

# Aggressive tax planning & BEPS - effect on concept of PE and source tax rules

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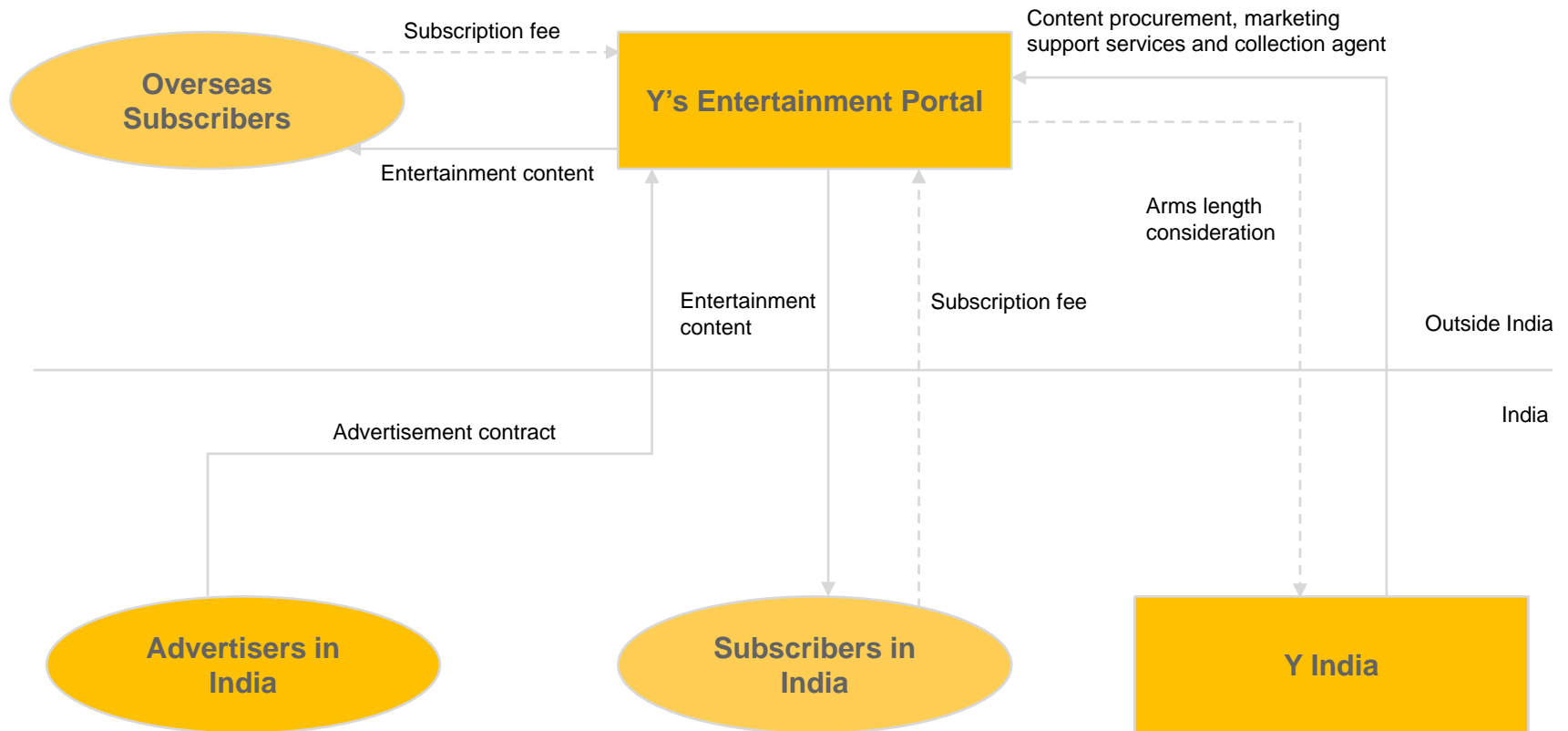
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# Case Study 1 : Digital Economy and PE



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## Facts & Background

- ▶ Y Co is an overseas company and it owns YZone, an online video on demand subscription portal
- ▶ A person who uses Y portal accepts certain licence terms
- ▶ Y Co's server is located outside India
- ▶ Y Co has a subsidiary in India

