



**BEPS and Indian domestic tax law:
Increased exposure to a Permanent
Establishment (PE)**

The Dbriefs India Spotlight series

Sunil Shah / Rajiv Bajoria / Himanshu Patel / Sharath Rao
11 June 2019

Agenda

- Introduction: BEPS and MLI – developments related to PE
- MLI – India's position in relation to PE
- Changes introduced in Indian domestic tax law compared with MLI changes on PE
- Case studies
- PE attribution – draft report issued by Central Board of Direct Taxes
- Questions and answers

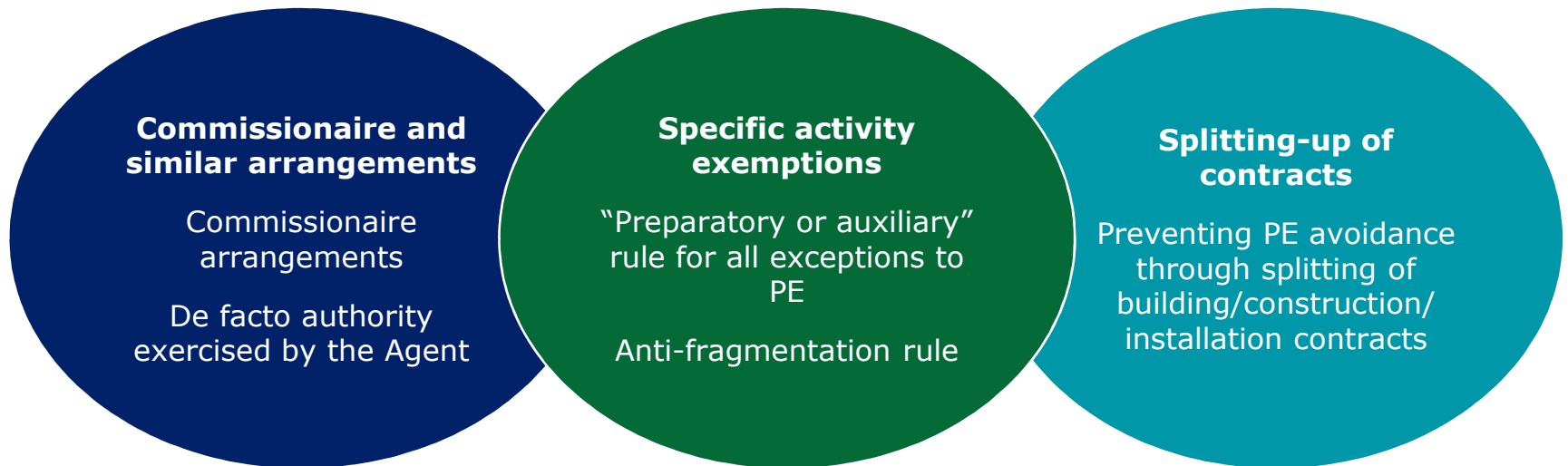
Introduction

BEPS and MLI – developments
related to PE

Permanent Establishment (PE)

Changes on account of BEPS and MLI

- As a culmination of the joint efforts of OECD and G20 countries to tackle Base Erosion and Profit Shifting (BEPS), the final BEPS package consisting of 15 Actions was released in October 2015
- The BEPS Actions requiring amendments to tax treaties are currently being implemented by way of a Multilateral Instrument (MLI)
- BEPS Action 7 “Preventing the Artificial Avoidance of Permanent Establishment Status” and Part IV of the MLI seek to introduce the following changes to the definition of PE



