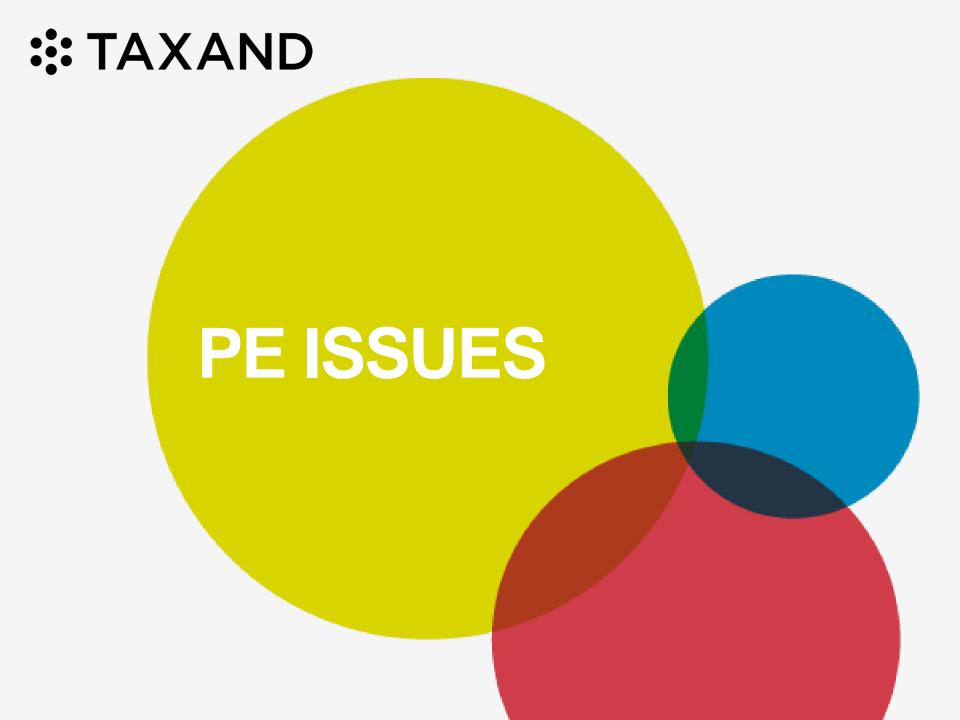


OUTLINE

- 1. PE Issues
- Case Study 1
- 3. Liaison office can it constitute a PE?
- 4. Service PE
- 5. Case Study 2
- 6. Agency PE
- 7. Case Study 3
- 8. Case for a virtual PE yet?





SOME ISSUES



- Should the presence be 'visible' in the contracting state?
- Would an isolated presence qualify as a PE?
- Does the presence cover tangible and intangible assets too?
- Do movable places of business with a temporary fixed location meet the locus test?
- Mere legal right to use a place sufficient to constitute a PE or would actual use be relevant?
- Does illegal occupation constitute a PE?
- Do websites, electronic hubs and computer mainframes located in a country constitute a PE?
- What if commercial activities, transactions and managerial decisions are at altogether different jurisdictions – which create PE?
- Concept of 'place of business' evolving and expanding

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SOME EXERCISES

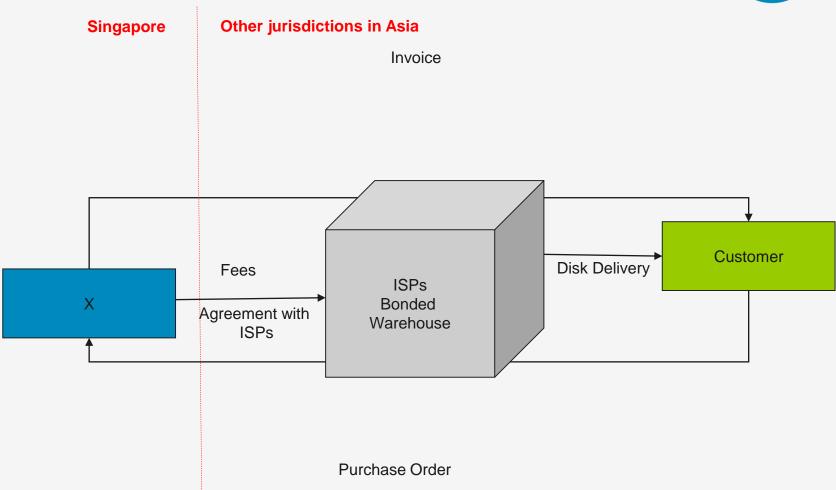
- Fishing boat operated within the territorial waters?
- Circus or a carnival performing at different places in a city?
- Concert tours, music shows?
- Restaurants and shops on-board ships in international traffic?
- **Home offices?**
- ➡ Partner's premises a PE for the partnership?