## Analysis

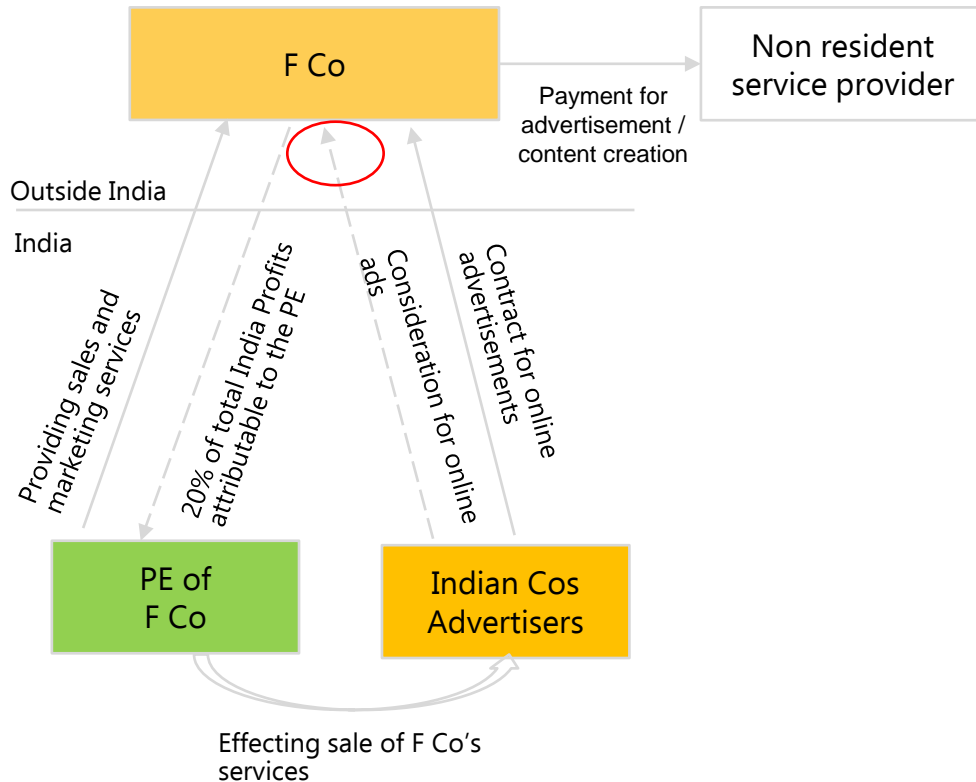
- ▶ Revenue streams
  - ▶ Subscription revenue
  - ▶ Advertisement revenue
- ▶ Characterisation of revenue under traditional rules
  - ▶ Royalty/ Fees for technical services
  - ▶ Business income
- ▶ PE Evaluation under traditional rules
  - ▶ Fixed placed PE
  - ▶ Service PE
  - ▶ Agency PE

## BEPS initiative

- ▶ Equalisation levy (Action Plan 1)
  - ▶ Advertisement revenue
- ▶ To tackle artificial avoidance of PE
  - ▶ Modifying the list of exceptions to the definition of PE regarding preparatory or auxiliary activities, mode of conclusion of contracts and anti-fragmentation rules
  - ▶ Targeted action by certain countries to tax companies operating through website presence

BEPS initiative on Digital Economy is an ongoing process as more business models evolve

