



Permanent Establishments – Attribution of Profits and BEPs Action 7

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Agenda

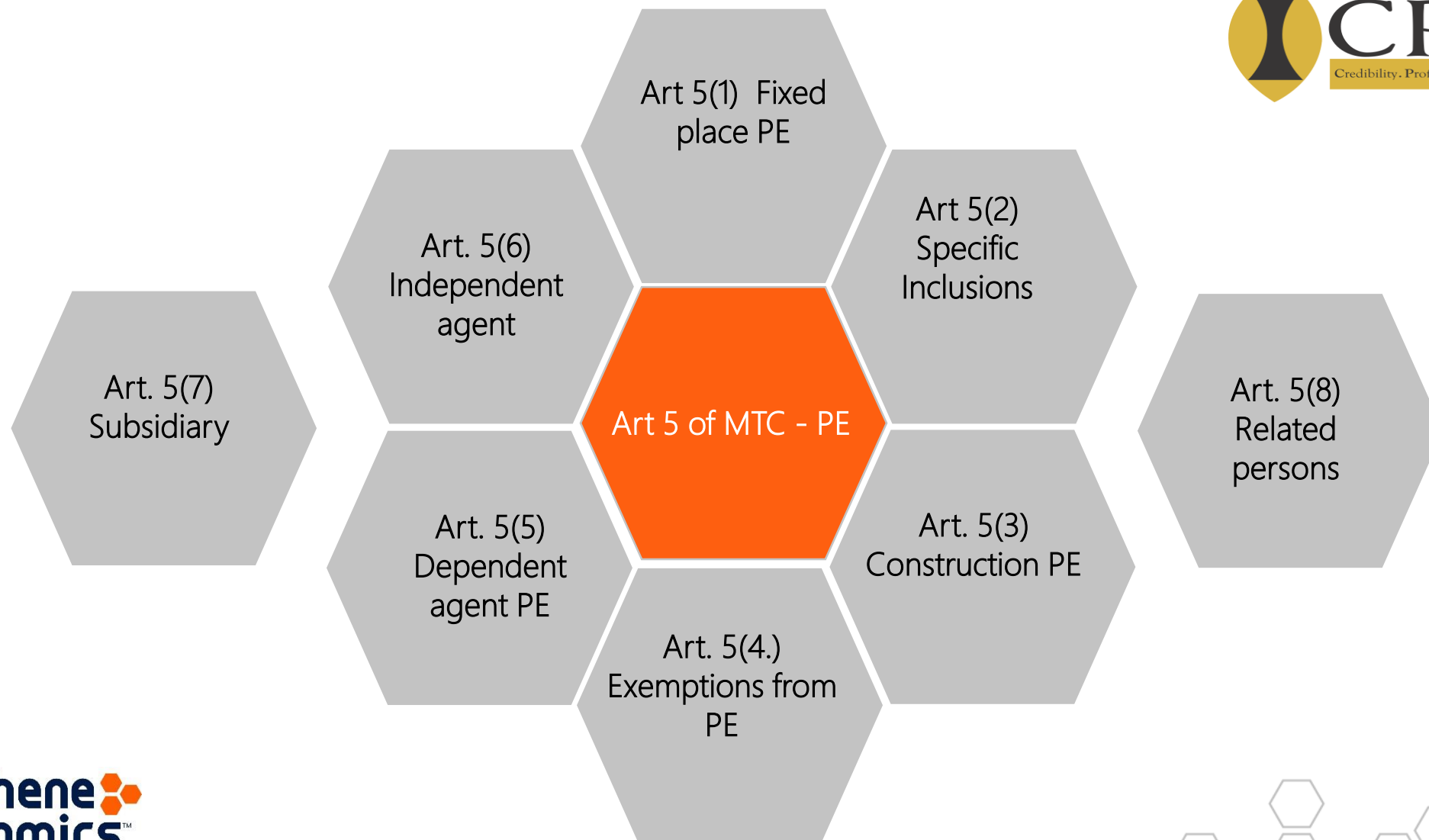


1. What is a PE
2. Types of PE
3. PE Triggers & Risks
4. What has Changed - BEPS & PE
5. Attribution of Profit
6. Case Study
7. Q & A

