



Impact of Indian Tax Position on OECD Model- A professional view

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Introduction

- ▶ **Prelude to positions**
- ▶ **India's key positions –issues and Implications**
- ▶ **Concluding thoughts**

Prelude to Positions



Prelude to positions

- ▶ **OECD : “..... observations do not express any disagreement with the text of the convention, but usefully indicate the way in which those countries will apply the provisions of the Article in question.” [Para 30: Introduction to the Model Commentary]**
- ▶ **“We do not always agree with each other but, at least know where we disagree”¹**
- ▶ **Status of Positions: do they prevail over:**
 - ▶ **Unambiguous treaty texts or protocols**
 - ▶ **Contemporaneous bilateral correspondence**
 - ▶ **Indian or international judicial precedents**
- ▶ **Absence of observations on other parts – acquiescence?**

¹ Jeffery Owens & Mary Bennett, OECD Centre for tax policy and administration on ‘OECD model Tax convention – why it works.’

India's key positions – Issues and Implications



POEM in determination of residence

▶ **India Position:**

- ▶ Apply 'place of activity test' as India **does not adhere** to the interpretation on POEM
- ▶ In determining POEM, place where the main and substantial activity of the entity is carried on is **also** to be considered

▶ **Comments**

- ▶ India Position is not consistent with established judicial precedents
- ▶ Whether India Position lays down an alternative test, or a cumulative test, or an influencing consideration?
- ▶ Activities may be multiple and spread in different countries
- ▶ How to localise “main and substantial” activity of shipping, aircraft or E-activities!
- ▶ Is India Position influenced by potential of stray abuses?

PE – Article 5(2) significance

OECD Commentary	India Position
Stated examples (branch, factory, office, etc) - PE only if requirements of Article 5(1) are met	Stated examples in all cases will necessarily be regarded as PE
Comments <ul style="list-style-type: none">▶ No contra position expressed on Article 5(4) dealing with preparatory, auxiliary service▶ Dilutes threshold of construction PE?▶ Percolation to other Articles – say, Income from Employment▶ Profit attribution under Article 7(1)?	

PE- presence of properties

OECD Commentary	India Position
<p><u>PE for lessor if:</u></p> <ul style="list-style-type: none">▶ Participation and decision making or operation under direction, control and responsibility of lessor▶ Activity which is entrepreneurial in nature and meets permanence test <p><u>No PE for lessor :</u></p> <ul style="list-style-type: none">▶ Due to mere leasing of tangible/intangible property without maintenance▶ Operation of ICS by lessor's personnel under direction, responsibility and control of lessee	<ul style="list-style-type: none">▶ Presence of tangible/intangible properties by themselves could constitute PE 'in certain circumstances'

PE- presence of properties

Comments

- ▶ No guidance about determination of “certain circumstances”
- ▶ Is not OECD guidance for PE trigger well defined?
- ▶ Blurring distinction between operating v/s. finance lease
- ▶ Creating conflict on presence of intangibles v/s. royalty taxation
- ▶ Enterprises in shipping and aircraft activities

Agency PE

OECD Commentary	India Position
Attending to or participating in the negotiations by itself not sufficient to conclude that 'authority to conclude contracts' is exercised	<ul style="list-style-type: none">▶ “In certain circumstances”, mere attendance or participation is sufficient▶ Authority to negotiate essential elements (not necessarily all) of a contract is sufficient
Comments <ul style="list-style-type: none">▶ Subjectivity inbuilt 'in certain circumstances'▶ Tests of “authority to conclude” and “securing of orders” are judicially noted▶ Authority to negotiate ≠ Authority to conclude▶ Vice of exposure to vicarious liability on the representative?	

PE -Electronic commerce

OECD Commentary	India Position
<ul style="list-style-type: none">▶ Server may constitute fixed place PE for enterprise operating server▶ Website on server which is at disposal of enterprise may constitute PE▶ Website (combination of electronic data and software) cannot create PE in absence of physical presence; not a tangible property; lacks location▶ No 'place of business' merely by hosting a Website on a particular server of choice situated at a particular location;▶ Hosting typically involves service contracts	<ul style="list-style-type: none">▶ In certain circumstances, website can create a PE▶ Depending on facts, an enterprise can be considered to have a 'place of business' by virtue of hosting a website on a particular server at a particular location

PE -Electronic commerce

Comments

- ▶ Vagueness of “in certain circumstances”; “depending on facts”
- ▶ Are not exceptions well defined by OECD itself?
- ▶ Website if it is culmination of development process in India, it is taxed fairly
- ▶ Is it the desire to treat website access as igniting PE?