MLI

India's position in relation to
PE

Permanent Establishment – MLI

India’s position in relation to PE

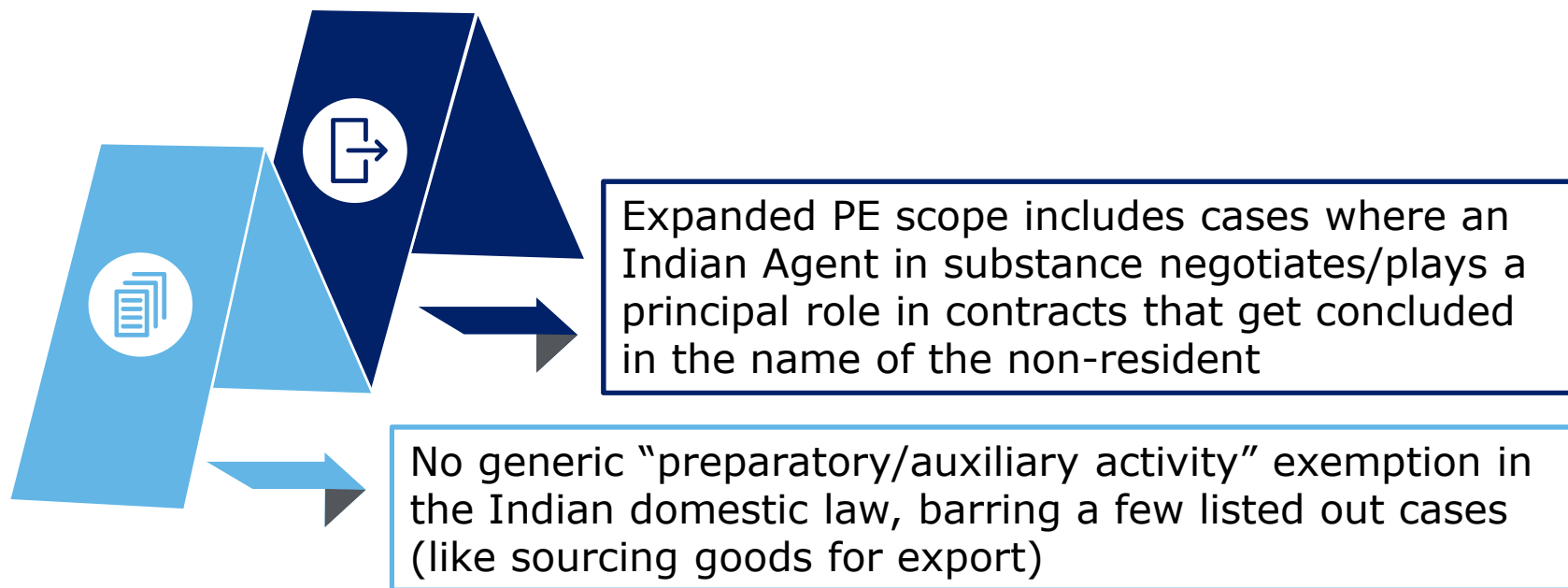
Part of MLI	Corresponding BEPS Action Plan	Article in MLI	India position
IV	Action plan 7	Article 12: Commissionaire and similar arrangements	Opted for provision to apply to all its Covered Tax Agreements (CTA)
	Avoidance of PE status	Article 13: Specific activity exemptions	Opted for Option A – exemption from PE available only if activities carried on are preparatory and auxiliary in nature
		Article 14: Splitting-up of contracts	Opted for provision to apply to all its CTAs

- Any particular provision of the MLI would get adopted in an Indian tax treaty only when the same provision/option is accepted by the other contracting state as well

Changes introduced in Indian domestic tax law compared with MLI changes on PE

Changes introduced in Indian domestic tax law compared with MLI changes on PE

- Indian domestic law concept of PE (termed as “business connection”) has been enlarged to incorporate BEPS Action 7 changes (with some modifications)



Expanded PE scope – a comparison with Article 12 MLI



Explanation 2 to Section 9(1)(i) of the Income Tax Act, 1961 (the Act) as amended vide Finance Act 2018

“Business connection” to now include any business activities carried through a person who, acting on behalf of the non-resident,

