

# INSTALLATION PE

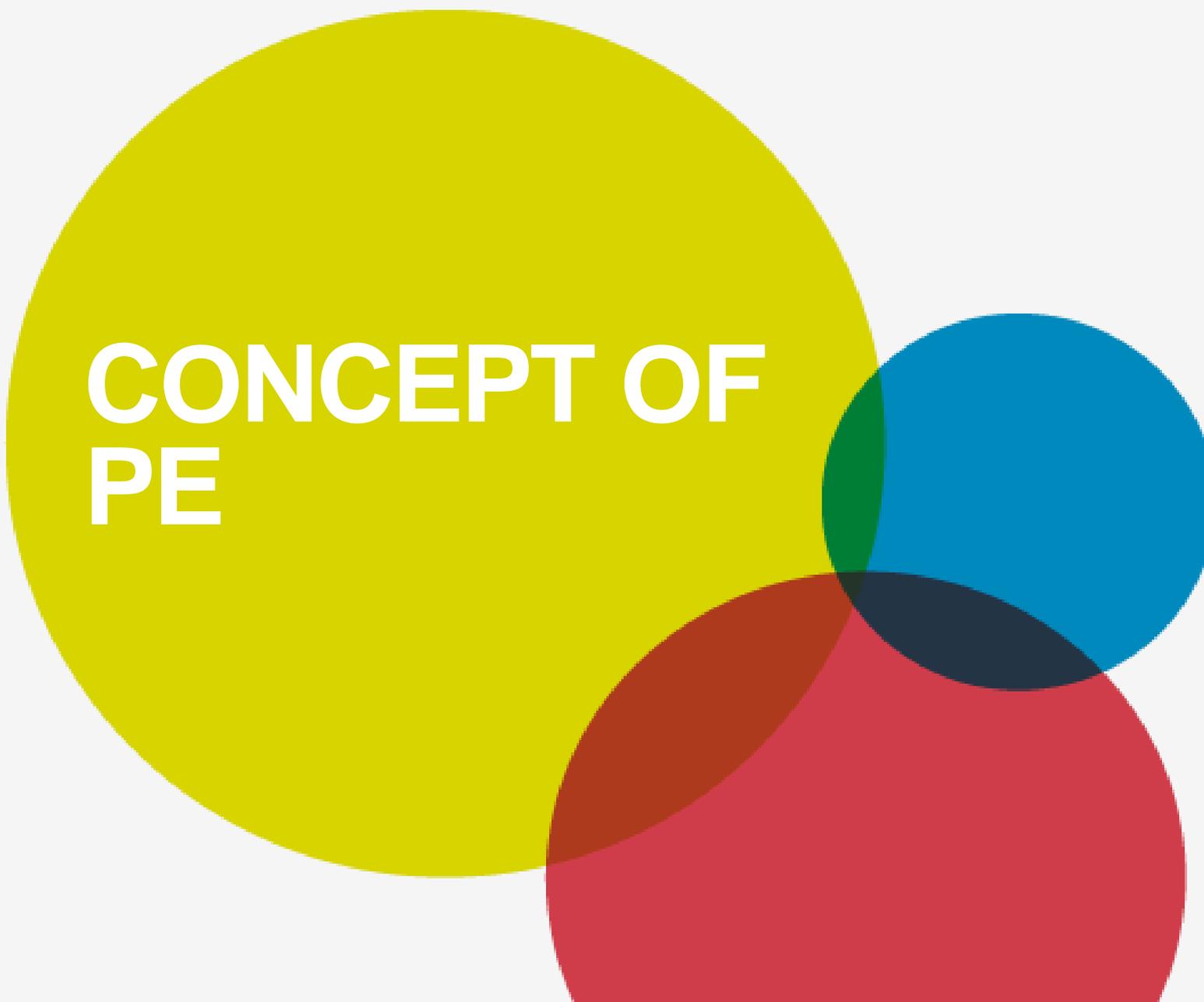
**Martin Ignacio D. Mijares**

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**August 28, 2018**

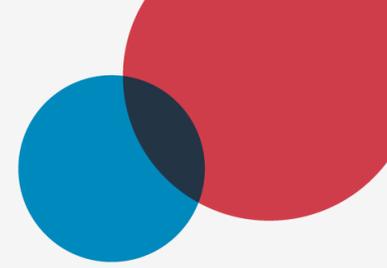
# OUTLINE

1. Concept of PE
2. Installation PE – Concept
3. Measurement of time period
4. Country positions/ observations on Installation PE
5. BEPS Action Plan 7
6. Some judicial rulings on Installation PE
7. Case Studies



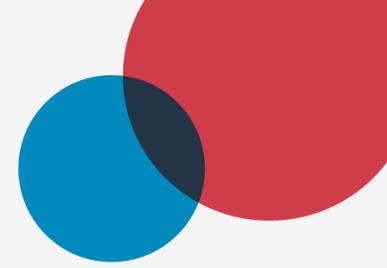
**CONCEPT OF  
PE**

# Concept of PE



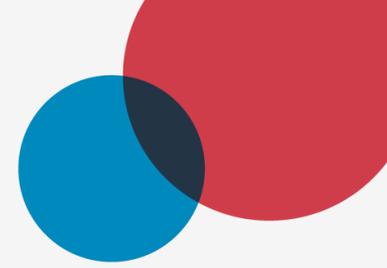
- ❖ PE is a taxable presence that an enterprise of one contracting State has in another contracting State
- ❖ PE is a compromise between a State of source and State of residence for purposes of taxation of business profits
- ❖ PE does not necessarily give rise to a legal presence

# Role of PE concept in treaties



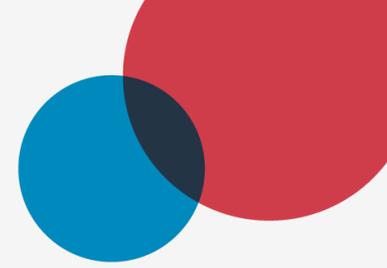
- ❖ Main use: Determine taxing right in State of residence of enterprise
- ❖ Assess business activity in State of source
- ❖ Determine taxing right in State of source (potential source)
- ❖ Is there a PE?
- ❖ Profit Allocation/Attribution
- ❖ Allocation/Attribution factors