CASE STUDY 1 - FACTS







CASE STUDY 1 - FACTS



- X is a tax resident of Singapore and manufactures and sells hard disk drives to Customers across Asia
- Proposal for X to enter into arrangements with Independent Service Providers ("ISPs") to stock the disks in various jurisdictions and supply these to Customers on a Just-in-Time basis
- Customer would place an order on X for its requirement based on which X would issue necessary directions to the ISP; X would invoice the Customer and ISP would invoice X
- ISP is to make available an identified place for storage of X's goods
- Upon advance notice, X's employees were allowed to enter ISP's warehouse for physical inventory inspection, audit, repackaging, etc.



CASE STUDY 1 - FACTS



- ISP was to put in place / apply its existing Vendor Management Inventory model
- Operating system of ISPs to support electronic data interchange, furnish receipt, sale advice and inventory reports
- ISP was economically independent and undertook this activity for a number of manufacturers



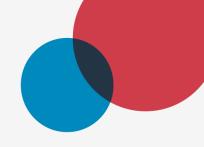
CASE STUDY 1 - QUESTIONS



- Whether ISPs would constitute a PE?
- Would the analysis be any different if the hard disks were supplied on a consignment basis under the ownership of X?
- Would the analysis be any different if the stock stored was not of material to be sold but material in the nature of spares to be used only
 - (a) as stand-by material; (b) only for servicing any repairs
- Would the analysis be any different if the stocking is made at the request of a particular single Customer, limited to supplies to be made to that Customer on a request basis in the following situations:
 - The ISP is engaged and paid by X
 - The ISP is engaged and paid by the Customer



CASE STUDY 1 - QUESTIONS



If a PE is constituted, what would be the income attributable to the PE, if it has been remunerated on an arms length basis?







LIAISON OFFICE – CAN IT CONSTITUTE A PE



* A LO typically:

- Is a representative office
- Functions as a communication channel between the head office and customers
- Is prohibited from undertaking any commercial trading or industrial activities and any other income generating activities, directly or indirectly

Trends:

- Increasing focus of the Revenue Authorities across various jurisdictions to check the actual scope of activities of such LOs
- For instance, India has introduced rules for detailed reporting by LOs on an annual basis to check the level of activity of each LO





SERVICE PE – CONCEPT



- Article 5(2) / (3) of the DTAA furnishing of services by a non-resident in a contracting State through employees or other personnel may result in creation of "Service PE"; provided the duration of such services exceeds the specified period
- Services may be rendered to an associated enterprise of the service provider or a third party service recipient
- The permanence element of a PE is replaced by a test of minimum length of time in the case of service PE as in the case of installation PE
- It is important to evaluate the requirements of Article 12 before examining the Service PE clause
- The calculation of length of time is based on man days



STEWARDSHIP



- Stewardship services are rendered to protect the interest of the customer/ principal
- Stewards are typically not involved in the day-to-day management or in rendering the services undertaken by the service provider
- Their function is essentially of quality control and ensuring confidentiality
- Usually, the foreign enterprise does not receive fees from the recipient of such services and the cost of the personnel performing these services is also borne by the foreign enterprise
- Given the above, stewardship activities do not lead to the constitution of a service PE



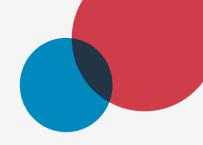
SECONDMENT



- The typical features of a secondment are:
 - An employee of enterprise X in State X is seconded to enterprise Y in State Y; <u>he continues on the payroll of</u> <u>enterprise X</u>
 - Employee resides and renders services in State Y; he reports to enterprise Y
 - The employee may continue to be paid by enterprise X who in turn is reimbursed by enterprise Y
- Critical parameters in determining the existence of a PE or otherwise
 - Commercial justification
 - Enterprise which exercises control over the employee
 - Existence or otherwise of a lien on employment with enterprise
 X for the employee