- a. Has and habitually exercises in India an authority to conclude contracts on behalf of the NR or **habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by the non-resident and the contracts are**
 - i. **In the name of the non-resident; or**
 - ii. **For the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that non-resident has the right to use; or**
 - iii. **For the provision of services by the non-resident**

Exclusion

Activities of an independent agent acting in ordinary course of business, provided that any person who acts mainly or wholly on behalf of a principal non-resident or such other non-resident(s) which is/ are under control or controlling interest of principal non-resident or under common control as principal agent cannot be treated as an independent agent



Article 12 of MLI

Notwithstanding the provisions of a Covered Tax Agreement that define the term “permanent establishment”, but subject to paragraph 2, where a person is acting in a Contracting Jurisdiction to a Covered Tax Agreement on behalf of an enterprise and, in doing so, **habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:**

- a) **In the name of the enterprise; or**
- b) **For the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or**
- c) **For the provision of services by that enterprise**

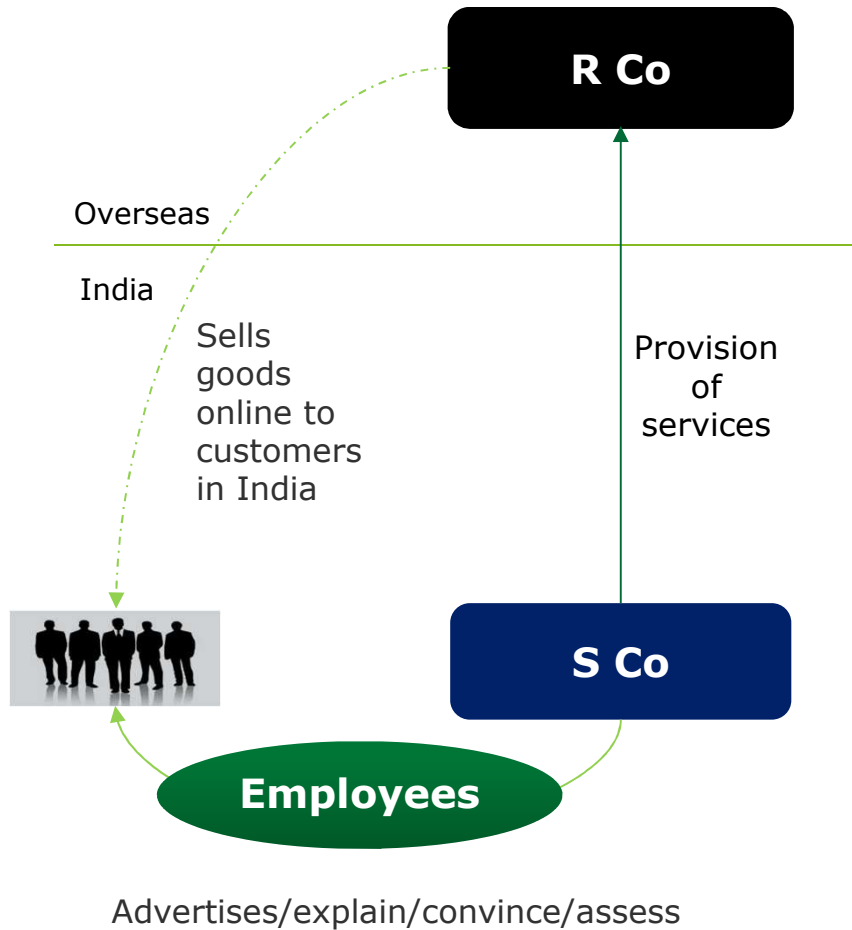
Exclusion

Activities of an independent agent acting in ordinary course of business, provided that any person who acts exclusively or almost exclusively on behalf of its closely related enterprise cannot be treated as an independent agent

India has opted for Article 12 to apply to all its tax treaties. Canada, Cyprus, Luxembourg, Singapore, UK, etc., have reserved the right not to apply Article 12 to their tax treaties.