# BASIC RULE PE



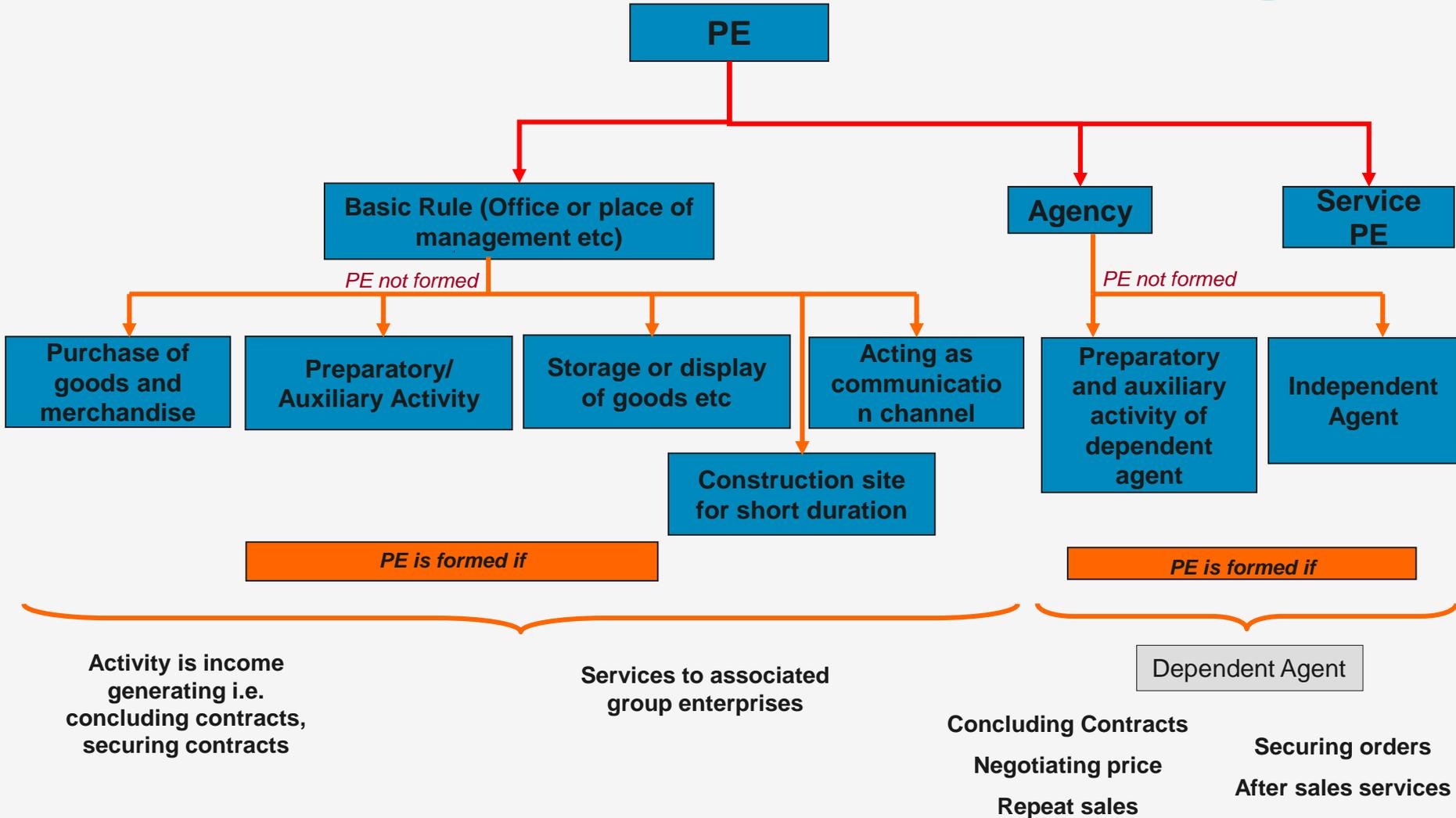
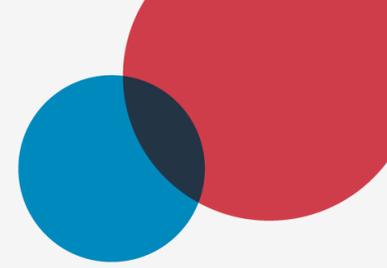
- ❖ **Situs test** – There must be a fixed place of business
- ❖ **Locus test** – The fixed place of business must be located [in a] certain territorial area
- ❖ **Tempus test** – The use of the fixed place of business must last for a certain period of time
- ❖ **Use test** – The taxpayer must have a certain right of use [over] the fixed place of business
- ❖ **Business activity test** – The activities performed through the fixed place of business must be of a business character

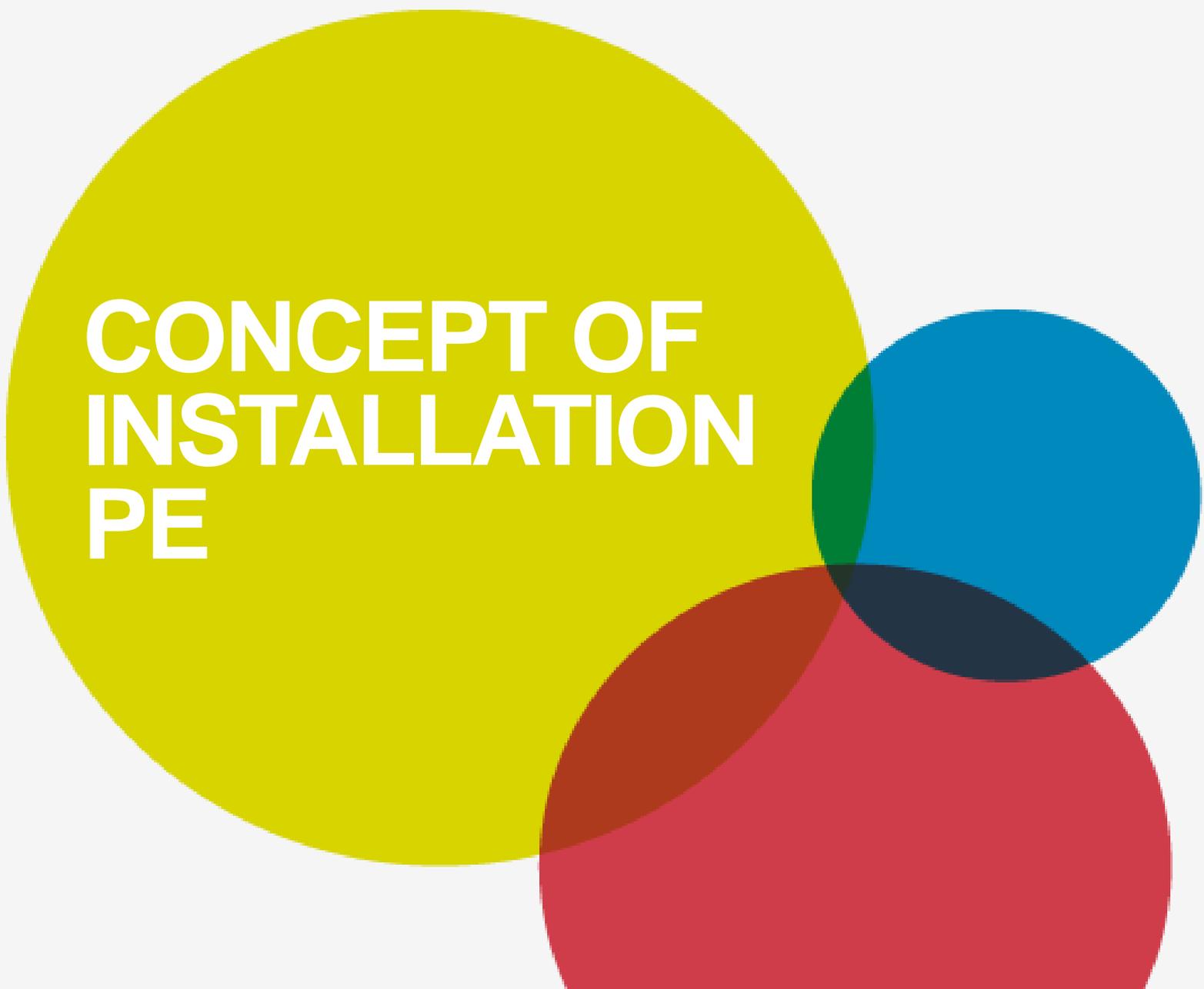
# OECD Model – Article 5



- ❖ Article 5(1) Basic rule PE
- ❖ Article 5(2) Specific PE
- ❖ Article 5(3) Construction, Building and Installation Projects and Service PE (UN Model)
- ❖ Article 5(4) Exclusions
- ❖ Article 5(5) Dependent agent
- ❖ Article 5(6) Independent agent
- ❖ Article 5(7) Subsidiary

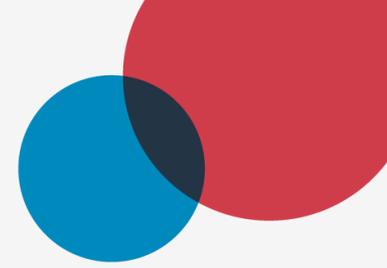
# Concepts of PE - summarized





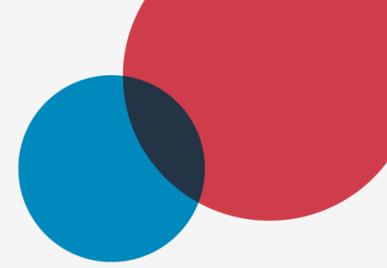
**CONCEPT OF  
INSTALLATION  
PE**

# INSTALLATION PE UNDER UN/OECD MODEL



- ❖ Article 5(3)(a) of the UN Model Convention 2011
  - The term Permanent Establishment ('PE') encompasses a building site, a construction, assembly, or installation project or supervisory activities in connection therewith,
  - However, such site, project or activities are to last for more than 6 months to constitute a PE
  
