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TAX ALERT

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INDIAN SUPREME COURT ON FIXED PLACE PERMANENT ESTABLISHMENT PRINCIPLES

A. CONCEPT OF PE

With globalisation economic/ trading activities spreading across jurisdictions the enterprises nowadays have presence in several jurisdictions. The taxability of activities undertaken at the foreign soil by enterprise is closely linked to permanent establishment ("**PE**"), a concept created by international tax and treaty law, which has assumed considerable significance. The countries often exercise taxing rights by employing deeming fictions to bring the income within its tax net. Under the terms of various tax treaties, existence of a PE in source State is a pre-requisite for the purpose of taxation by that jurisdiction on business profits of a foreign enterprise. The term PE is generally defined in various double tax avoidance agreements ("**DTAAs**") as *"a fixed place of business through which the business of a foreign enterprise is carried on wholly or in part"*. In addition, a PE may also be constituted by virtue of certain activities of the foreign enterprise such as carrying on the sales activities through a dependent agent in India or furnishing of services through employees in India exceeding the prescribed period.

Under the Income Tax Act, 1961 ("**IT Act**") any income arising to a non-resident, whether directly or indirectly *inter alia* through or from any business connection is deemed to accrue or arise in India. Therefore, if a non-resident has a PE in India, then business connection stand established in India.

In view of the above background, we have discussed herein below an important ruling delivered by the Indian Supreme Court:

B. SUPREME COURT RULING IN FORMULA ONE CASE

Hon'ble Supreme Court of India ("**SC**") recently in a landmark ruling laid down basic principles of a FPPE (*defined below*) in a specific fact-scenario, which involved the conducting of a motor racing championship in India for a brief period of three days. In its judgment, SC has ruled against the taxpayer and held that such brief activity would also result in a PE in India.

The SC in ***Formula One World Championship Ltd.***[1], upheld the decision of the Hon'ble Delhi High Court ("**Delhi HC**") that FOWC (*defined below*), a non-resident, constituted fixed place permanent establishment ("**FPPE**") in India by virtue of the international circuit namely Buddh International Circuit ("**Circuit**") in India where the motor racing event was hosted. Therefore, the payments made by Jaypee to FOWC for rights acquired to host, stage and promote Formula One World Race Championship ("**F1 Championship**") racing event in India, was held to be taxable in India as 'business income' of FOWC. In other words, the SC held that FOWC earned income in India through the Circuit by conducting racing event in India over which it exercised complete control. The SC also held that withholding obligation is limited to the appropriate portion of income chargeable to tax in India and computation of the same was directed to the Assessing Officer (AO).

To ascertain whether the Circuit was at disposal of FOWC so as to constitute a FPPE referred to arrangements between Jaypee, FOWC and its affiliates, to note that the arrangements demonstrated that entire racing event was

[1] Formula One Championship Ltd. v. CIT Civil Appeal No. 3849 of 2017.

controlled by FOWC. The access to the Circuit by FOWC and its affiliates during the three days of the event along with two weeks preceding and one week succeeding the event was held to be sufficient to constitute necessary permanence required to establish a FPPE.

Facts

The taxpayer, Formula One World Championship Ltd. ("**FOWC**"/ **Appellant No.1**), a UK tax resident; Fédération Internationale de l'Automobile ("**FIA**"), the regulatory body for auto sports events; and Formula One Asset Management Ltd ("**FOAM**") entered into agreements, under which FOAM licensed commercial rights in the F1 Championships held all across the world to FOWC for a period of 100 years. In India, FOWC entered into a Race Promotion Contract ("**RPC**") with Jaypee Sports International Ltd. ("**Jaypee**") (FOWC and Jaypee together referred to as "**Appellants**"), by which FOWC granted Jaypee the right to host, stage and promote the Formula One Grand Prix racing event in India for a consideration of USD 40 Million. Simultaneously, an agreement contemplated under the RPC, was entered into between FOWC and Jaypee, permitting restricted use of certain intellectual property belonging to FOWC. FOWC and FIA had also entered into contracts with participating teams, to bind the teams to participate only in the racing events on the official racing calendar set by the FIA. Jaypee had also entered into commercial agreements with three of FOWC's affiliates.

