Contents:

- **Permanent Establishment (PE)**
- **Basic rule PE**
- **Specific PE**
- **Construction PE**
- **Service PE**
- **Agency PE**

Permanent Establishment (PE)

"International taxation should be based on political, residential or economic factors between the taxpayer and the taxing state." The primary use of the PE concept is to determine the right of a state to tax the profits of an enterprise of another state. In some aspects the concept of PE is similar to the concept of 'business connection' as under section 9 of Income Tax Act, 1961.

Types of PE:-

- Basic rule PE
- Construction/ Installation PE
- Service PE
- Agency PE

No definitive tests; here facts based determination.

Basic Rule PE

- ✓ There must be a fixed place of business (*situs test)*;
- ✓ The fixed place of business must be located [in a] certain territorial area (*locus test*);
- ✓ The use of the fixed place of business must last for a certain period of time (*tempus test*);
- ✓ The taxpayer must have a certain right of use [over] the fixed place of business (*ius test*);
- ✓ The activities performed through the fixed place of business must be of a business character (*business activity test*)

Locus Test:

- ✓ All three tests (locus, situs and business activity) must be satisfied
- ✓ Presence to be 'visible' in the other contracting state
- ✓ Usually linked to a geographical location
- ✓ Movable places of business with a temporary fixed location meet the locus test
- ✓ Activities carried out within a defined geographical location could constitute a PE; eg, a diving offshore vessel functioning within a defined area, dealer selling merchandise from a mobile vehicle etc.,

Tempus Test:

- ✓ No minimum threshold under Indian law
- ✓ An isolated activity cannot lead to establishment of a fixed base PE as the ingredients of regularity, continuity and repetitiveness are essentially missing
- ✓ If a non-resident is carrying its activities through a place which is exclusively available to its business in India then that place will be deemed to be its fixed place PE even if the same is used for a day
- ✓ Interestingly, in a recent ruling, the AAR has held that conducting of golf tournament in India for a week's duration does not lead to existence of a fixed base PE in India. *[Golf in Dubai, LLC, In re (306 ITR 374)]*

IUS Test:

- ✓ Place should be at the disposal of the foreign enterprise for the purpose of its business activities
- ✓ The foreign enterprise should have the ability to exercise some right or dominion or control
- ✓ The place may be owned, rented or leased;
- ✓ Legal right to use need not be the sole determinant; factual use or exercise of such right will have a greater bearing
- ✓ Even illegal occupation could constitute a PE

Business Activity Test:

- ✓ The definition of PE requires that the business of the foreign enterprise, wholly or partly, ought to be carried out through the fixed place
- ✓ Place of business must 'serve' the business activity and not be 'subject to' it
- ✓ The use of the premises by an agent for the purpose of the business of the principal may lead to the interpretation that such premises are at the disposal of the principal and therefore constitute a PE *[Galileo International Inc and Maruthi Info and Tech Centre v DCIT (114 TTJ 289)]*
- ✓ Similarly, in *ACIT v DHL Operations BV (108 TTJ 152),* the office of a local courier company was considered to constitute a PE for the foreign company engaged in providing courier services since the foreign company delivered packages to the local courier company for onward delivery to the addressee

Specific PE

DTAA Article 5(2) provides for an illustrative list of facilities constituting a PE.

The term ***PE includes*** especially:

- A place of management
- A branch
- An office
- A factory
- A workshop; and
- A mine, an oil or gas well or any other place of extraction of natural resources
- Warehouse
- Store or premises used as a sales outlet

Exclusions:

The following are ***excluded*** from the definition of PE:

✓ Use of facilities solely for storage or display of merchandise

✓ Maintenance of stock of goods solely for the purpose of processing by another enterprise

✓ Maintenance of a fixed place of business solely for

- Advertising
- Supply of information
- Scientific research
- Other similar activities which have a preparatory or auxiliary character

Further, in case of Ikea Trading (Hong Kong) Limited (2008-TIOL-23-ARA-IT), the AAR held that a liaison office engaged merely in the purchase of goods and export to group companies on behalf of the parent company does not constitute a PE in India for the parent company.

Construction PE:

DTAA [Article 5(2)]:

- ✓ Building site
- ✓ Construction project
- ✓ Installation project
- ✓ Roads, bridges, canals, pipelines, excavating, dredging [C5(17)]
- ✓ Renovation (not mere maintenance or redecoration)
- ✓ Planning and Supervision
  - On-site planning and supervision (of the erection of a building) included – regardless of whether supervisor is the building contractor
  - Only if site/ project lasts > 12 months (Note this period varies among different DTAA's)

Service PE:

- ✓ DTAA [Article 5(2)]
  - furnishing of ***services***, including consultancy services,
  - by an enterprise ***through employees or other personnel*** engaged by the enterprise for such purpose,
  - but only if - activities of that nature continue within a contracting state for more than 90days within any 12 months period or services are performed within that State for a related enterprise.
- ✓ The permanence element of a PE is replaced by a test of minimum length of time in the case of Service PE as in case of Construction PE.
- ✓ It is important to evaluate the requirements of Article 12 before examining the service PE clause.

Agency PE:

- ✓ The primary test for an agency is the legal ability of the agent to bind the principal to a third party. Replaces requirement of fixed place of business.
- ✓ ***Independent agent*** – no PE
  - legal and economic independence
- ✓ Only ***dependent agent*** constitutes a PE who-
  - acts on behalf of enterprise
  - has authority to conclude contracts
  - has no authority but habitually maintains stock of goods and regularly delivers goods for the enterprise
- ✓ No PE if agent acts in ordinary course of business.
- ✓ PE in the State would be only in respect of activities which the agent undertakes for the enterprise.

Further, in case of *Speciality Magazines (P) Limited (2005) 274 ITR 310 (AAR),* a NR publisher of magazines engaged an Indian company as an advertisement concessionaire for which it obtained a percentage of the consideration received. The AAR held that although the Indian company obtained about 75 percent of its revenue from the NR publisher, it cannot be treated as a dependent agent PE since it catered to a number of clients on a similar basis. Interestingly, in the above case it was held that the expression 'secures orders almost wholly for the enterprise' would mean that at least 90%of the revenues are sourced from the NR Company.

Miscellaneous Concepts:

Websites:

- ✓ Data and software which is used by, or stored on equipment located in a country may not necessarily form a PE. For example, an internet web site, which is a combination of software and electronic data, does not in itself constitute a tangible property and also does not have a location. Hence, it can not constitute a "place of business", and consequentially, a PE
- ✓ A website would fail the following tests even if the website is to be hosted on a particular server at a particular location:
  - The locus test
  - The permanence test
  - The disposal test

  However internet website may constitute a PE in certain circumstances in India.

Servers:

- ✓ A dedicated server which is owned/leased by an enterprise of one state in another state would constitute a PE for the enterprise.
- ✓ Depending on the facts, a foreign enterprise may be considered to have a PE by the virtue of it hosting its website on a particular server in India. Under such a scenario, foreign enterprises having internet website hosted on servers located in India owned by third party service providers may constitute PE