- ❖ Article 5(3) of the OECD Model Convention 2014
  - 'Assembly project' or 'supervisory activities' are not included
  - Period should be more than 12 months

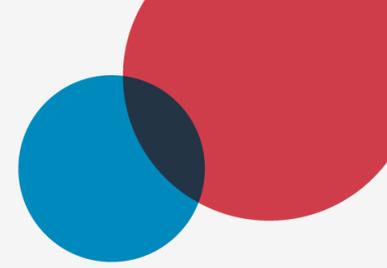
# CONCEPT



- ❖ Building site or construction or installation project including the construction of buildings, bridges or canals, excavating and dredging and the laying of pipelines
- ❖ Installation project means putting together or re-grouping of pre-fabricated elements such as the erection of steel scaffolding or units of production
- ❖ Final assembling of moveable objects (e.g. airplanes) also covered by the above term
- ❖ Planning and supervision covered only if carried on by the building contractor himself
- ❖ Delivery of materials to a construction or assembly project is not itself a construction or assembly project

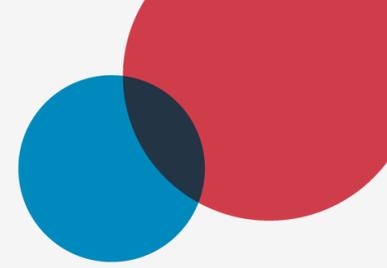
## ❖ TAXAND

# INSTALLATION PE – SOME EXAMPLES



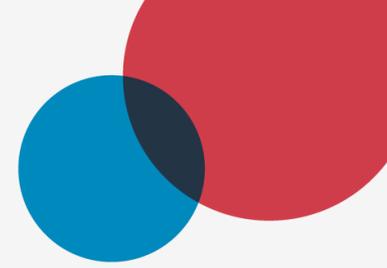
- ❖ Installation PE under India – France tax treaty
  - *A building site or construction, installation or assembly project constitutes a permanent establishment only where such site or project continues for a period of more than six months*
  - *an installation or structure used for the exploration of natural resources provided that the activities continue for more than 183 days*
  
- ❖ Installation PE under Indonesia – Malaysia tax treaty
  - *a building site or construction, installation or assembly project which exists for more than 6 months*

# INSTALLATION PE – SOME EXAMPLES



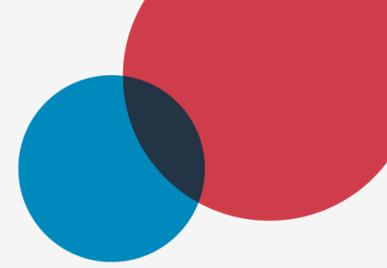
- ❖ Installation PE under India – UK tax treaty
  - *a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity, being incidental to the sale or machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment*

# INSTALLATION PE – SOME EXAMPLES



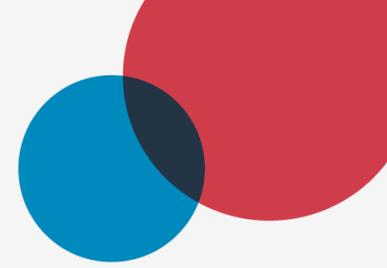
- ❖ Installation PE under Singapore – China tax treaty
  - a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than 6 months;
  
- ❖ Installation PE under India – Malaysia tax treaty
  - *A building site or construction, installation or assembly project or supervisory activities in connection therewith constitutes a permanent establishment only if such site, project or activities last more than 9 months*

# INSTALLATION PE – SOME EXAMPLES



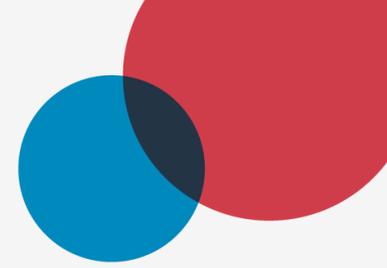
- ❖ Installation PE under Philippine – Kuwait tax treaty
  - A building site, a construction, assembly, erection or installation project or supervisory activities in connection therewith carried out in a Contracting State, constitutes a permanent establishment only if such site, project or activities continue for a period of more than three months.

# TEMPUS TEST

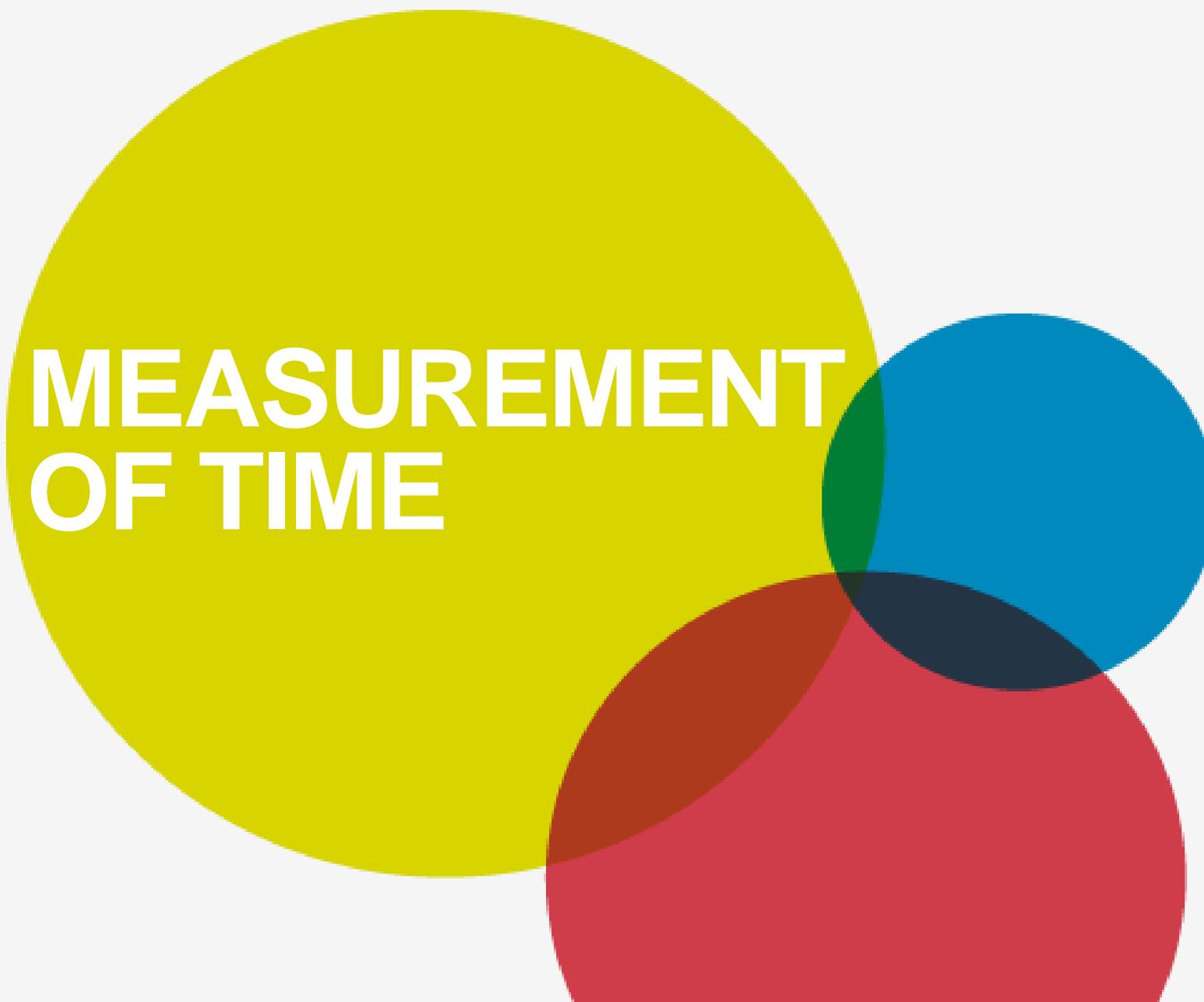


- ❖ The permanence element of a PE is replaced by a test of minimum length of time
- ❖ The minimum period starts when the enterprise starts to perform business in connection with the building or construction or installation project
- ❖ Building works for different ordering parties mark the beginning of new periods even if they are operated at one and the same place