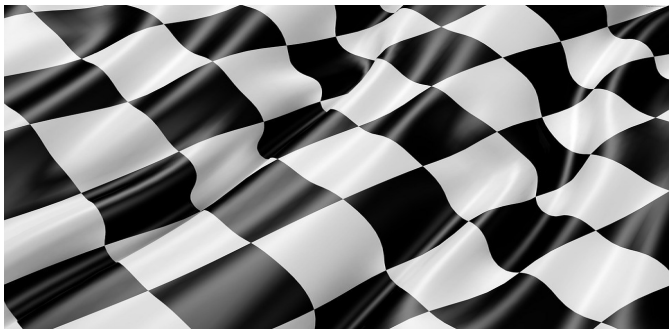
The Appellants approached the Authority for Advanced Rulings ("**AAR**") seeking an advance ruling on the taxability of the consideration receivable by FOWC under the IT Act. The Delhi HC held that FOWC had constituted FPPE in India under India-UK DTAA through the Circuit. Therefore, the amount paid/ payable under RPC by Jaypee to FOWC was taxable as business income arising from the grant of privilege of hosting and staging the event and the same was not for obtaining any intellectual property rights. Aggrieved by the ruling of the Delhi HC, the Appellants and Indian Revenue Authorities ("**Revenue**") preferred an appeal before the SC. The main question in the present appeal, therefore, pertained to whether FOWC constituted a PE under the DTAA and accordingly, whether the amounts received by FOWC were taxable in India.

Arguments

The Appellants argued that for constitution of a PE it was essential that premises or place should have been at the disposal of the enterprise. There was nothing in the RPC or any agreement with FOWC, whereby a fixed place was ever available with FOWC at its disposal. Jaypee did neither lease the stadium, nor its premises nor any part thereof to FOWC. The entitlement to live television feed from the event used by FOWC was contended not to mean that any part of its business was transacted in India. Further, the contracts entered into by Jaypee with FOWC affiliates were independent bargains, and were concluded on principal to principal basis.

Appellants argued that it was Jaypee who was responsible for conducting races and had complete control over the event from construction/ laying down the contract for the motor race event till its conclusion. Referring to the clauses under the RPC pertaining to obligations and warranties of FOWC, Appellants submitted that the role of FOWC was primarily that of advising, assisting and consulting with Jaypee in relation to the event in such manner as FOWC considered necessary for the staging and promotion of the F1 Championship racing event in India to the mutual benefit of the parties. It was also contended that FOWC had no physical control over the Circuit. Further, Appellants submitted that even if it is accepted that FOWC had control over the Circuit, since the entire event was for the period of three days in a year, possession of the Circuit for only three days would not constitute PE.

It was argued by the Revenue that Circuit was at the disposal or under control of FOWC so as to constitute a FPPE since FOWC was carrying out a business activity i.e. conduct of F1 Championship racing event in India through such Circuit. FOWC yielded income, in the form of consideration for facilitating the event, exploitation of commercial rights like advertisements, sale of tickets, broadcasting rights, such income was attributable to the event and hence, was subject to tax in India. The contention was made by referring to various clauses of eleven agreements between different parties including Jaypee, FOWC and its affiliates. For instance, (i) Circuit was built to suit the specifications required for hosting a F1 Championship, (ii) the entire Circuit was exclusively booked for the duration of event, two weeks before and one week after the event and no other event could have taken place at that time, (iii) FOWC or its personnel or agents had full access to the Circuit during this period, (iii) the entire ownership of live feed and the right to exploit it through sports contracts for media, television network, gaming, rights etc. were exclusively with FOWC, (iv) provision of various services *inter alia* liaison and supervision of other parties at the event, travel, transport etc. by FOWC and its affiliates. Therefore, it was submitted by the Revenue that even though the right to promote, host and stage the event ostensibly remained with Jaypee, it could not, in real sense of the term, exploit its rights, and such rights were to be exercised by FOWC and its affiliates.



Decision

The SC observed that the question of PE exposure under Article 5(1) of India-UK DTAA revolved around the fact as to (i) whether FOWC had a fixed place in India, if yes, (ii) did it carry on business and commercial activity in India from such place.

The SC referred to definition of PE under the IT Act and Article 5(1) of India-UK DTAA and noted that PE includes[2]/ means[3] a fixed place of business through which the business of an enterprise is wholly or partly carried on. The SC discussed the main features under Article 5(1) of India-UK DTAA to constitute PE as:

(a) Presence of a business of a foreign enterprise in a source State (FOWC in the instant case);

(b) Existence of a fixed place of business, which is at the disposal of the enterprise; and

(c) The business of such enterprise wholly or partly is carried on through such place.