Case studies

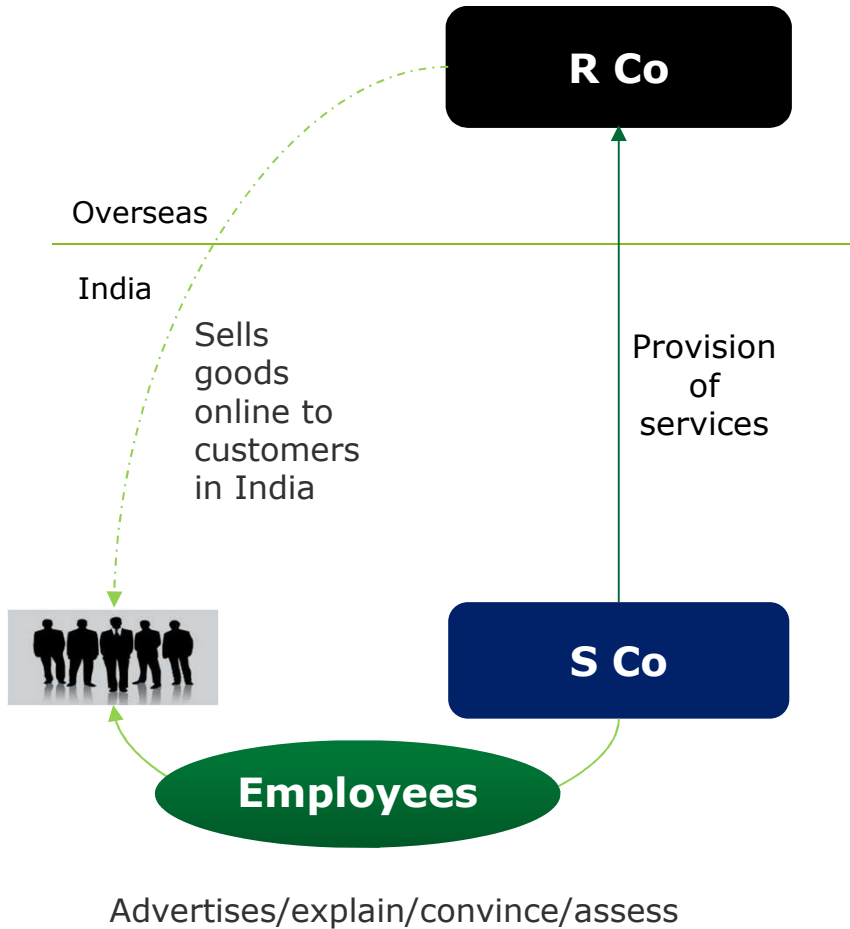
Case study 1



Facts

- R Co is a Company incorporated outside India
- R Co sells goods in India online through its own website
- S Co (subsidiary of R Co) acts exclusively for R Co. S Co's employees undertake the following activities
 - Advertising and marketing and promotional activities for R Co's products (in general)
 - Assess requirement of customer for any particular product
 - Explain to them the standard terms of R Co's contracts including pricing (not authorized to modify the terms)
 - Convinces them to buy R Co's products
- S Co's employees get incentive on sale of R Co's product
- The contract is entered directly between R Co and the customer online

Case study 1 (Cont'd)