Services by AE and PE trigger

OECD Commentary	India Position
<ul style="list-style-type: none">▶ MNC Group company providing services to other group entities as part of its own business does not, of itself, constitute PE of recipient of service▶ Economic benefit to recipient of service or purchaser of goods is not equivalent of conduct of business of recipient of goods or services in the source country▶ Situation may be different if the premises are at disposal of the group concern	<ul style="list-style-type: none">▶ Manufacture or provisioning of service on behalf of group concern may constitute a PE of the group entity if other requirements of Article 5 are satisfied
Comments <ul style="list-style-type: none">▶ Position applies only 'if other requirements of Article 5 are satisfied'▶ CBDT Circular on BPO taxation confirms that there is no PE in dealings through an independent agent	

Service PE

OECD Commentary¹	India Position
<ul style="list-style-type: none">▶ Services performed outside the State – no taxation by source country▶ Requirement of minimum level of presence in Source State▶ Taxation on gross basis not appropriate▶ On principle, no different from import of goods	<ul style="list-style-type: none">▶ Taxation rights not restricted when services are furnished from outside that State▶ Furnishing of services sufficient for creation of a service PE▶ Physical presence not relevant▶ Taxation on gross basis is also appropriate▶ Principle applicable to profit from sale of goods not applicable to taxation of services
<p>¹No specific rule on service PE; 2008 Update provides guidance</p>	

Service PE

Comments

- ▶ Positions not unfair if meant to protect right of taxation of FTS on gross basis under its tax treaties
- ▶ On service PE ignition and taxation, India tax treaties are, on principle, consistent with OECD guideline
- ▶ Constraint of territorial nexus as envisaged by Supreme Court in *Ishikawajima Harima Heavy Industries (IHHI) v DIT (SC)*¹

“it is necessary that the services not only be utilized within India, but also be rendered in India or have such a **“live link”** with India that the entire income from fees as envisaged in article 12 of DTAA becomes taxable in India”

“Applying the **principle of apportionment** to composite transactions which have some operations in one territory and some in others, is essential to determine the taxability of various operations”

- ▶ In absence of FTS Article, offshore technical services held not taxable in India

¹ [288 ITR 408]

Construction PE- threshold determination

OECD Commentary	India Position
<ul style="list-style-type: none">▶ For construction PE, 12 month test applies to each individual project	<ul style="list-style-type: none">▶ A series of consecutive short term sites or projects operated by a contractor would give rise to PE
Comments <ul style="list-style-type: none">▶ Preponderant judicial precedents favour OECD view▶ India UK treaty protocol : Apply more than six months' test separately to each site or project which has no connection with any other site or project and to each group of connected sites or projects	

PE profit attribution to Construction PE

▶ OECD Commentary

- ▶ Attribution limited to activities carried on by the enterprise through the PE (Para 24*)
- ▶ Goods supplied by other parts of the enterprise, do not represent activities 'carried on through the PE', hence supply profits not attributable to PE (Para 25*)
- ▶ Provision of services (planning, designing, drawing blueprints, technical advice) from outside the State of PE are not profits attributable (Para 25*)

▶ India Position

- ▶ India **not** in agreement with the interpretation given in para 25

*Commentary on Article 7.

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PE profit attribution to Construction PE - Comments

- ▶ **Domestic law restricts right of taxation to “operations carried out in India”**
- ▶ **Extract from Supreme Court decision in Hyundai Heavy Industries¹**

“We reiterate, in the circumstances, not all the profits of the assessee company from its business connection in India (PE) would be taxable in India, but only so much of profits having economic nexus with the permanent establishment in India would be taxable in India”
- ▶ **Extract from Protocol to India German Treaty dt. 29th November 1996**

“Income derived by a resident of a Contracting State from planning, project, construction or research activities as well as income from technical services exercised in that State in connection with a permanent establishment situated in the other Contracting State, shall not be attributed to that permanent establishment”

1(291 ITR 482)

Taxation of royalties

OECD Commentary	India Position
<ul style="list-style-type: none">▶ Information concerning industrial, commercial or scientific experience as covered in royalty definition refers only to previous experience▶ Royalty Article does not apply to payments for new information obtained as a result of performance of service at the request of the payer	<ul style="list-style-type: none">▶ Information concerning industrial commercial or scientific experience is not confined only to previous experience
Comments <ul style="list-style-type: none">▶ Service v/s. pre-existing IPR tool	

Taxation of royalties

▶ OECD Commentary

- ▶ Complete alienation of IPR is not royalty. Part alienation granting geographically limited / time limited rights may also not be royalty, being consideration for alienation of ownership rights
- ▶ Design, model or plan covered by royalty covers only existing designs, etc. The service contract is not royalty
- ▶ Copying software as an essential step of enjoying copyrighted product does not amount to use of IPR. Method of transferring computer program does not affect characterisation. Multiple copies pursuant to site licence / networking licence is not royalty for commercial exploitation
- ▶ Distribution right of software is not equivalent to use of IPR. Payment for exclusive distribution right of product / service is not royalty but business income

▶ India Position

- ▶ India has reserved its position on the above interpretations of OECD. India is of the view that **some of the payments** may constitute royalties

Taxation of royalties – Comments

- ▶ **No clarity on scope of “some payments”**
- ▶ **Distinction between service and product is well established in Indian Law**
- ▶ **Preponderant judicial precedents support OECD interpretation on:**
 - ▶ **Geography linked alienation of know-how**
 - ▶ **Distribution right of software unconnected with disclosure of secret tools**
 - ▶ **Distinction between grant of copyright v/s. copyrighted article**

Concluding Thoughts



Concluding thoughts

- ▶ Do Positions conform with Indian judicial precedents?
- ▶ Treaties that India has today
- ▶ India's future tax treaty policy
- ▶ Canon of certainty
- ▶ An action has a reaction !

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