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Permanent Establishment is constituted due to presence of equipment, network in India. Transaction processing services involves licensing of brand, IP as well and hence, a portion of income is royalty and effectively connected with PE. Attribution to be made considering functions performed by the foreign processing centre

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Facts of the case

- Mastercard Asia Pacific Pte. Ltd. (MAPPL) belongs to the Mastercard group, one of the leading global payment solution providers.
- MAPPL is the regional headquarters for the Asia Pacific, Middle East and Africa (APMEA) region and renders transaction processing services to customers located in the said region.
- The cards are issued by customers of MAPPL, which are primarily banks and financial institutions. MAPPL has entered into a Master License Agreement with each of the customers and charges transaction processing fees relating to authorization, clearing and settlement of transactions.
- The customer is provided with a Mastercard Interface Processor (MIP) that connects to Mastercard's Network and processing centres. A MIP is about the size of a standard personal computer and is placed at the customers' locations in India. MIPs are owned by the Indian subsidiary, i.e. Mastercard India Services Private Limited (MISPL).
- The broad steps involved in the authorization of a transaction are specified below:
 - Preliminary examination/validation for authorization like PIN processing, validation of card codes, names and address verification happens through MIPs located at customer banks premises in India.
 - MIPs alert the acquirer bank if they notice error and the data is not authorized.
 - MIPs encrypt the data for transmission.
 - Transmission happens through transmission tower, leased lines, fiber optic cable, nodes, internet (owned by third party service provider), and Master Connect and MasterCard File express, Application software (owned by the Applicant). These are located in India as well as outside India.
 - The server outside India performs functions of securing transaction flow, securing validation (to prevent hacking), fraud checks through algorithm and stand in services. These are also important activities for securing the transaction and for preventing frauds.
 - The authorization is done by Issuer bank in India.
- Though the authorization is effectively done by the Issuer Bank, MAPPL facilitates the authorization of transaction in a secured manner.
- Facts related to the process of clearing and settlement are - Global Clearing Management System (GCMS), that forms part of MAPPL's Network transaction processing infrastructure located outside India processes the raw data. For each transaction, GCMS performs data validation and data integrity checks to ensure that the transaction data can be processed. From the GCMS, the transaction data is transferred to the Settlement Account Management System (SAM) which is again located outside India. SAM performs the necessary calculations to determine the final settlement amounts. SAM sends out daily the information regarding the net settlement position for each of the customer banks to Bank of India (BOI). On the basis of this information, BOI posts the entries in the accounts of the customer banks for the settlement to get completed.
- MISPL renders following services to MAPPL:
 - Marketing and liaising services
 - Advisory support services
 - Transaction processing support services via the MIPs

- MAPPL and MCI have entered into an agreement, whereby the rights were granted to MAPPL, so that business in the APMEA region can be undertaken.

Issues under consideration

- Whether MAPPL has a PE in India in respect of services rendered with regard to use of a global network infrastructure to process card payments for customers in India?
- Whether the fees received from the Indian customers is taxable as royalty income or fees for technical services in India?

Ruling of the AAR

MIPs constitute Fixed Place PE

- Role played by MIPs is significant in facilitating the authorization process as without the initial verification/validation by MIPs, the authorization would not happen. The AAR therefore held that the same is a significant activity for authorization part of the transaction processing and cannot be said to be preparatory or auxiliary in nature.
- The AAR also observed that the MIPs, though shown to be owned by MISPL, are at the disposal of MAPPL for the following reasons:
 - MISPL is merely rendering support services and not transaction processing services. Thus, the functions performed by MIPs are the functions of MAPPL and not MISPL
 - MAPPL charges customers for the installation of MIPs
 - Software inside MIPs are owned by MAPPL
 - The cost of maintenance and upgradation are indirectly recovered from MAPPL
 - All the risk mitigating functions are performed by MAPPL and all decisions with respect to MIP are taken by MAPPL
- The fact that cost of MIPs is only a fraction of the cost of processing centres located outside India, is not relevant.
- The AAR therefore held that since MIPs are situated in India and are at the disposal of MAPPL and are not performing preparatory or auxiliary services, it creates PE of MAPPL in India.

Mastercard network constitutes Fixed Place PE

- As regards settlement, it was held that settlement is the actual movement of funds between customers. The said activity is being done by BOI in India.
- The AAR observed that significant activities relating to clearance and settlement takes place in India and therefore, the question was whether this creates a PE for MAPPL in India.
- Mastercard network consists of MIPs (owned by MISPL), transmission tower, leased lines, fiber optic cables, nodes and internet (owned by third party service provider)

and Application software - Master Connect and Master Card File express (owned by the MAPPL).

- AAR held that the Application software is owned by MAPPL. MIPs as discussed earlier are already at disposal of MAPPL. Further, part of network provided by third party service provider in India is also at disposal of MAPPL. The AAR therefore held that the Mastercard network in India is at the disposal of MAPPL.
- It also compared the functions performed by MAPPL with that of the Computerized Reservation System (CRS) in the case of Amadeus and Galileo, which were installed at the travel agents' place.
- Based on above, AAR held that the Master Card Network also created fixed place PE of MAPPL in India.