Questions

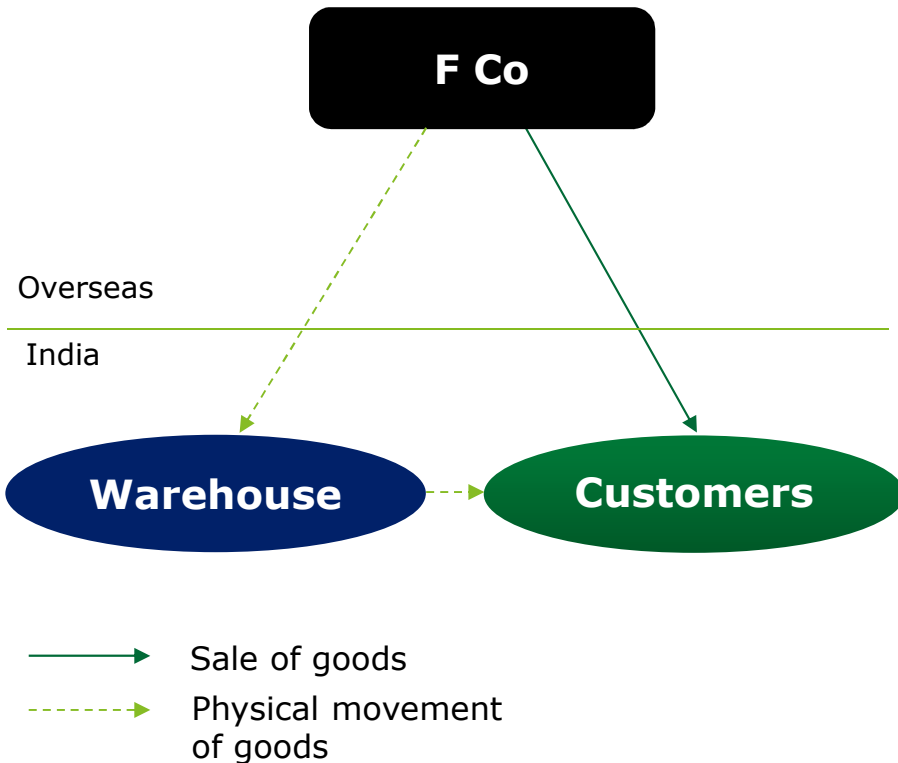
- Whether S Co's employees play principal role in concluding the contracts?
- What if India has a treaty with the country in which R Co is a tax resident but this country has not notified its tax treaty with India for the purpose of MLI?
- What if the employees' role was only restricted to advertising and marketing and promotional activities for R Co's product in general, with no linked incentives?
- Whether mere communication of price to customers leads to contract conclusion activities?

Polling question 1

In case your company makes direct sales to customers in India from outside, do you have a marketing entity in India?