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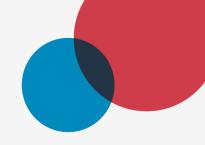
DEPUTATION



- The typical features of deputation are:
 - An employee of enterprise X in State X is deputed to enterprise
 Y in State Y; he shifts to the payroll of enterprise Y
 - Employee resides and renders services in State Y; he reports to enterprise Y
 - Salary of the employee is paid by enterprise Y
- It may be possible to demonstrate that the employee does not retain a lien on his employment with enterprise X



DEPUTATION



- Deputation may not be preferred since:
 - Employees are keen to retain a lien
 - Continuity of social security/ provident fund/ mortgage could be affected
 - Position of the employee within the organization could be affected
 - The period for which the services of the employee are required could be short



PLACE OF PROVISION OF SERVICES

- The persons rendering the services and the persons availing the services may be in different locations
- For example:
 - The employee is present in the state where the services are being rendered (i.e., Enterprise X in State X provides services to Enterprise Y in State Y)
 - The employee is not present in the state where the services are being rendered (i.e., An employee of Enterprise X in State X is present in State Z for rendering services to Enterprise Y in State Y)



PLACE OF PROVISION OF SERVICES

 The employee is present neither in the state where the services are being rendered nor in the state where the services are utilized (i.e., an Employee of Enterprise X in State X who is present in State Z for rendering services to Enterprise Y of State Y and the services are to be utilized in State Y)



OTHER PERSONNEL



- According to OECD, the business of an enterprise is carried on mainly by the entrepreneur or persons who are in paid employment relationship with the enterprise. These personnel include employees and other persons receiving instructions from the enterprise
- The interpretation of "other persons" referred to above is based on the principle of *noscitur a sociis*
- Some issues arising in interpreting "other persons" are:
 - Whether non-individuals are included?
 - Whether employees of another enterprise included?
 - Should the personnel be dependent on the enterprise?
 - Is there an overlap between service PE and agency PE or are they mutually exclusive?