Set out below is the brief analysis of significant factors constituting FPPE in the present case.

- *Business of enterprise*

  FOWC was the exclusive commercial rights holder in relation to F1 Championship and FOWC was carrying out the business of exploitation of such commercial rights in India. Such rights, *inter alia,* included the right to host, stage and promote F1 Championship events, exclusive media rights (including all use of audio-visual material and data in the media space), right to authorise access to a circuit.

- *Fixed place of business*

  The SC noted that whether an establishment constituted FPPE of an enterprise depends on the premises being at the disposal of the enterprise i.e. whether the enterprise had right to use the said place and had control thereupon. The SC affirmed that at all material times FOWC had full access exclusively to the Circuit. The SC further held that control required over fixed place of business could not be trivialised for the reason of its short duration, as though duration of the event was for limited days for that entire duration FOWC had full access through its personnel. It was clarified that commercial arrangements between the parties showed that Jaypee's capacity to act was extremely restricted during the event, and it was FOWC which played a dominant role in conducting F1 Championship racing event in India.

  It was also held that given the kind of business activity involved in the instant case, i.e. racing and exploitation of all the bundle of rights FOWC had as commercial rights holder, there may not be substantiality in an absolute sense with regard to the time period, however both the exclusive nature of the access and the period for which it has access, FOWC was having a shifting or moving presence. In nutshell, it was observed that the presence was fixed, as contemplated under Article 5(1) of the DTAA given the nature of activity, exclusive access and the period for which it was accessed. Hence, the presence was neither ephemeral or fleeting or sporadic. Also, the RPC tenure for five years indicated repetition. Therefore, since the presence was in a physically defined geographical area, and given the nature of activity though permanence was only for the relative period of the duration of the F1 Championship racing event in India, it was held that FOWC had control over the Circuit which constituted its fixed place of business. Some of the following arrangements were observed to indicate the control of FOWC and its affiliates over racing event in India:

  (a) Required Jaypee to give back its Circuit rights etc. to the affiliates of FOWC.

  (b) Obligated Jaypee to engage FOWC affiliate for generating television feed and revenue arising from aforesaid activity was to be received by the affiliates of FOWC.

  (c) Provision of certain services including liaison and supervision by affiliate of FOWC.

  (d) Physical control of the Circuit (such as form and specifications related to the Circuit was to be approved by FOWC) was with FOWC and its affiliates during the entire period of the event.

- *Business carried on through fixed place of business*

  The SC held that Circuit was a fixed place, over which FOWC and its affiliates had dominant control, through which different race events including racing event in India was conducted. It was also held that FOWC undertook its business which was exploitation of the commercial rights through actual conduct of F1 Championship racing event in India at the Circuit from which income was generated in India. All possible commercial rights, including advertisement, media rights, etc. and even right to sell paddock seats, were assumed by FOWC and its associates.

  While upholding the decision of the Delhi HC that FOWC carried on its business in India through the Circuit within Article 5(1) of the India-UK DTAA constituting FPPE in India, the SC observed that payment received by FOWC was business income earned through PE in India and hence chargeable to tax in India. It was also observed that only the part of income of FOWC attributable to the said PE would be

2. Section 92F(3)(iii) of the IT Act.
3. Article 5(1) of India-UK DTAA.

treated as business income and tax was required to be deducted only on such part of the income.

C. INTERNATIONAL JURISPRUDENCE

The SC in the present case extensively relied on international tax commentaries by eminent scholars Mr. Philip Baker and Prof. Klaus Vogel to analyse the principles underlying the concept of FPPE to arrive at the aforesaid decision. In this light, it would be pertinent to discuss the international tax jurisprudence surrounding this concept. The model tax conventions provide for satisfaction of following conditions to constitute a FPPE in a source State:

(a) There must be a place of business

(b) Such place of business is at disposal of the enterprise

(c) Such place must be fixed

(d) The enterprise carries on its business through such fixed place of business

Place of business at disposal

The term 'place of business' is not defined in the respective DTAAs and is internationally interpreted to indicate a geographical *situs* where the foreign enterprise performs important functions of its business. The OECD (Organisation for Economic Co-operation and Development) commentary on model tax convention states that this term covers any premises, facilities used for carrying on business of the enterprise whether or not is used exclusively for that purpose. It is clarified that even if premises are not available for carrying on the business of the enterprise but simply has a certain place at its disposal, a place of business could be said to exist. The nature of place of business shall be that of a physical location regardless of size or location of physical structure[4]. The courts overseas have held a hotel room[5], a stall or pitch in a market[6], sales booth at an exhibition[7] to constitute a 'place of business'.