# KEY ISSUES

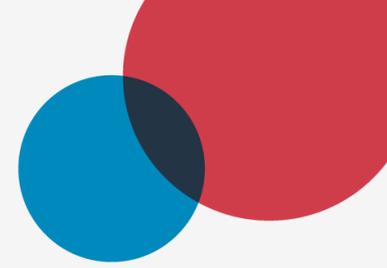


- ❖ Whether series of short-term unrelated contracts covered?
- ❖ Treatment to be given to temporary gaps?
- ❖ Whether sub-contractor days should be counted towards main contractor days?
- ❖ Implications in case the period of the project or activity extends over two tax years
  - Could PE be said to be in existence in the first year though it does not exist for the prescribed time during the first year?
  - Taxability of income of the employees, who could otherwise claim short stay exemption
  - Withholding tax obligations on payment to such employees
  - Advance tax obligations



**MEASUREMENT  
OF TIME**

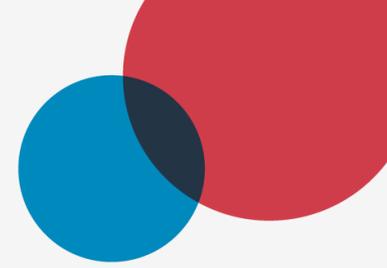
# PERIOD TO BE CONSIDERED



## *Commentary to OECD Model Convention 2014*

- ❖ A site exists from the date on which the contractor begins his work, including any preparatory work, in the country where the construction is to be established (e.g. a planning office is installed)
- ❖ It continues until the work is complete or permanently abandoned
- ❖ A site should not be regarded as ceasing to exist when work is temporarily discontinued – for e.g., due to:
  - bad weather
  - shortage of material
  - labour difficulties

# PERIOD TO BE CONSIDERED

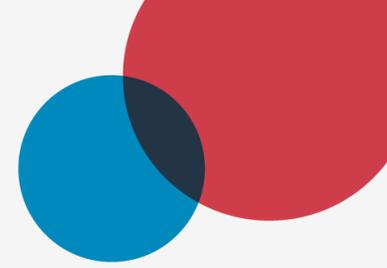


## ❖ General contractors and subcontractors –

*“If an enterprise (general contractor) which has undertaken the performance of a comprehensive project subcontracts parts of such a project to other enterprises (subcontractors), the period spent by a subcontractor working on the building site must be considered as being time spent by the general contractor on the building project. The subcontractor himself has a permanent establishment at the site if his activities there last more than twelve months.”*

- In case of sub-contract, time period of the sub-contractor also to be considered
- Sub-contractor himself may have a PE if duration exceeds the threshold limit

# PERIOD TO BE CONSIDERED

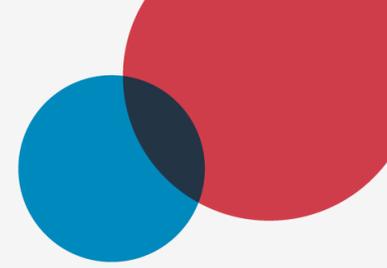


## ❖ Scattered projects

- In some projects, due to its nature, contractor's activity has to be re-located continuously or at least from time to time as the project progresses
- This would be the case for instance where roads or canals were being constructed, waterways dredged, or pipe-lines laid
- Similarly, where parts of a substantial structure such as an offshore platform are assembled at various locations within a country and moved to another location within the country for final assembly, this is part of a single project

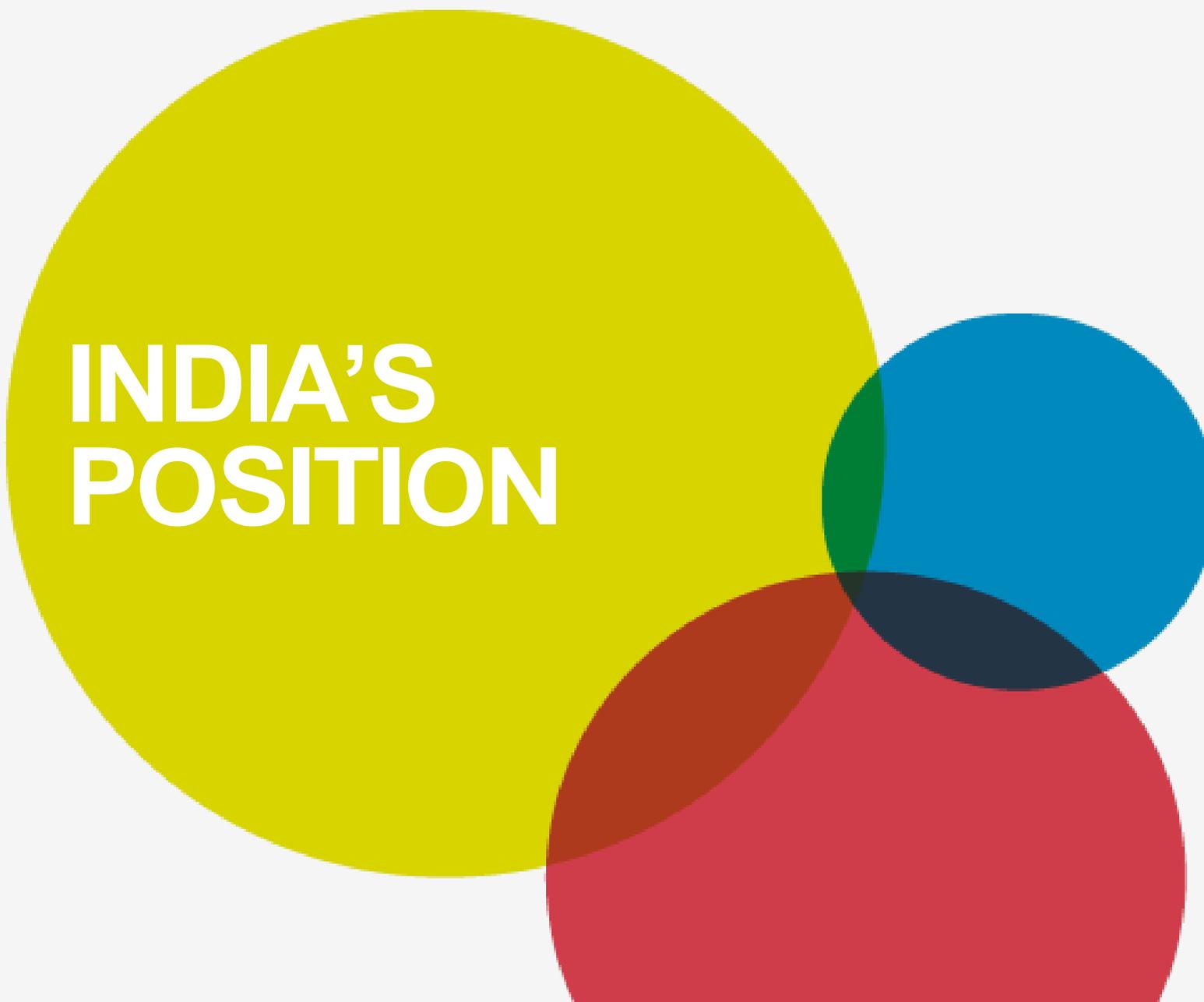
❖ In such cases, the fact that the work force is not present for twelve months in one particular location is immaterial