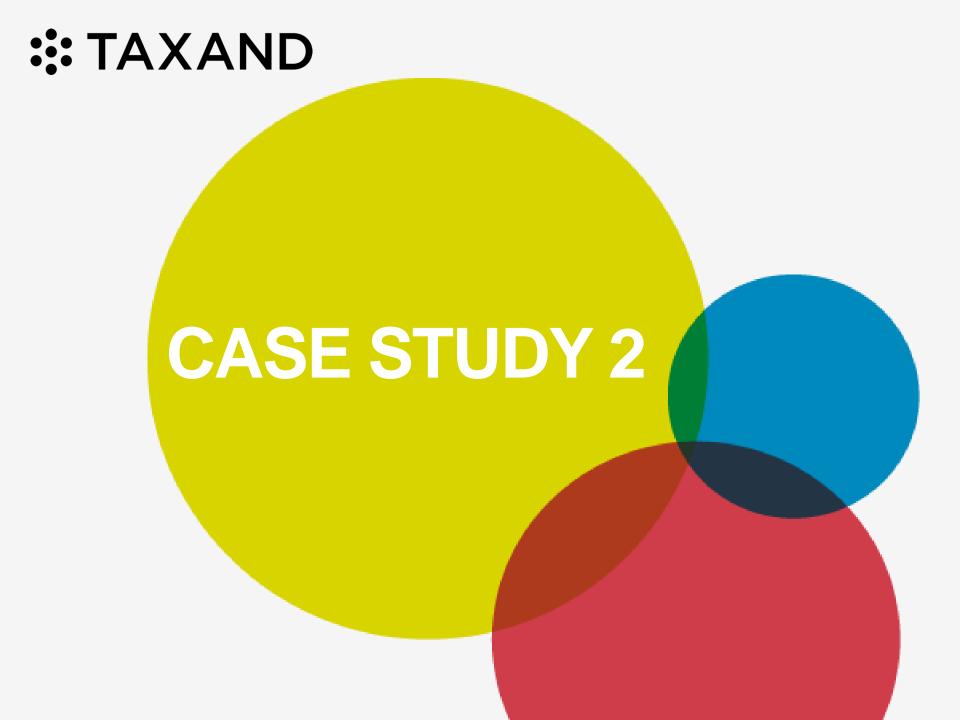


SERVICE PE - KEY ISSUES

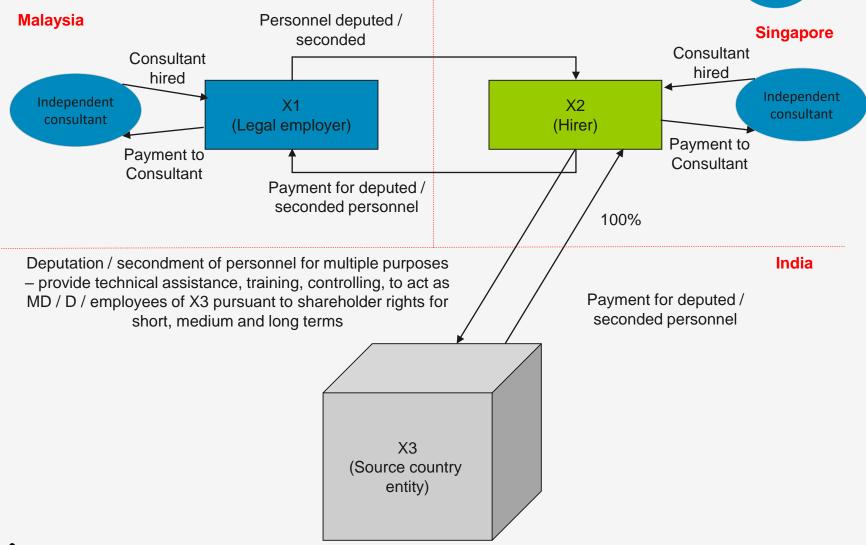


- The period of 6 months within a 12 month period:
 - Month as a calendar month?
 - Month as a period of 30 days?
 - How should the word 'month' be interpreted for twelve month calculation?
 - Should the services be rendered for a continuous period of 6 months?
 - Outsourcing of services to any independent contractor / any other enterprise – whether service PE?





CASE STUDY 2 - FACTS





CASE STUDY 2 - FACTS

- X1, X2 and X3 are a part of a multinational group of companies
- X2 is also a 100% shareholder of X3
- X3 has a requirement of personnel and X2 being the shareholder intends to depute / second some of its personnel to X3, and towards this end, personnel are supplied by X2 to X3
 - X2 sends some of its own employees to X3 and also engages an independent consultant and sends to X3
 - X2 also sources personnel from X1 who stay on the payrolls of X1 X1 also engages an independent consultant to supply for X2's requirement
 - The independent consultants and respective employees are clearly informed of the role and period for the deputation / secondment to X3 in India



CASE STUDY 2 - QUESTIONS



- Which entities / persons create a PE / fixed base in India?
 - X2
 - X1
 - X2's independent consultant
 - X1's independent consultant
- What would your advice to Group X to minimise the exposure to constituting a PE?
- If a PE is constituted, what part of such person's profits would be taxable in the source country?





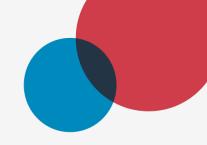
AGENCY PE



- The primary test for an agency is the legal ability of the agent to bind the principal to a third party
- Under tax treaties:
 - Agency PE replaces requirement of fixed place of business
 - Independent agent does not constitute a PE legal and economic independence
 - Only dependent agent constitutes a PE who,
 - Acts on behalf of an enterprise
 - Has authority to conclude contracts on behalf of an enterprise
 - Has no authority but habitually maintains stock of goods and regularly delivers goods for the enterprise



AGENCY PE



- 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



AGENCY PE - KEY ISSUES



- Action plan 7 prescribes several amendments to Article 5 to address the OECD'S concerns about the potential for companies to enter into following types of arrangements that would artificially avoid the occurrence of PEs:
 - Contracts which are concluded by the commissionaire are not binding on the foreign enterprise (as they are not in the name of the foreign enterprise)



AGENCY PE - KEY ISSUES



- Other similar arrangements involve situations where:
 - Contracts substantially negotiated in a state are finalized or authorized abroad; or
 - Agent is of independent status even though it is closely related to the foreign enterprise on behalf of which it is acting.
- These activities result in eroding the tax base of the country where the sales took place