BOI premises constitutes fixed place PE

- The AAR observed that the settlement activity is the function of MAPPL, carried out by BOI as an agent of MAPPL and under its instruction and responsibility. Further, it is not a principal-to-principal transaction as the liability is always of MAPPL and employees of BOI carry out their work according to the instructions of MAPPL.
- The employees of BOI, carrying out the settlement function, are under the control and supervision of MAPPL. The space occupied by them in BOI is at the disposal of MAPPL.
- The AAR observed that BOI is also carrying out other banking functions as it is an established bank in India. However, it is well understood that for constituting PE, the space may not be exclusively used by the non-resident enterprise.
- It was therefore held that BOI premises constituted fixed place PE of MAPPL.

MISPL constitutes fixed place PE

- The AAR held that the acceptance of PE in the case of erstwhile LO to buy peace of mind shall not take away the admitted position in the tax return, despite the fact that the position resulted from Mutual Agreements Procedure (MAP) agreement and such agreements are not binding for years not under MAP.
- In case, MCI was of the view that there is no PE, tax return should have been filed with nil income. Thus, offering income in the tax return indicates that the position of PE has been accepted, despite the fact that MCI clearly mentioned in the return for all year(s) that it does not have any PE in India.
- The AAR further observed that the transaction processing activities were earlier shown to be carried out by the LO of MCI and MISPL has shown these as support services in its Functional Analysis Report (FAR). These are the same functions and risks related to transaction processing which were earlier carried out by MCI in India and still carried out by MISPL (as MISPL had taken over everything), but not shown in the FAR of the MISPL.
- In view of the above, the subsidiary company MISPL constitutes PE of MAPPL in India.

Restructuring/reorganization was not a colorable device

- The AAR observed that there were valid reasons relating to achieving business efficiency and commercial expediency for the operations to move from US to Singapore by the Applicant.

- Based on the facts relating to restructuring and the manner in which it was undertaken, the AAR held that the restructuring/reorganisation was not a case of tax avoidance or a colourable device.

Employees of MAPPL constitute Service PE

- The AAR observed that the employees of MAPPL visited India for a period of more than 90 days, i.e., more than the prescribed threshold period for constituting Service PE under India-Singapore DTAA.
- The employees visited India for understanding the future requirement, informing new products and to monitor efficiency of the operations and not for signing the contracts. The AAR held that meeting clients in India to whom services are rendered or talking about the possibility of improving and adding services is not stewardship in nature.
- The AAR therefore held that the employees visiting India are providing services to Indian clients and hence once they cross threshold of 90 days, a Service PE is created.

Employees of BOI do not constitute Service PE

- The AAR observed that employees of the bank are neither employees of MAPPL nor engaged by MAPPL for undertaking business functions. Therefore, employees of BOI do not constitute Service PE of MAPPL.

MISPL constitutes Dependent Agent PE

- The AAR observed that though the proposals or counter proposals are vetted by MAPPL, it would ultimately get accepted by the customers, when MISPL brings that proposal or counter proposal to such customers. The said activity satisfies the requirement of 'securing order'.
- Regarding the question whether the contracts were secured habitually or not, the AAR observed that the term "habitually" is to be interpreted in the context of business of MAPPL. The AAR observed in the case of MAPPL, even though two or three new contracts were entered into in a year, the requirement of "habitually" would be satisfied as MISPL was involved in all such transactions.
- On the basis of the above, the AAR held that MISPL constitutes a dependent agent PE in India on account of habitually securing orders for MAPPL.

Nature of income – Whether income is royalty in nature on account of usage of brand name, trademarks, marks and logo

- Under the Mastercard Licence Agreement (MLA), rights have been granted to use trademarks and marks owned by Mastercard, solely in connection with the payment card program.
- The AAR observed that the dominant purpose of the agreement was to allow the use of intangibles for the payment card programs. There was no justification for MAPPL to license its trademark/logo for transaction processing but were needed by Banks/FIs for attracting people to buy their cards.
- The AAR further observed that MAPPL pays royalty to its US parent for the use of intangibles in India - but does not receive royalty back from Indian customers to whom these intangibles have been further licensed. The AAR also observed that MAPPL has incurred significant expenditure on advertisement and sales promotion in India. It was held that if the use of brand etc. was merely incidental to the transaction processing services, then there was no need to incur such expenditure on advertisement / promotion in India.

- Based on the above, the AAR held that a portion of income received from the customers by MAPPL is in the nature of royalty. However, since the royalty is effectively connected with PE, the same would be taxable along with business income (the remaining portion of income) under Article 7 of India-Singapore DTAA.
- The AAR further held that certain payment received by MAPPL could be considered as royalty on account of use of equipment, secret process or computer software.

Attribution of income

The AAR agreed that significant activities are also carried out by MAPPL outside India. Thus, the entire revenue received by MAPPL from the customers cannot be attributable to the Indian PE.

Conclusion

The AAR has held that the Applicant has a PE in India based on the specific facts of the case. In arriving at the conclusion that there is a fixed place PE, the AAR seems to have assumed that the third party network infrastructure was at the disposal of the Applicant and that the preparatory and auxiliary exemption was not available. For the Service and DAPE too, the liberal interpretation has been made of the terms provided in the tax treaty.

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