# PERIOD TO BE CONSIDERED



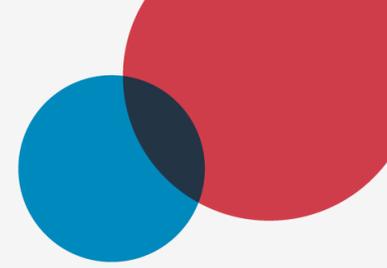
- ❖ The activities performed at each particular spot are part of a single project, and that project must be regarded as a permanent establishment if, as a whole, it lasts more than twelve months
- ❖ 12 month test to apply to each individual site or project
- ❖ Activities may extend over more than one Calendar year or Assessment year
- ❖ Time spent on unconnected sites or projects should not be considered for the 12 month period
- ❖ Legal Acts are excluded in calculating the time limit
- ❖ Trial run is to be included in the minimum period
- ❖ After sales services, if either sufficiently connected with the building, installation or assembly work could trigger PE
- ❖ PE cannot be said to arise in case of auxiliary services provided subsequent to a fully completed assembly or installation project

## ❖ TAXAND



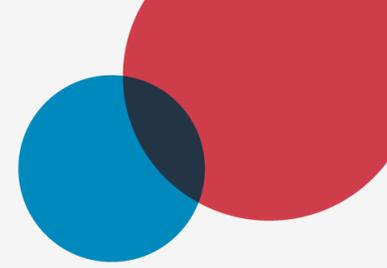
**INDIA'S  
POSITION**

# INDIA'S POSITION/OBSERVATION



- ❖ The 2017 Update states that a building site or construction or installation project constitutes a PE only if it lasts more than 12 months. It is clarified that work undertaken on a site after the construction work, pursuant to a guarantee that requires an enterprise to make repairs, would normally not be included in the original construction period.
- ❖ India does not agree with such interpretation
  - According to India, any work undertaken on a site shortly after the construction work has been completed, including repair works undertaken pursuant to a guarantee, may be taken into account as part of the original construction period

# INSTALLATION PE UNDER INDIAN TREATIES



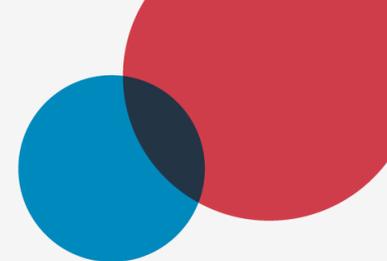
❖ India has adopted the UN model, with some variations

| Country  | Building site or construction, installation or assembly project or supervisory activities in connection therewith  |
|--|--|
| US   | More than 120 days in any 12 month period  |
| Australia, France, Germany, Japan, Netherlands | More than 6 months   |
| China, Singapore                               | More than 183 days   |
| Belgium, Italy, UK                             | <ul style="list-style-type: none"><li>• More than 6 months; or</li><li>• Where such project or supervisory activity is incidental to sale of machinery /equipment, more than 6 months <u>and</u> charges payable towards the above exceed 10 percent of sale price of machinery /equipment</li></ul> |
| Luxembourg, Mauritius                          | More than 9 months   |
| Cyprus   | More than 6 months   |

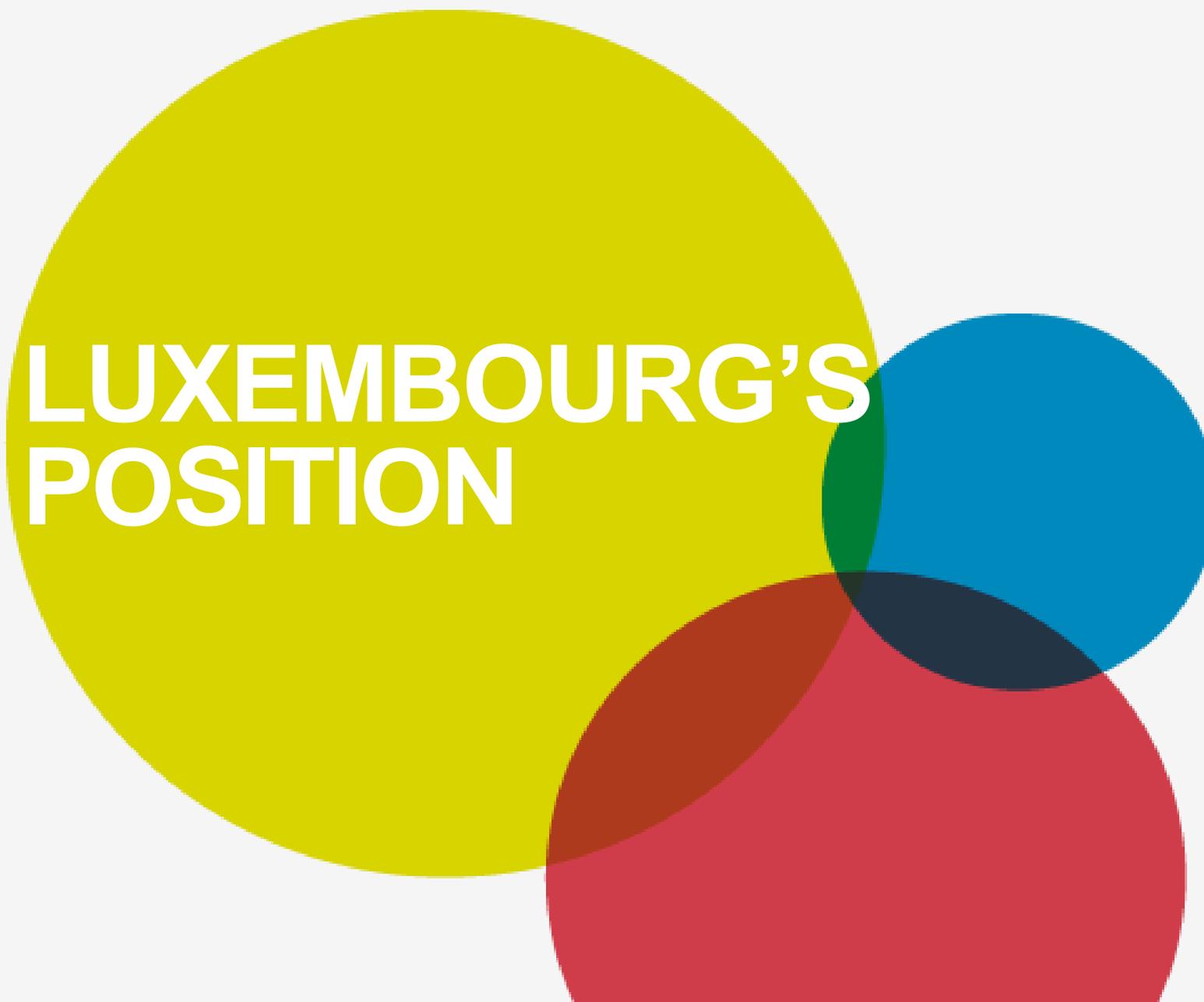


# MALAYSIA'S POSITION

# MALAYSIA'S POSITION/OBSERVATION

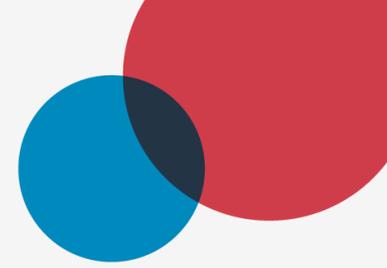


- ❖ The installation PE is the most common type of PE in Malaysia, where the tax authorities are not otherwise aggressive in pursuing PEs (to date)
- ❖ Generally, a PE will be based on the length of time of the individual project and will not include a series of short term projects
- ❖ Most Malaysian DTAA's have a separate paragraph in the PE article to cover supervisory activities in relation to a building site, construction, installation or assembly project