- Yes
- No
- Expected near term
- Don't know/not applicable

Case study 2



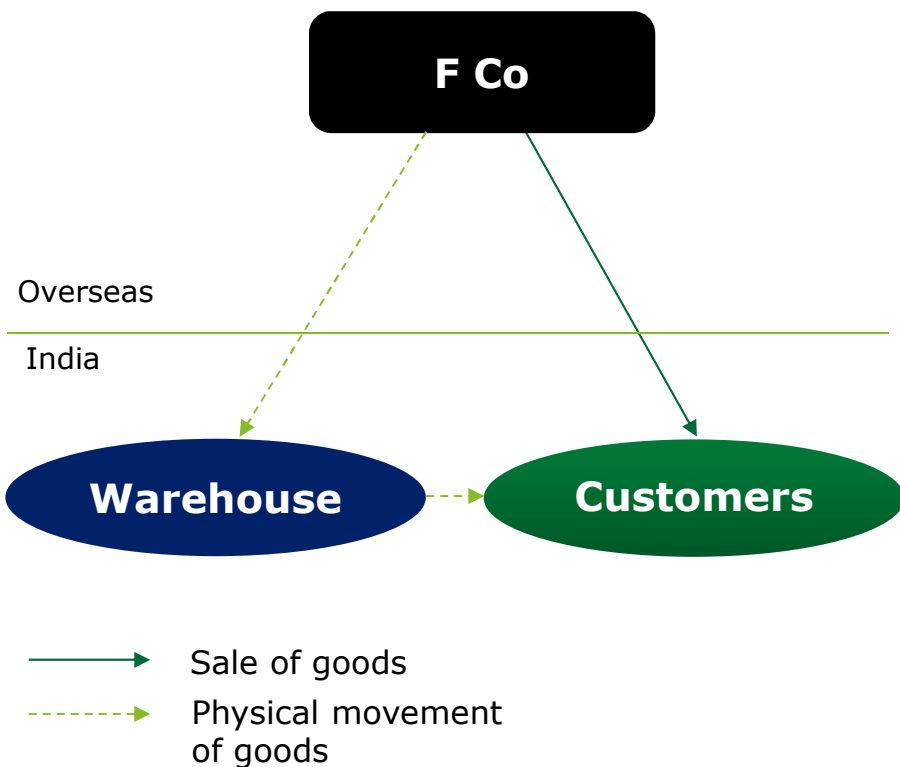
Facts

- F Co. is an e-commerce company
- Customers purchase goods from F Co. through an online portal
- F Co. maintains a large warehouse in the local jurisdiction, from where goods are delivered to the customers
- Substantial number of personnel are engaged for storage and delivery of goods

Relevant treaties

- Where exclusions from PE, i.e., Article 5(4), includes use of facilities for storage or delivery, maintenance of stock for storage, or delivery

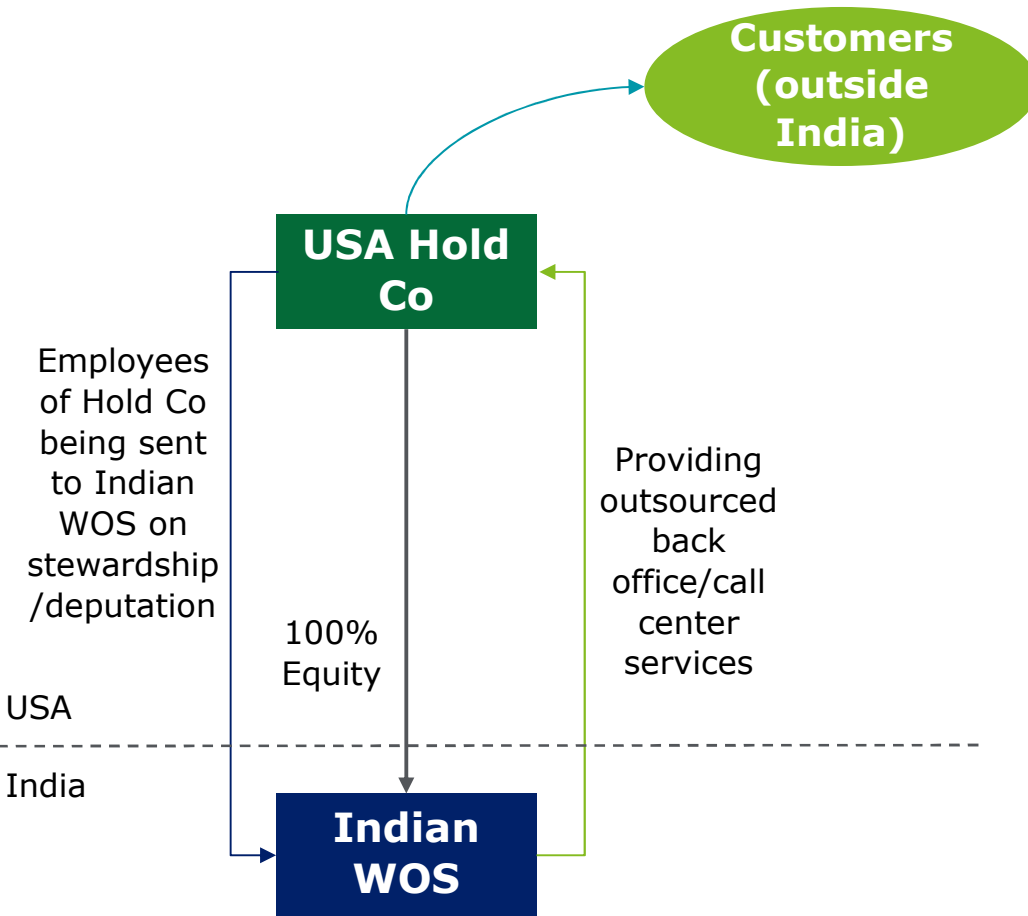
Case study 2 (Cont'd)



Questions

- Whether the activities of storage and delivery qualify as “preparatory or auxiliary” in nature for F Co.?
- Whether the specific activity exemption from fixed place PE is available to F Co. – pre and post BEPS?