What is permanent establishment

- PE is defined as a fixed place of business in which a person/business entity carries on business for at least six months. (Art 5(1) MTC OECD & ITA Cap 470).
- a place of management, a branch, an office, a factory, a workshop, and a mine, an oil or gas well, a quarry or any other place of extraction of natural resources, a building site, or a construction or installation project, which has existed for six months or more, where that person wholly or partly carries on business
- Finance Act 2014 - Expanded definition of a PE to include a person's dependent agent.

What constitutes a PE?





Types of PEs

- Fixed place PE
- Dependent agent PE
- Construction PE
- Service PE
- Exemptions - PE is deemed not to exist when a place of business is engaged solely in certain activities- preparatory or auxiliary (such as maintenance of stocks of goods for storage, display, delivery or processing, purchasing of goods or merchandise, collection of information)



Triggers

- Provision of services
- Business travellers or seconded employees
- Construction ,assembly or installation projects
- Sales through agents
- Arrangement involving sub-contractors



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- Tackles common tax avoidance strategies used to prevent the existence of a PE, including through agency or commissionaire arrangements instead of establishing related distributors.
- prevent the misuse of specific exceptions to the PE definition, which relate to activities of a preparatory and auxiliary character.
- Tax avoidance avenues:
 - Fragmentation of cohesive business functions
 - Commissionaire arrangements- an arrangement through which a person sells products in a given State in its own name but on behalf of a foreign enterprise that is the owner of these products
 - Contracts finalised abroad
 - Preparatory or auxiliary activities

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- Commissionaire arrangement – Art. 5(5) and Art. 5(6) are amended to lower the PE threshold
- Exemptions – limited to activities of a preparatory or auxiliary nature only
- Fragmentation of activities - Introduction of Article 5(4.1) anti fragmentation rules , mitigate breakup of an operating business into several small business units in order to benefit from the preparatory or auxiliary exemption.
- Splitting of contracts - Application of a principal purposes test rule & aggregation of time spent on connected activities

Attribution of profits

- Attribution of profits is done in line with article 7 of model tax convention
- Unilateral interpretations – High likelihood of double taxation or double non taxation instances.
- Attribution is if it were a separate and independent enterprise engaged in the same or similar activities under same or similar conditions taking into account of assets, functions and risks assumed by the enterprise through the PE and through other parts of the enterprise.
- Profits attributable to the PE should be the ones that the entity could have earned if it was functionally a separate entity i.e. a PE is hypothesised as an independent entity.

Attribution of profits

- Approaches used
 - Force of Attraction Rule - going beyond profits derived by PE
 - Authorised OECD Approach – 2 step approach
 - One- performing an hypothesis appropriately (PE treated as functionally separate)
, functional and factual analysis (performing comparability analysis)
 - Two - determining the profits of the hypothesised separate and independent enterprise based upon a comparability analysis

Case review

- Mumbai v. Morgan Stanley & Co case went AAR & went to the high court
 - *If MS & Co. have a PE in India through the arrangement;*
 - *If the method used for transfer pricing between MS & Co. and MSAS was the most appropriate method, and was the price paid at arm's length; and*
 - *If there is a PE in India, would there be anything further attributable to the PE if the PE was compensated on an arm's length basis.*
- Commissioner of Income Tax vs Hyundai Heavy Industries Co. Ltd on 18 May, 2007

Case review

- outsourcing of services such as back-office operations to a captive service provider will not per se create a permanent establishment of the parent in India
- The SC sought to differentiate the tax treatment between persons performing a stewardship function in relation to the deputation of employees.
- single-entity approach for the attribution of profits to a PE by ruling that the payment of an arm's-length price by the non-resident to the PE extinguishes any further attribution of profits to tax.



Next steps

Should you have any questions please let us know

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