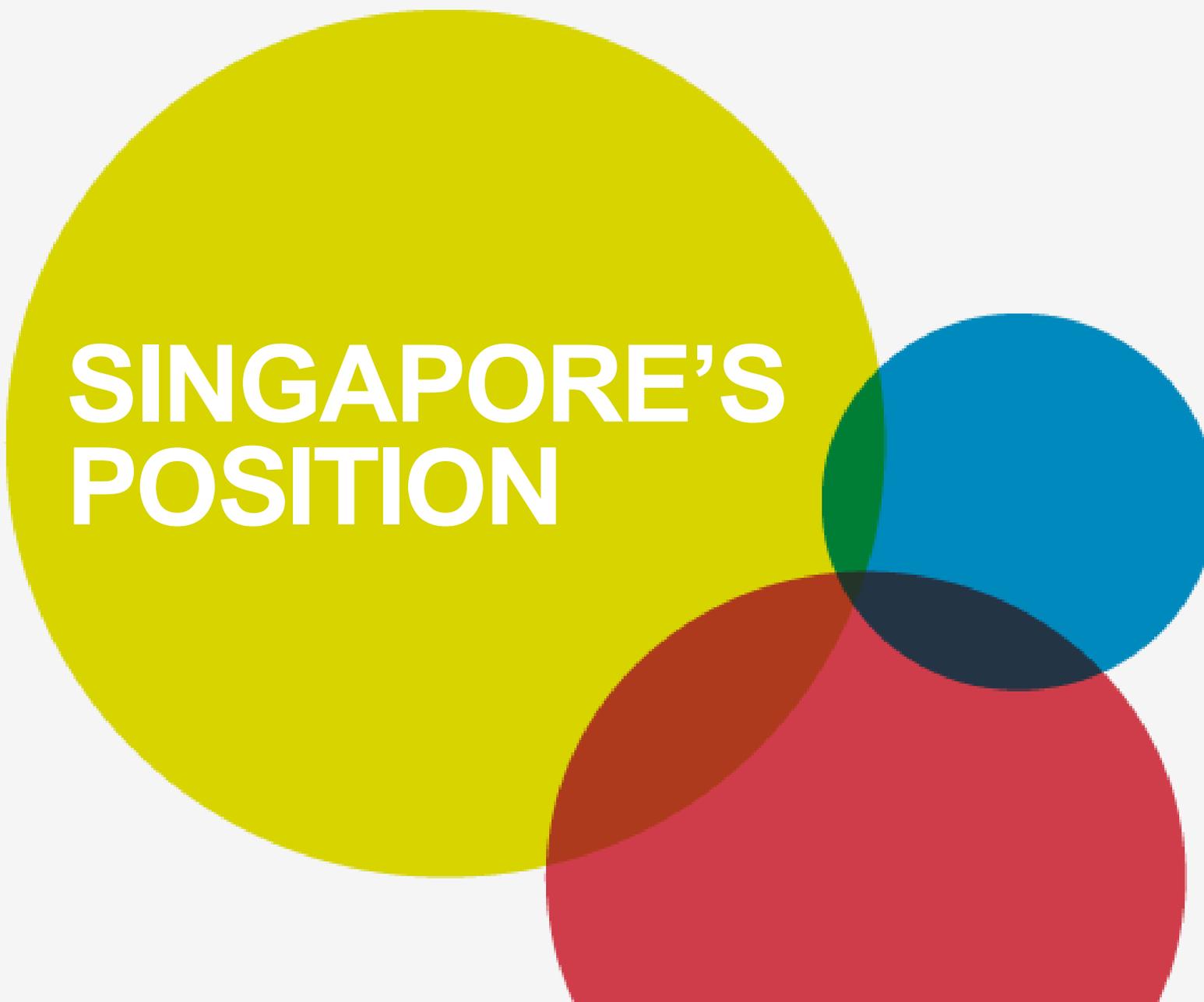


# LUXEMBOURG'S POSITION

# LUXEMBOURG'S POSITION / OBSERVATION

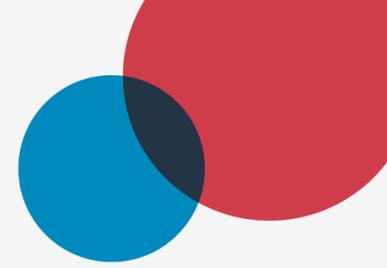


- ❖ In its treaties, Luxembourg generally follows the definition of the OECD model tax convention : “A *building site or construction or installation project* constitutes a permanent establishment only if it lasts *more than twelve months*.”
- ❖ In some other treaties however, and this is the case of the treaty with India, in order to come to an agreement with the other contracting state, Luxembourg has agreed to include a PE provision, which is closer to the one of the UN Model and includes, as requested by India, “*construction, installation or assembly project or supervisory activities in connection therewith*”.



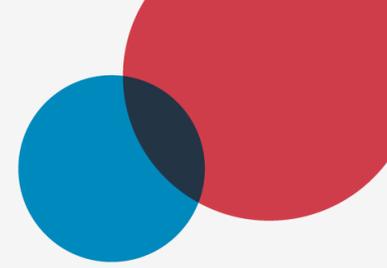
**SINGAPORE'S  
POSITION**

# SINGAPORE'S POSITION / OBSERVATION



- ❖ Permanent establishment concept – allied to the concept of income taxation on the basis of residence
- ❖ Income tax in Singapore – payable on income sourced/earned in Singapore and on foreign income brought into Singapore – residence as such does not actually even figure in the “charge of income tax”
- ❖ Enterprises carrying on business in the Host State – where a non-resident person carries on a trade or business of which only part of the operation is carried on in Singapore, the income shall be deemed to be sourced from Singapore and taxable in Singapore to the extent the income cannot be directly attributable to the operations carried on outside Singapore

# SINGAPORE'S POSITION / OBSERVATION

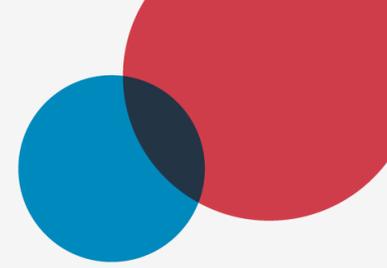


- ❖ The underlying tension between the residence-based perspective and the territorial perspective underlines some of the unanticipated problems that taxpayers encounter



# INDONESIA'S POSITION

# INDONESIA'S POSITION / OBSERVATION

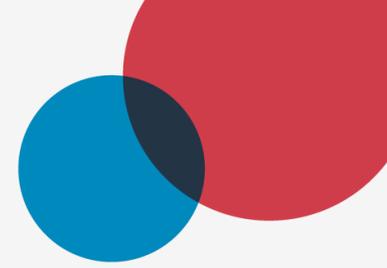


- ❖ However, in some treaties (such as Indonesia-Egypt, Indonesia-Japan, Indonesia-France) the time test applies for each of the individual site or project
- ❖ Below is an example of one of the treaties as stated above:
  - **Installation PE under the Japan – Indonesia treaty**  
*A building site or construction or installation project constitutes a permanent establishment only if it lasts more than six months*
- ❖ In some cases where the tax treaty is inapplicable, the Indonesian Tax Law does not specify the time test period to determine the existence of a PE. Thus, any installation or construction project conducted by a non-treaty partner country in Indonesia will straight away be deemed as a PE



**PHILIPPINES'  
POSITION**

# PHILIPPINES' POSITION / OBSERVATION

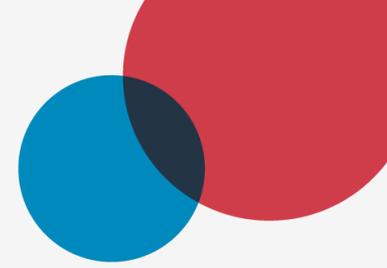


- ❖ Generally follows the OECD model
  - Period range from 6 months to as short as 3 months (90 days)
- ❖ In cases where a tax treaty does not apply, Philippine tax law employs the “continuity of commercial dealings” test
  - In order that a foreign corporation may be regarded as doing business within a State, there must be continuity of conduct and intention to establish a continuous business, such as the appointment of a local agent, and not one of a temporary character



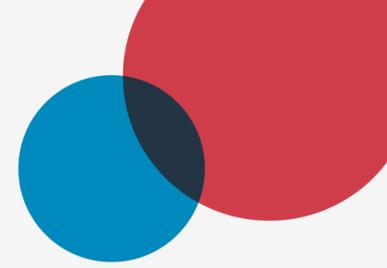
**BEPS ACTION  
PLAN 7 –  
SPLITTING UP  
CONTRACTS**