- To address these issues, Action Plan 7 recommends change in the wordings of the OECD MC
 - DAPE rules strengthened PE constituted if agent habitually concludes contracts, or habitually plays the principal role leading to conclusion of contracts that are routinely concluded without material modification by the enterprise
 - Independent agent test tightened excludes entities which act exclusively or almost exclusively on behalf of closely related enterprise



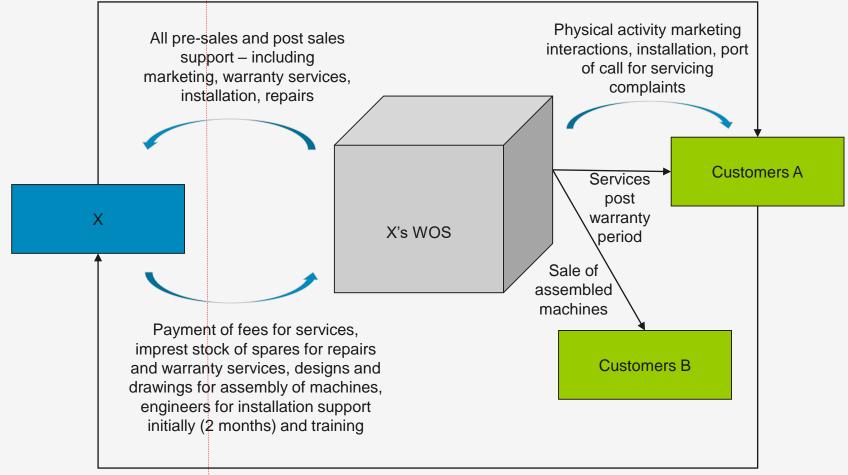


CASE STUDY 3 - FACTS

Singapore

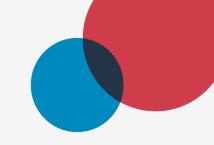
Other jurisdictions in Asia

Sale of machines / invoice





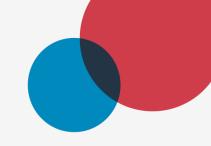
CASE STUDY 3 - FACTS



- X is a manufacturer of certain compact machines
- X sets up subsidiaries in various countries in Asia to undertake distribution of its machines, and upgrade these sides slowly to become capable of manufacturing – the initial step is to enable assembly locally in the source country
- X's WOS undertakes market research and other marketing activities to draw customers to X's machines
- Customers A access X's WOS which discusses the sale with Customers A and the sale arrangement is agreed to and concluded by X in Singapore
- X sends its employees to train employees of X's WOS to undertake installation, assembly and repairs (for 2 months initially) of the machines
- X sends the drawings and designs for the assembly to X's WOS

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CASE STUDY 3 - FACTS



- X also sends its spares and consumables to X's WOS, which are stocked at the latter's premises and used for the warranty services, and also for after sales services (post warranty)
- The after sales services (post warranty) are contracted between X's WOS and the Customers directly but the pricing is as per the standard applied by X as a Group for the region
- Customers A can reach out to X's WOS in case they have any complaints and after intimating X, X's WOS undertakes the repair / servicing; X's sale contract with Customers A does not indicate a separate price for installation or warranty services
- On a stand alone basis, X's WOS also sells its assembled machines to Customers B – all contracting here is between Customers B and X's WOS