# Case Study 2 : Equalisation Levy & PE : Interplay



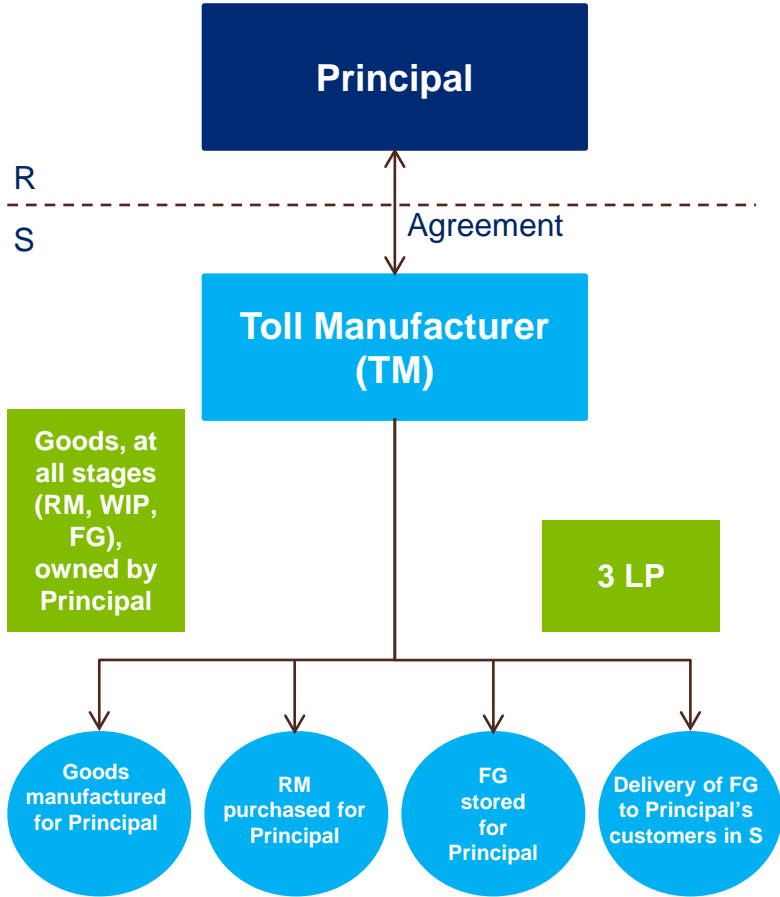
- ▶ F Co is contracted by the Indian advertisers for online advertisements – total revenue from Indian Advertisers is 100
- ▶ F Co Net Profit (Margin) is 15%
- ▶ The Indian PE of the F Co undertakes sales and marketing functions for F Co
- ▶ F Co has been filing returns & is being assessed to tax in India
- ▶ Profit attributable to the PE is 20% of the overall India profits of F Co
- ▶ F Co is also making payments to an overseas service provider for advertisement / content creation services for self consumption

**The entire amount of 100 is not subject to EQL?  
F Co liable to withhold EQL on payments made to non resident service provider?**

Mr. Steve Towers



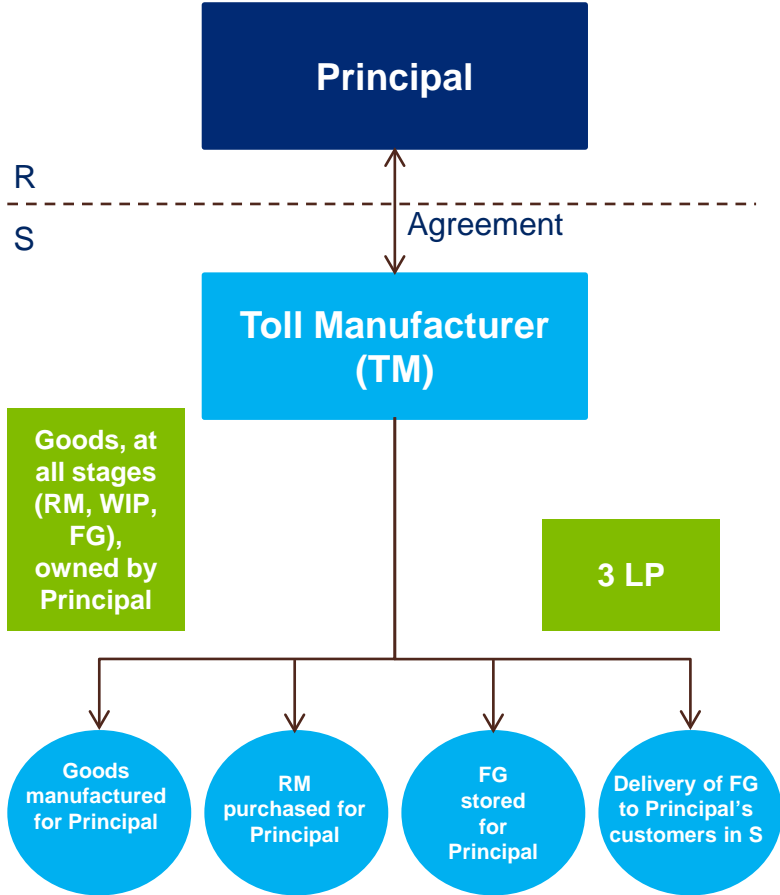
# Facts



- Under agreement between Principal and TM, TM performs 4 related functions for Principal:
  - **Manufactures** goods for Principal (with Principal owning the goods at all stages of the manufacturing process)
  - **Purchases** raw materials (RM) on behalf of Principal (i.e. TM concludes contracts binding on Principal)
  - **Stores** finished goods (FG), on behalf of Principal, for an average of 3 weeks after the completion of the manufacturing process
  - **Delivers** certain FG to Principal's customers in Country S



# Facts (cont'd)



- When directed by Principal to do so, TM releases custody of certain FG to a third party logistics provider (3LP). 3LP transports the FG to their final destination outside Country S
- Also, when directed by Principal to do so, TM itself transports certain FG to Principal's customers in Country S
- Principal's employees rarely visit TM's premises
- Principal and TM are 100% affiliates
- Principal is TM's only customer
- **Does Principal have a PE in Country S :**
  - under OECD model treaty, after the BEPS Action 7 changes are made?
  - under UN model treaty?

