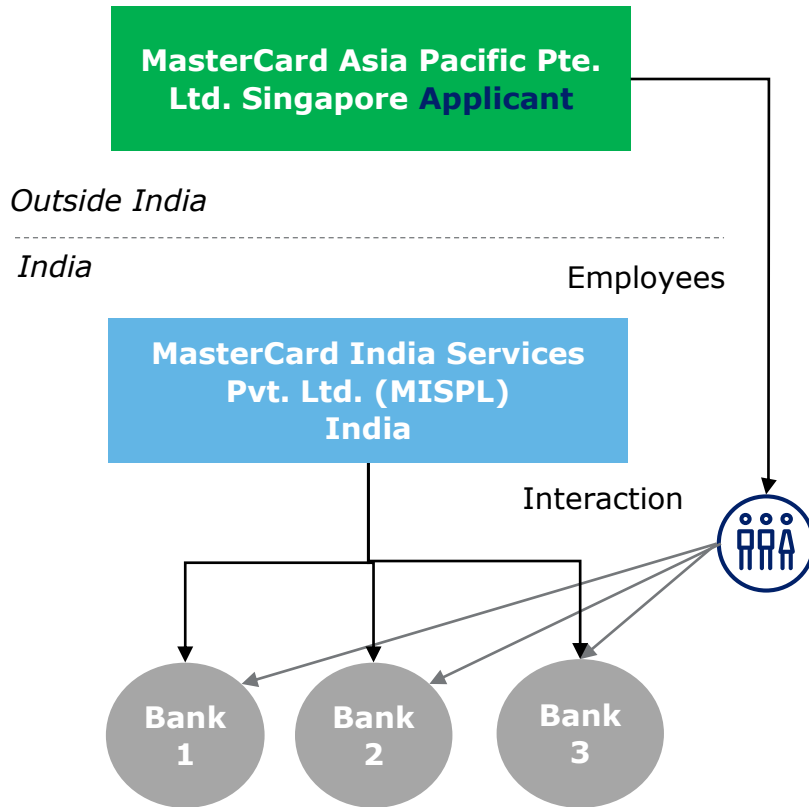
India Observations on OECD Commentary

Para	India position
Para 38 – International roaming facility of telecom networks [2010]	A roaming call is a composite process. It requires a composite use of various pieces of equipment located in the source and residence country and the distinction proposed in para 38 was neither intended by the wording of Art. 5 nor logical
Para 36 – leasing of ICS equipment [2008]	Tangible or intangible property could result in PE in certain circumstances
Para 124 – Website and server [2008, 2017]	PE could constitute on any equipment through a website...if ... Depending on facts, opening the website on that equipment includes downloading of automated software, such as cookies, which use that equipment to collect data from that equipment, process it in any manner or share it with the enterprise

On fixed place PE through Bank of India (BoI) premises – Settlement activity

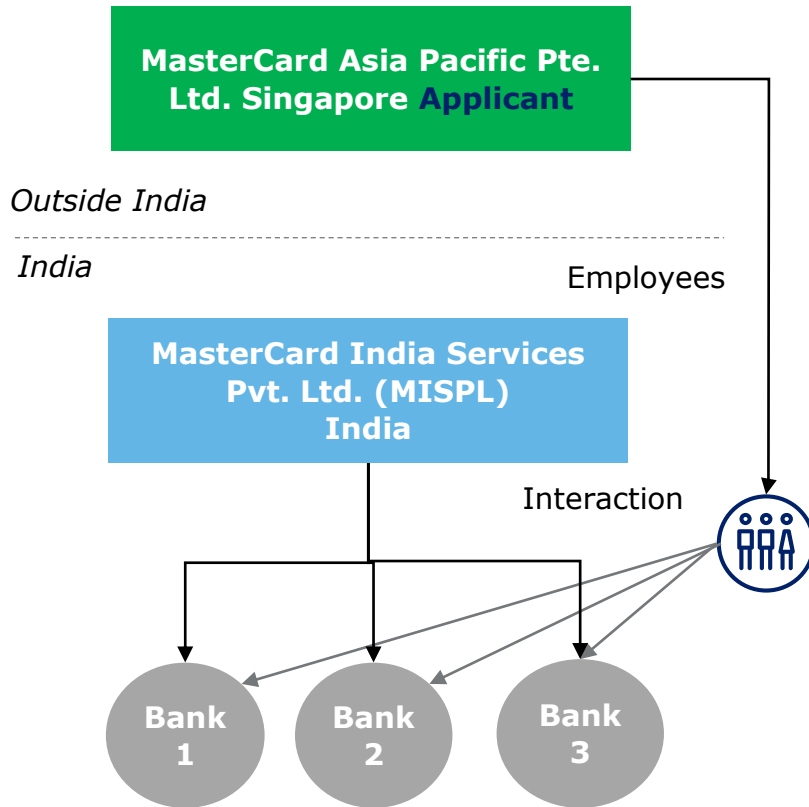
- Applicant's important business activity of settlement is carried on at the premises of BoI.
- Dedicated team of BoI employees performs this activity and the responsibility for any errors is that of the applicant.
- Employees of BoI are under control and supervision of the applicant and the space occupied by them in BoI is at the disposal of the applicant.
- The fact that BOI is acting as an agent of the Applicant and under its instruction and supervision, and has a space at its disposal, it means that the space is at the disposal of the Applicant.
- For constituting PE, the space may not be exclusively used by the non-resident enterprise.
- Amount of remuneration paid to BoI cannot determine the significance of the work.
- BoI was not a dependent agent. Nevertheless, it was an agent of the applicant, though independent.
- Hence, BoI premises create applicant's PE in India.