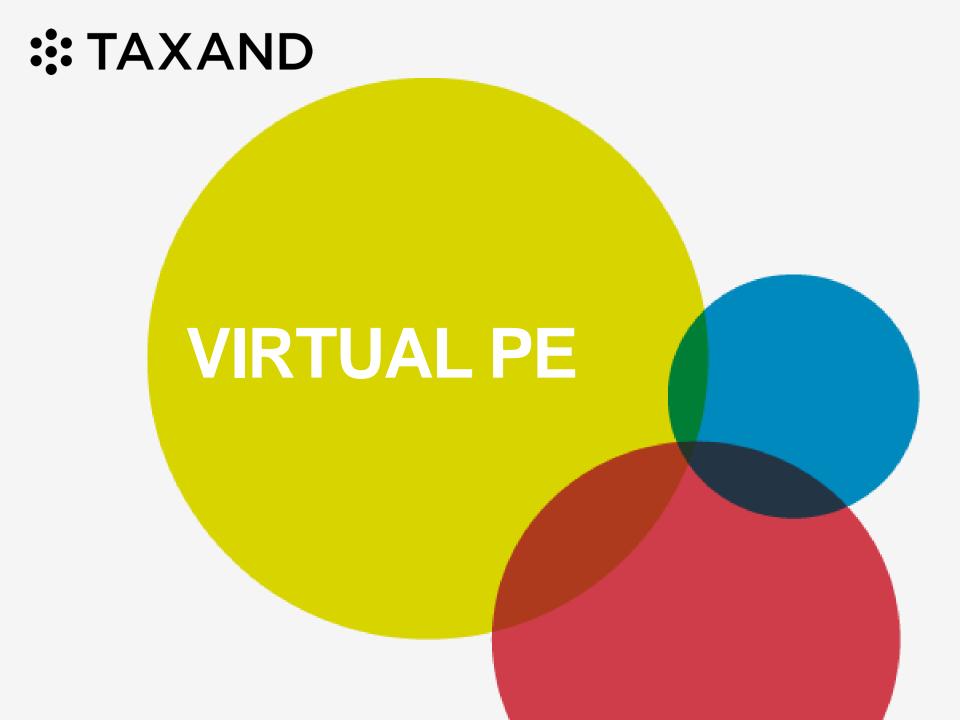


CASE STUDY 3 - QUESTIONS



- Does X's WOS constitute a PE for X in the source country? What kind of PE?
- If all activities in the source country were undertaken by independent parties, would the conclusion be any different?
- What would your advice to X be if this were to be the economic model in order to minimise the exposure to constituting a PE?
- If a PE is constituted, what part of X's profits would be taxable in the source country?





NEED



- Globalization & centralization, sustained and supported by technology
- International tax law is faced with the following primary issues
 - Accommodating and controlling new, increasingly virtual business models
 - Allocation of profits and losses to specific activities and locations
 - Attribution of taxing authority to specific jurisdictions
 - Growing role of intangible assets in business operations



NEED



- Rationale of fixed place test (regarded as evidence of economic allegiance to the source country) increasingly doubted
 - E-commerce activity possible with no substantive presence only offices undertaking activities (purchase, storage) – falling within preparatory and auxiliary
 - No need for branch offices, in-country staff interaction can be done remotely
 - People replaced by software
- There is increasing fear that e-business would frustrate tax authorities all over the world in obtaining their fair share of tax since e-business is not confined to physical boundaries
- Tendency of enterprises to locate head office operations in tax havens/ low tax jurisdictions

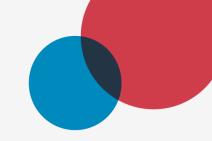




Addressing the tax challenges of the Digital Economy

- With the rapid penetration of digitization, it is impossible to ringfence the digital economy from rest of the economy for tax purposes
- Digital economy and its business models present some key features which are potentially relevant from a tax perspective *viz* mobility, reliance on data, network effects, the spread of multisided business models
- Digital economy raises the following broader tax challenges for policy makers:
 - Nexus Reduced need for physical presence raises question whether current rules to determine nexus with a jurisdiction are appropriate





- Data Data is a primary input into process of value creation in digital economy and possibility to gather and use information from various sources creates problem as to how to attribute value to such data
- Characterization Development of new digital products or means of delivering services creates uncertainties in relation to characterization of payments made in context of new business models, cloud computing in particular
- Collection of VAT Absence of an effective international framework to ensure VAT collection in the jurisdiction of consumption as well as a significant administrative burden in managing tax liabilities generated by high volume of low value transactions





- Task Force on Digital Economy ('TFDE') discussed and analyzed potential options to address broader tax challenges, and recommended the following:
 - Modify list of exceptions to the definition of Permanent
 Establishment ('PE') to ensure that it is not possible to benefit
 from the 'preparatory or auxiliary' activities exception
 - Apply principles of International VAT/ GST Guidelines and introduce collection mechanisms included therein to address issue in collection of VAT /GST on cross-border transactions, particularly in case of B2C transactions





- Other options analyzed by TFDE but not recommended at this stage include:
 - New nexus based rules on significant economic presence
 - Withholding tax on certain types of digital transactions
 - Equalization levy to ensure 'equal treatment' of foreign and domestic suppliers
- Aforesaid options could, however, be introduced by countries in their domestic laws, provided they respect existing treaty obligations, or in their bilateral tax treaties







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