# BEPS ACTION PLAN 7 – SPLITTING UP OF CONTRACTS



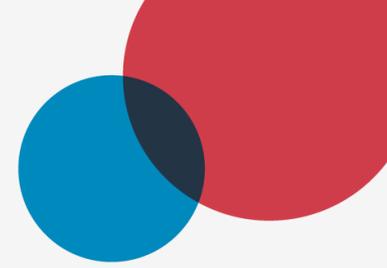
- ❖ The final report addresses splitting up of contracts between group companies to circumvent 12-month time period for constituting a PE for building sites and construction or installation project
- ❖ Paragraph 18 of the Commentary on Article 5 of OECD Model Convention discusses concerns re splitting-up of contracts in order to abuse the exception in Article 5(3)
- ❖ The concern to be addressed in the following manner:
  - Principal Purposes Test (PPT) rule to be adopted under Action Plan 6 to address BEPS concerns related to the abusive splitting-up of contracts
  - For States that are unable to address the issue through domestic anti-abuse rules, an alternative provision to be used regarding splitting-up of contracts issue

# BEPS ACTION PLAN 7 – SPLITTING UP OF CONTRACTS



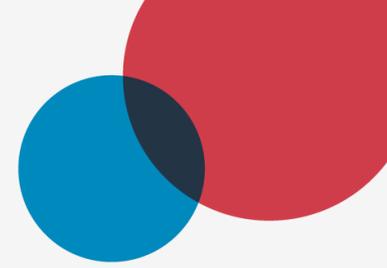
- ❖ Para 18 to *inter alia* provide that time spent on ‘connected activities’ at the same installation project by enterprises ‘closely related’ to the main contractor, to be added to the time spent by the main contractor at that installation project

# BEPS ACTION PLAN 7 – SPLITTING UP OF CONTRACTS



- ❖ Determination of whether activities are connected to depend on the facts and circumstances of each case. Factors that may especially be relevant for that purpose *inter alia* include:
  - whether the contracts covering different activities were concluded with the same person or related persons;
  - whether the contracts covering different activities were concluded with the same person or related persons;
  - whether conclusion of additional contracts with a person is a logical
  - consequence of a previous contract concluded with that person or related persons;

# BEPS ACTION PLAN 7 – SPLITTING UP OF CONTRACTS

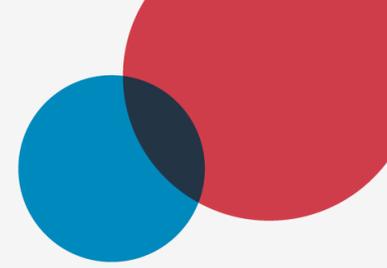


- whether activities would have been covered by a single contract absent tax planning considerations;
- whether nature of the work involved under different contracts is the same or similar;
- whether same employees are performing the activities under the different contracts.



**SOME JUDICIAL  
RULINGS ON  
INSTALLATION  
PE**

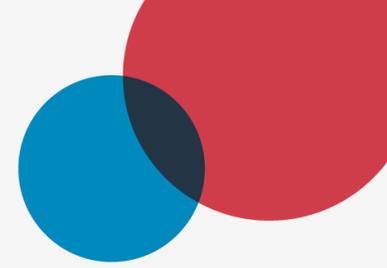
# CAN PROJECT OFFICE CONSTITUTE A FIXED PLACE PE?



## Facts

- ❖ HH Co Ltd, (“the Company”) a tax resident of Country A was engaged in the business of executing installation, construction and assembly project of various oil companies in Country B
- ❖ The Company had a project office in Country B since 1983 and the installation, construction, assembly, etc. was carried on at the project sites
- ❖ The Company had executed three installation contracts in Country B for which permission for establishing project office for preparatory or auxiliary work was obtained in Country B
- ❖ The duration of each of the execution contract lasted less than 6 months

# CAN PROJECT OFFICE CONSTITUTE A FIXED PLACE PE?

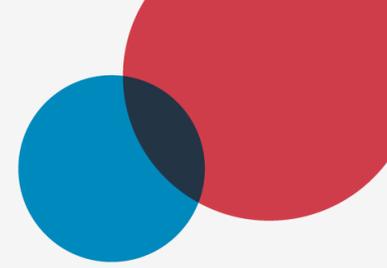


## Held\*

- ❖ Article 5(3) being a specific provision would override Article 5(1) and 5(2)
- ❖ The Project office performs coordination activity for execution of the works contract, such activities are preparatory or auxiliary in nature. Hence no fixed place PE
  - Mere correspondence from the Project office is of no relevance in concluding that the office constitutes a PE in Country B
  - It is irrelevant that the project office was in existence for a number of years
- ❖ The works contract were completed within less than 6 months period, hence no Installation PE

*\* Held in the case of Hyundai Heavy Industries – Delhi Tribunal*

# SHOULD THE PERIOD UNDER REPAIR BE CONSIDERED?



## Fact

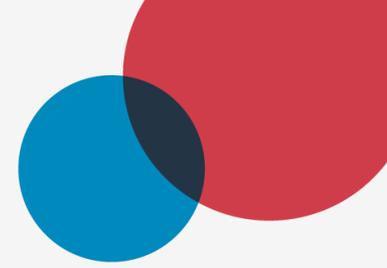
- ❖ The taxpayer, a resident company of Country A was an offshore drilling contractor, who was to execute a contract relating to drilling including mobilizing of rig in Country B
- ❖ The taxpayer had given an address in Country B as the office address in the contract relating to drilling operations
- ❖ In executing the contract, rig had to undergo repairs, which was to be done by the taxpayer on a remuneration

## Issue for consideration

- ❖ Whether the period when the rig was under repairs is to be considered as being used for the purposes of the contract?
- ❖ Whether merely an office address is sufficient to conclude that the taxpayer had a PE in Country B?

❖ **TAXAND**

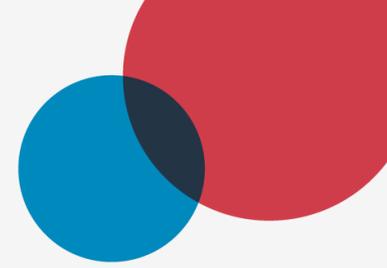
# SHOULD THE PERIOD UNDER REPAIR BE CONSIDERED?



## Held\*

- ❖ An installation or a structure could become a PE only if it was actually used for exploration or exploitation of natural resources for a period of more than 120 days. The activity of repairs and mobilization of the rig were not for exploration or exploitation of natural resources.
  - The rig could be considered to be used for exploitation of mineral oil only when it was positioned at the appointed place for the exploration of mineral oil.
- ❖ Drawing inference from the OECD commentary, it was observed that mere office address could not be said to constitute a PE, unless business activities are carried out from such place
  - The rig could be considered to be used for exploitation of mineral oil only when it was positioned at the appointed place for the exploration of mineral oil.

# SHOULD THE PERIOD UNDER REPAIR BE CONSIDERED?

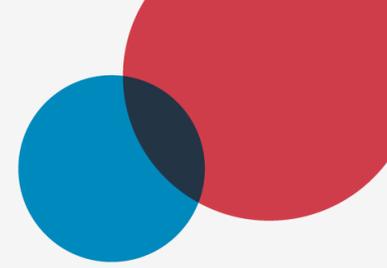


## Held\*

- Since there was no evidence to show that any business was carried on except that the address was mentioned in the agreement, it could not lead to an inference that the taxpayer had a fixed place PE in Country B

*\* Held in the case of R&B Falcon Offshore Ltd – Delhi Tribunal (Affirmed by Delhi HC and Revenue's SLP dismissed by Supreme Court)*

# CAN VESSEL CONSTITUTE A FIXED PLACE PE?



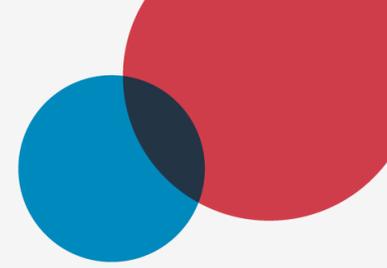
## Facts

- ❖ A company of Country A executed pipeline projects in territorial waters of Country B using diving support vessel as base

## Held\*

- ❖ Vessel can be described as a fixed place of business
- ❖ However, pipeline project did not exceed threshold period of 183 days - hence no PE in Country B