On service PE through applicant's visiting employees – Transaction procession activity



- 90-day test under the treaty is met
- Employee activities like interaction with clients, taking feedback from them, informing them about new products are an integral, monitoring operation efficiency, part of applicant's services rendered to clients and are not steward activities.

On agency PE through MISPL activities



- No habitual conclusion of contracts by MISPL on behalf of applicant
- On facts, AAR concluded that MISPL **habitually secured orders** for the applicant which was a criterion for PE creation in the India-Singapore tax treaty.
- Some activities done by MISPL for securing orders - providing proposals prepared by applicant to Indian banks, transmission of counter proposals and changes to proposals between applicant and customers in India, acceptance of order/ agreement from customer for applicant.
- Seven new contracts in 2/3 years.
- Hence, applicant had agency PE through MISPL

Profit Attribution

Approach of the Indian judicial authorities

"It holds that once a transfer pricing analysis is undertaken, there is no further need to attribute profits to a PE. The impugned ruling is correct in principle insofar as an associated enterprise, that also constitutes a PE, has been remunerated on an arm's length basis taking into account all the risk-taking functions of the enterprise. In such cases nothing further would be left to be attributed to PE. The situation would be different if transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise. In such a situation, there would be a need to attribute profits to PE for those functions/risks that have not been considered."

- SC in DIT v. Morgan Stanley [2007] 292 ITR 416 (SC) as reiterated in ADIT v. E-Funds IT Solution Inc. [2017] 399 ITR 34 (SC) and Honda Motor Co. Ltd. v. ADIT [2018] 301 CTR 601 (SC)

"Even in the case of dependent agent PE, the FAR profile of the Applicant AE is different from FAR of the dependent agent (Indian subsidiary). It is only when the two FAR are the same that one can say that there cannot be any further attribution." [para 26.3, Mastercard]

Right profit attribution and PE trigger

“Thus, there are some functions and risks related to transaction processing which were earlier carried out by MCI in India and are still carried out by MISPL (as MISPL had taken over everything) but not shown in the FAR of the MISPL. Therefore, the subsidiary company MISPL creates PE of Applicant in India. The fact that MISPL is carrying on work of the Applicant, to that extent facility, service, personnel and premise of MISPL are at the disposal of the Applicant. This is for the reason that it is through these facility, service, personnel and premise, the Applicant is carrying on transaction processing activity and undertaking risks which are not reflected in the FAR of MISPL.” [para 19.7.2.1, MasterCard]

“In effect thus the entire marketing and administrative support work is done by the assessee in India, through the Indian subsidiary and without adequate arm’s length consideration, at a fixed place in India. This is carrying on the business of the assessee in India through a fixed place of business.” [para 62, Nokia]

Points to ponder

Virtual
projection

Alter Ego

Software /
network results in
PE

Significant
Economic
Presence

ALP - DAPE

FAR analysis

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Panel Discussion