

# Permanence test to be linked to nature and requirements of the business for constitution of a PE

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## In brief

Recently<sup>1</sup> the Authority for Advance Rulings (AAR) held that the degree of permanence for the purpose constituting a fixed permanent establishment (PE) should be seen *qua* the nature and requirements of the business. The threshold of duration should not be linked to the constitution of a fixed PE in India. The AAR relied on the principles laid by the Supreme Court (SC) in the case of *Formula One*<sup>2</sup> and held that permanence test is tied with nature of project.

## In detail

### Facts

- The applicant, a Belgian entity entered into a Service Agreement (SA) with an Indian entity for the provision of lighting services on a turnkey basis, for the Commonwealth Games Delhi, 2010 (event) in India.
- As per the SA, the applicant was also responsible for the following:
  - Provision of necessary equipment and their installation, including laying of cables, erection of structures for the event;
  - Acquiring all authorisations, permits and licenses required under law to perform the services;

- Ensuring adequate insurance to cover all risks associated with the provision of the services;
- Providing maintenance for repair/ rectification, throughout the event.
- On-site space was allocated to the applicant for duration of the event, for storage of its tools and equipment.
- The applicant's employees were present in India for a period of 66 days for preparatory work, installation, provision of service and dismantling of the equipment.

### Issue before the AAR

Whether the consideration under the SA was taxable in India under the Income-tax Act, 1961 (the Act) or Double Taxation Avoidance Agreement

(tax treaty) between India and Belgium?

### Applicant's contentions

- It had a transient presence in India, which could not be regarded as PE, as it did not meet the cumulative conditions of business activity, power of disposition, permanence and location.
- It did not satisfy the criterion of constituting PE under Article 5(2)(j) of the tax treaty, as the applicant was present in India for less than 6 months.
- The consideration under the SA did not qualify as 'fee for technical service' (FTS), as the services did not make-available<sup>3</sup> technical knowledge, experience, etc., to the service recipient. The consideration did not also

<sup>1</sup> AAR No. 1330 of 2012

<sup>2</sup> Formula One World Championship Limited v. CIT [2017] 80 taxmann.com 347 (SC)

<sup>3</sup> Protocol to India-Belgium tax treaty, read with Article 12 of India-Portugal tax treaty provides that FTS, *inter alia*, mean payments in consideration of rendering of any technical or consultancy services if such services make available technical knowledge, experience, skill, know-how or processes.

qualify as ‘royalty’.

### Revenue’s contentions

- The applicant had a PE in India, as it satisfied all the requisite tests, *inter alia*, dedicated on-site space at its disposal, carrying of business of lighting for the event, etc.
- In cases where nature of business is peculiar, the time period for which the services were performed could not be the deciding factor for establishing PE.
- The consideration also qualified as royalty, as it was for “use” or “right to use” the intellectual property rights in the works of the applicant.

### AAR’s decision

- The different Articles of the tax treaty, is logically structured with a purpose. Thus, it should be read and comprehended paragraph-by-paragraph, and not straightaway onto Article 5(2)(j) of the tax treaty, as done by the applicant.
- The applicant satisfied all the tests for constituting a fixed PE in India, and the income arising from the SA was held to be chargeable to tax under Article 7 of the tax treaty.

### Business activity test

- The applicant had entered into SA to undertake the business in India of providing technical equipment and services for the event, including light, sound, video, etc.

### Disposal test

- The applicant had a lockable space on-site for storing its tools and equipment, implying that it had access and control over the space.

- In the absence of premises under its control, the applicant could not have carried out fabrication, maintenance, repair functions or operate the structure during the event.
- The applicant had sub-contracted some of its activities, which indicated the fact that the applicant had an address, an office from which it could call for and award contracts.
- The applicant had acquired all authorisations, permits and licenses also indicative that it had a place at its disposal.
- Insurance companies could not have insured equipment/ structures, unless the place was safe, in exclusive custody and disposal of the applicant.

### Permanence test

- The degree of permanence was necessitated by the nature and requirements of the business.
- In cognisance of the job assigned to the applicant, its presence could not be enduring or permanent.
- The applicant’s activities and presence was spread for a sufficiently long period of time over the entire duration of the event, thus fulfilling the permanence test.

### Location test

- There was a clear link between the place of business and an identifiable geographical point (i.e. on-site space provided to the applicant) from where business was conducted.

- The lighting facilities created and erected by the applicant coupled with the space available with the applicant constituted a part of place of business.
- The place of business may not be fixed to the soil, as long as it forms an intrinsic part of the income generating activity.
- Therefore, the determination of the existence of a PE would be based on the specific facts of the case and no general threshold of duration could be read into the requirements of fixed PE.
- The consideration could not be regarded as royalty as the applicant did not assign the right to use the know-how, technical experience, etc., to the recipient<sup>4</sup>.
- The consideration could not be regarded as FTS, as the services did not “make available” technical knowledge, experience, etc., to the recipient.

### The takeaways

- The AAR relied on the SC ruling in the case of *Formula One*<sup>2</sup> and upheld that the degree of permanence should be seen *vis-à-vis* the nature of business.
- The AAR also ruled out the applicability of threshold of duration to the fixed PE clause. This could be relevant for analysing PE exposure in future.

### Let’s talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

<sup>4</sup> This alert majorly focuses on the principles of PE as discussed by the AAR,

and does not discuss the ancillary issues of royalty and FTS in detail.

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