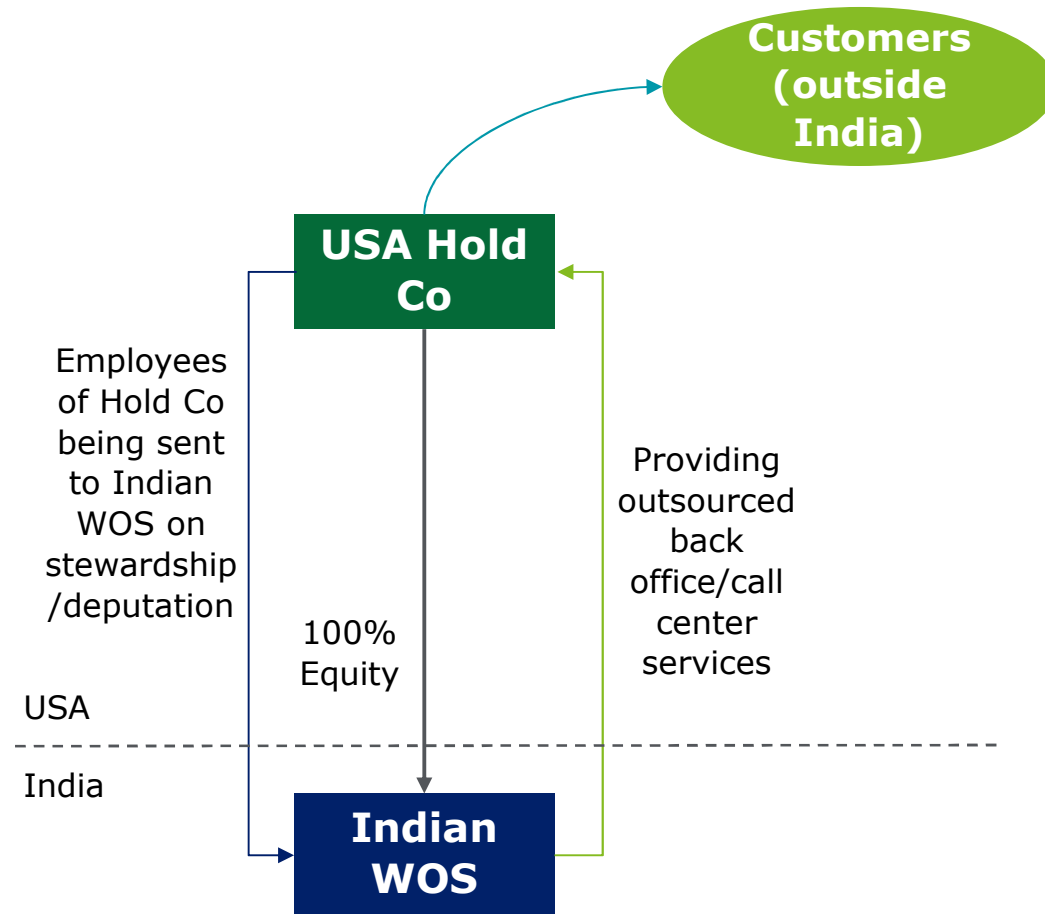
Case study 3



Facts

- Some employees of Hold Co are sent to India to perform only **stewardship** tasks (initial oversight, enforcing quality control standards)
- A few other employees of Hold Co are sent to India on **deputation/secondment** and
 - Direction and control over deputed employees is with Indian WOS; employment lien with USA Hold Co
 - Deputed employees work exclusively on the projects of Indian WOS
- Indian WOS reimburses the salary expenses to USA Hold Co. at cost

Case study 3 (Cont'd)



Questions

- Whether deputation of employees for performing stewardship tasks can be regarded as provision of service?
- Whether deputation of employees to work on regular projects of Indian WOS will qualify as a service provided by USA Hold Co?
- Whether the MLI changes, Article 13 in particular, will change the Service PE position?