# OECD model treaty, after Action 7 changes made (1/2)

## Art. 5(1)

- Are TM's premises "at the disposal" of Principal?

## Art. 5(4) exceptions

- "solely"
- combination of activities
- "of a preparatory or auxiliary character"
- Art. 5(4.1)

# OECD model treaty, after Action 7 changes made (2/2)

## Art. 5(5)

- Art. 5(4)(d)

## Art. 5(6)

- 2<sup>nd</sup> sentence

# UN model treaty

## Art. 5(5)(b)

- Maintenance + delivery

## Art. 5(7)

- 2<sup>nd</sup> sentence

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# Conclusion

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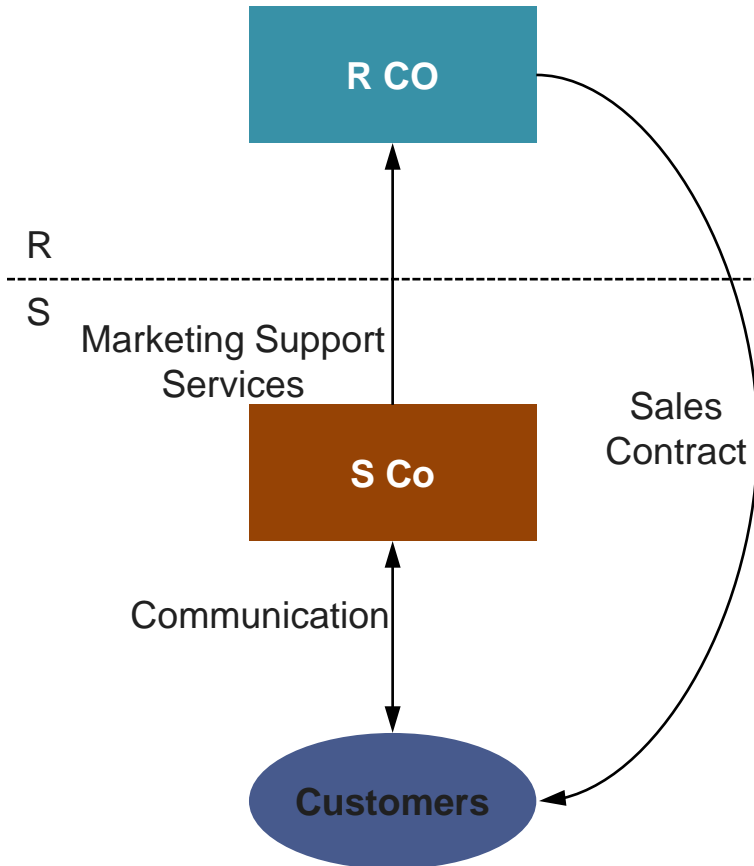
**Mr. Girish Gurnani**



# Amendments to Article 5(5)

Amended Art. 5(5)	Concerns	Recommendations
<p>“.... where a person is acting in a Contracting State on behalf of an enterprise and, in doing so, habitually concludes contracts or <b>habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, ....</b>”</p>	<ul style="list-style-type: none"><li>▪ Dilution of bright line of “Contract Conclusion Authority” for triggering PE... change will bring uncertainty</li><li>▪ No guidance on what is “without material modification”... Authority to conclude few T&amp;Cs -- triggering PE ?</li><li>▪ No guidance on related PE attribution ?</li></ul>	<ul style="list-style-type: none"><li>▪ Retain “Contract Conclusion” bright line</li><li>▪ Provide exhaustive guidance...<ul style="list-style-type: none"><li>○ What is “material modification”</li><li>○ Address real life cases e.g. elements are accepted with modification</li></ul></li><li>▪ Address related PE attribution... Attribution for Contract Conclusion vs Support in Contract Conclusion</li></ul>

# Marketing Services Company



- R Co sells its products through its website
- R Co has standard T&Cs including fixed price
- S Co acts as R Co's marketing agent in State S
- S Co has no authority to modify T&Cs including price
- Activities of R Co -- triggering PE ?