The Courts of different jurisdictions have illustrated the meaning and scope of FPPE[8] and noted that to constitute a fixed place of business it need not be owned or leased by the foreign enterprise (no formal legal right to use is required)[9], provided it is at the disposal of an enterprise having some right to use the premises for the purpose of its business. However, mere presence at a particular location or right to use a place solely for the purpose of the project undertaken on behalf of the owner of the premises may not constitute PE.

The word 'through' in Article 5 of DTAA (*dealing with PE*) demonstrated that the place of business qualifies only if 'it is at the disposal' of the enterprise. The enterprise would be able to use it as instrument for carrying on its business only if such place is under the control of the enterprise to a considerable extent. The modalities and intensity of control will depend on the nature of business activity being carried by a taxpayer. However, if the presence or control over a place is limited or transitory, such place would not qualify as place at the disposal of the enterprise.

Place must be fixed

The expression 'fixed' has two aspects: that of space (location test) as well as that of time (permanence test). The "location test" requires the place of business to be located at a specific geographical point or area or location. That place need not be affixed to soil as the deck of a ship located in territorial waters from which the foreign dealer transacted his sales was held to constitute a fixed place[10]. There should be some degree of permanency attached to the place of business to term it as 'fixed'. A mine or oil field may constitute a single place of business although activities therein may move from one location to another[11].

DTAAs do not refer to any minimum period for which a PE should be in existence in the source State. The word permanent does not mean occupancy at all times to come but merely indicates a place which is not temporary or interim and may include a movable place of business[12]. However, the term 'fixed' needs to be construed with reference to location and nature of business activity. If the nature of business activity is such that it is required to be carried only for a short duration, then a place of business in a source State where such business is carried on may constitute a PE. Foreign Courts have observed that the term 'permanent' is a relative term used in contradistinction to something transient, temporary, casual and therefore, presence of the foreign enterprise in the source State must be more than mere temporary or transitory.

4. IBFD Case No. 4992 (Central Tax Court of Italy), IBFD Case No. II R 12/ 92 (Federal Tax Court, Munich).
5. IBFD Case No. 4 K 2608/ 95 (Court of First Instance of Rhineland-Palatinate).
6. Rolls Royce Plc v. DDIT (2008) 113 TTJ 446 (Del), affirmed by Rolls Royce Plc v. DIT (2011) 339 ITR 147 (Delhi HC).
7. Joseph Fowler v. Her Majesty the Queen 1990 (2) CTC 2351 (Tax Court of Canada).
8. William Dudney v. R (1999) 99 DTC 147, Cour de Cassation of February 15, 1980 (1980) J1. De Droit Fiscal 321.
9. Universal Furniture Ind. AB v. Government of Norway (Stavanger Court, Case No. 99-00421, dated 19-12-1999 referred to in Principles of International Taxation by Anghard Miller and Lyn Oates, 2012).
10. In re (1999) 237 ITR 798 (AAR).
11. ADIT v. Valentine Maritime (Mauritius) Ltd (2011) 45 SOT 34 (Mumbai ITAT).

D. SIGNIFICANT TAKEAWAYS

This is a landmark decision dealing with the determination of PE specifically when the foreign enterprise operates for a short duration in India. As the SC has clarified that the duration for which the fixed place is available to the non-resident may not be the sole important criteria given the nature of business activity and extent of control exercised. So long as the premises are under control of the non-resident for the limited duration and the non-resident carries out its business activities from the said premises during that period, it may constitute a FPPE of the non-resident in India. The SC also relied on various international tax commentaries and judicial precedents to arrive at the conclusion in the instant case.

As discussed above, the DTAA does not prescribe the minimum period for the constitution of a FPPE. Perusal of the OECD commentary suggests that a PE would be constituted where a place of business exists for a reasonable period of time (usually three to twelve months)[13], thereby activities undertaken for short duration by a foreign enterprise may not constitute PE in the source state. However, it also clarifies that such understanding may vary given the nature of business activity carried by the taxpayer.