Polling question 2

Do you have storage facilities in India where goods are delivered to customers in India for sales made from outside India?

- Yes, self managed
- Yes, third party managed
- No

PE attribution

Draft report issued by Central
Board of Direct Taxes

Attribution of income to permanent establishment in India

Draft report – 16 April 2019

- Attribution of profit to a “Permanent Establishment” (PE) of a non-resident in India has been a subject matter of controversy due to lack of clarity in existing rules
- Central Board of Direct Taxes (India’s apex body for tax administration) issued a draft report on attribution of income to the PE

Key proposals

- The report discusses different approaches to profit attribution – (1) “FAR approach” and (2) “demand and supply” approach; rejects FAR approach by underlining India’s position to OECD MC
- Regarding “demand and supply” approach, the report outlines two methods – “formulary apportionment” method and “fractional apportionment” method
 - Formulary approach requires apportionment of global profits; in absence of such details, the same may not be practically feasible
 - Fractional apportionment may be consequently followed; equal weightage to be given to three factors, i.e., sales, employees, and assets
 - In respect of digital models, a fourth factor being “users” to be considered
 - The above weights to be applied to “profits derived from Indian operations”, which will be higher of
 - a)** Revenue derived from India* Global operational profit margin (i.e., EBITDA margin), or
 - b)** 2% of the revenue derived from India
 - Any compensation paid to local enterprise (which has been taxed in India) to be deducted – in line with Supreme Court ruling in Morgan Stanley

Attribution of income to permanent establishment in India

Draft report – 16 April 2019

Comparison of existing and proposed rule

Proposed Formula

Profits attributable to operations in India =

“Profits derived from India” x [SI/3xST + (NI/6xNT) + (WI/6xWT) + (AI/3xAT)]

Where,

SI = sales revenue derived by Indian operations from sales in India

ST = total sales revenue derived by Indian operations from sales in India and outside India

NI = number of employees employed with respect to Indian operations and located in India

NT = total number of employees employed with respect to Indian operations and located in India and outside India

WI = wages paid to employees employed with respect to Indian operations and located in India

WT = total wages paid to employees employed with respect to Indian operations and located in India and outside India

AI = assets deployed for Indian operations and located in India

AT = total assets deployed for Indian operations and located in India and outside India

Existing formula

- i. At such percentage of the turnover so accruing or arising as the Assessing Officer may consider to be reasonable, or
- ii. On any amount which bears the same proportion to the total profits and gains of the business of such person (such profits and gains being computed in accordance with the provisions of the Act), as the receipts so accruing or arising bear to the total receipts of the business, or
- iii. In such other manner as the Assessing Officer may deem suitable.

Questions and answers

Thanks for joining today's webcast.

You may watch the archive on PC or mobile devices via Apple Podcasts, RSS, YouTube.

Eligible viewers may now download CPE certificates. Click the CPE icon at the bottom of your screen.



Join us 13 June at 2:00 PM HKT
(GMT+8) as our China Spotlight series
presents:

Robotic Processing Automation in China: A revolution and new era

For more information, visit
www.deloitte.com/ap/dbriefs

Contact information



Sunil Shah
Tax Partner
Deloitte Mumbai, India
sunilshah@deloitte.com



Rajiv Bajoria
Tax Partner
Deloitte Mumbai, India
rbajoria@deloitte.com



Himanshu Patel
Tax Partner
Deloitte Kolkata, India
himanshupatel@deloitte.com



Sharath Rao
Tax Partner
Deloitte Bengaluru, India
sharathrao@deloitte.com

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this communication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.



About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.

© 2019. For information, contact Deloitte Touche Tohmatsu Limited.