# PREPARATORY WORK VS PRELIMINARY ACTIVITIES



## Held\*

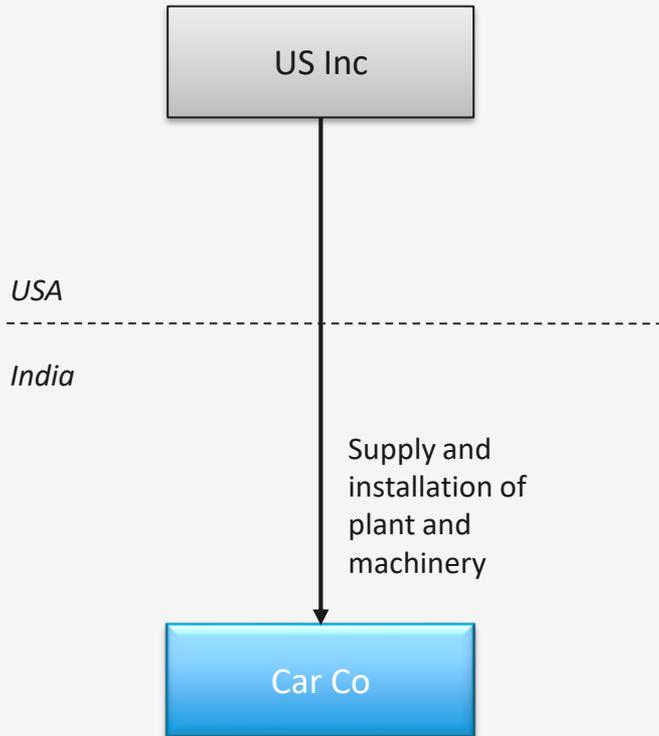
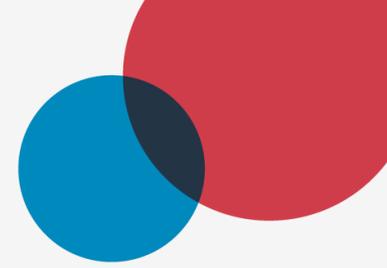
- ❖ Preparatory work for starting the project has to be distinguished from purely preliminary activities
- ❖ Occasional short visits of contractor's personnel for negotiations or doing some paper work in connection with the project or for taking the soil samples (for construction of pipelines), broadly speaking, will not trigger the start of the time-limit

*\* Held in the case of Cal Dive Marine Construction – Authority for Advance Ruling*



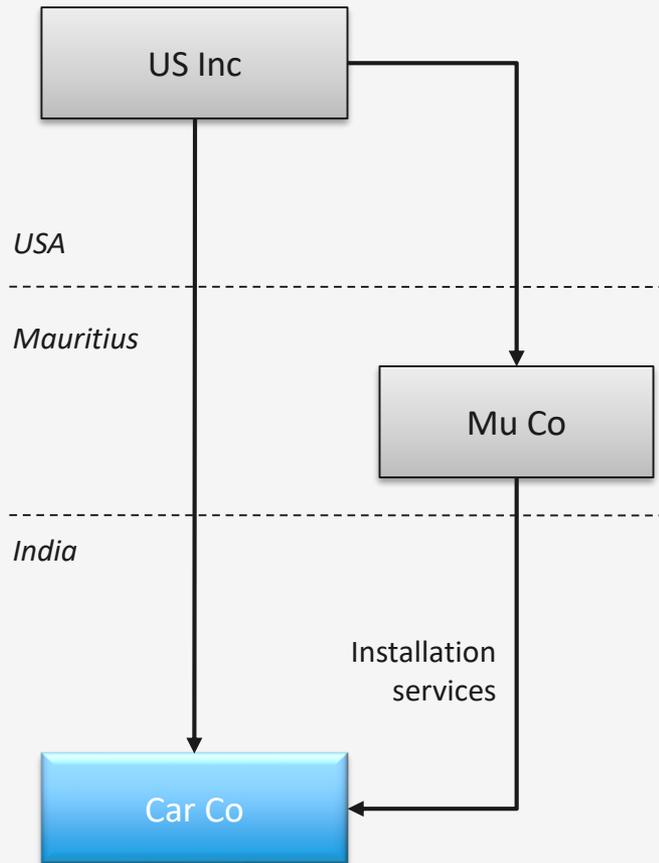
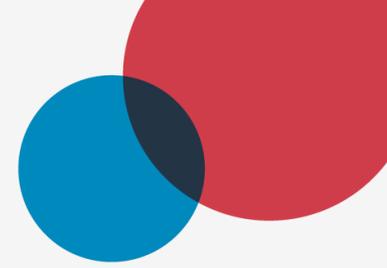
**CASE  
STUDIES**

# CASE STUDY - I



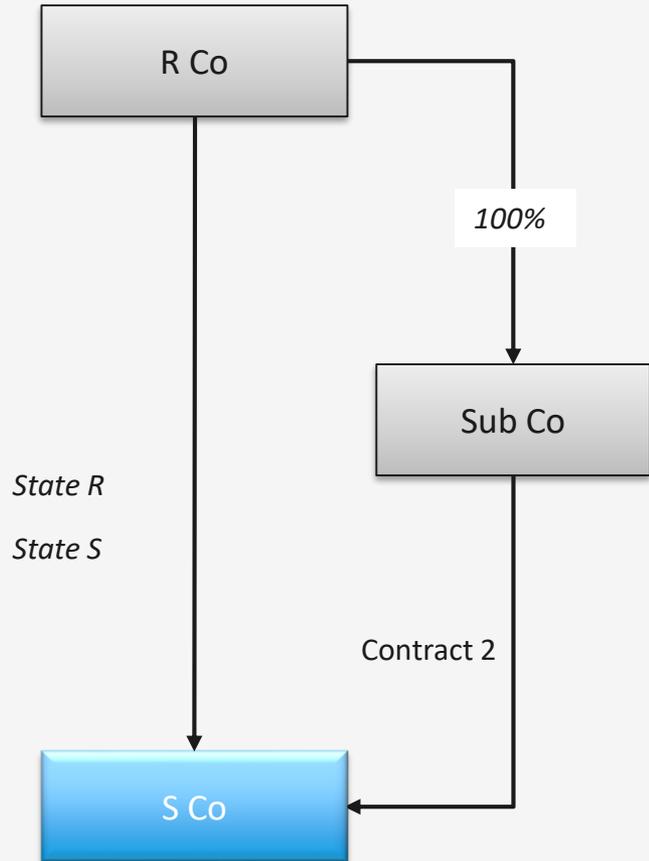
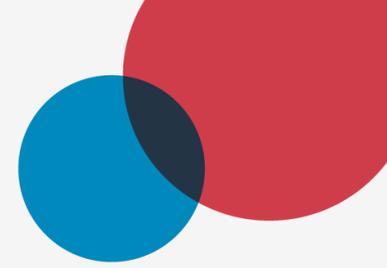
- ❖ US Inc supplies plant and machinery to a Car Co, its JV company in India
- ❖ US Inc also provides services in connection with the installation and assembly of the plant and machinery, for which employees of US Inc come to India and stay in India for a period of (a) 90 days; or (b) 150 days
- ❖ It also seconded personnel to guide the initial operations on aspects of Finance, MIS, technical aspects etc of the Car Co
- ❖ Analyze the tax implications of the transaction

# CASE STUDY – II



- ❖ US Inc supplies plant and machinery to Car Co
- ❖ Employees of US Inc are transferred to the payroll of Mu Co, who are seconded to Car Co for installation and assembly, for which the employees stay in India
- ❖ Analyze the tax implications of the transaction

# CASE STUDY – III



- ❖ R Co submitted a bid for construction of a power plant for S Co
- ❖ Construction is expected to last for 22 months
- ❖ During negotiations, contract is divided into two different contracts each lasting 11 months
- ❖ While the first contract would be executed by R Co, second contract to be executed by Sub Co, wholly owned subsidiary of R Co
- ❖ R Co to be jointly and severally liable with Sub Co for performance under Contract 2



THANK YOU

# ABOUT TAXAND

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