In *Fugro Engineers BV*[14] the Delhi Income Tax Appellate Tribunal ("**ITAT**") observed that no length of time is prescribed in Article 5(1) of India-Netherlands tax treaty and, therefore, if the place of business was available for the period in which its independent work can be completed, it shall constitute a PE. In *Monitor India Pvt. Ltd*[15] the Mumbai ITAT held that a consultancy service in India for less than 30 days did not constitute PE in India. Delhi Special Bench Tribunal in *Motorola Inc*[16] observed that occasional use by an enterprise of business premises of a group company did not create a PE. Further, the AAR in a case has held that a when the foreign enterprise rectified or supplemented installations of pipelines for 27 days for one project and 68 days for another project, it could not be stated to constitute a PE.

Given these rulings on the determination of PE, it is pertinent to note that the SC ruling in the present case was given in light of specific factual matrix *inter alia* the tenure of RPC being for five years which indicated permanence. Therefore, it may be possible for foreign enterprise carrying on a one-off activity for short duration to contend that this ruling may not be applicable in their factual matrix. Having said that, it does not rule out the possibility of Revenue placing reliance on the present ruling to contend that a PE has been constituted. Further, the specified thresholds for certain categories of PEs such as construction, supervisory or installation PE under the DTAAs may not get diluted by the present ruling.

The recently pronounced decisions including the present ruling, by various Indian judicial authorities in relation to PE exposure, such as ruling in *GE Energy Parts Inc*[17], *NetApp BV*[18], tends to indicate the aggressive view taken by the authorities in relation to PE. The authorities are looking at substance and totality of a commercial arrangement to decide whether a PE is established by *inter alia* considering the physical presence (extent of business operations), digital footprint (e.g. website design of corresponding Indian entity) and functional linkage between the foreign enterprise and its Indian counterpart (common directors, actual roles and responsibilities assigned and carried on). Further, it is also pertinent to note that not only the perception of Indian tax authorities towards PE determination is changing but also their detection techniques have become more sophisticated. Such as in the above mentioned decisions, the authorities analysed the business operations undertaken in India on behalf of the foreign enterprise by observing self-appraisal reports, email correspondences, filings with regulatory authorities etc.

Since the amount of profit attributable to PE of FOWC in India was not subject matter of dispute before the SC in the instant case and AO was directed to compute the same, given the peculiar facts of this case, the interesting question pertaining to extent of profit attribution to PE in similar cases would arise before Indian tax authorities, Tribunals and Courts. It remains to be seen, whether and to what extent the streams of income accruing in the hands of FOWC, namely: (i) fee received from Jaypee for granting the right to host, and (ii) payments received across the world in relation to telecasting, broadcasting, advertisement rights related to event, will be attributed to its PE in India.

The attribution would depend on proper analysis of functions performed, assets and resources deployed and risks undertaken (FAR) of FOWC and resultant characterization of its PE in India. The profit attribution would have to be carried in light of separate entity approach for attributing profits envisioned under Article 7 of tax treaties. It may be contended that the presence of FOWC in India in connection with hosting the event, which created FPPE in India, was in the nature of an event manager. Further, the intangible rights (broadcasting etc.) were exclusively with FOWC headquarters in UK and applying the separate entity approach, it may not be correct to allocate profits arising from such intangible rights to the PE of FOWC in India. Thus, it can be said that only arm's length profits earned by an event manager in India (similarly placed comparables) could be attributed to Indian PE of FOWC and not the whole income arising from exploitation of the intangible assets.

In this light given PE determination is a very fact based exercise, facts and circumstances of each case shall be carefully examined. In light of this decision, non-residents

12. Renoir Consulting Limited v. DDIT TS-211-ITAT-2014(Mumbai ITAT).
13. Para 7, United Nations Commentary on Model Convention (2011).
14. Fugro Engineers BV. V. ACIT (2008) SOT 78 (Delhi HC).
15. ACIT v. Monitor India Pvt Ltd ITA No: 2708/Mum/2008. (Mumbai ITAT)
16. Motorola Inc & Others v. DCIT (2005) 95 ITD 269 (Delhi)(SB).
17. GE Energy Parts Inc. v. ADIT Circle 1(2), International Taxation, New Delhi (2017) 78 Taxmann.com 2 (Delhi ITAT).
18. NetApp BV. v. DDIT (ITA No. 4781/Del/2013) (Delhi ITAT).

taxpayers are well advised to plan their business activities and the rights that they should seek not only from their Indian counterparts but also its other affiliates. The documentation should align with the actual conduct and no loose terms shall be used to avoid any functional linkage.

In terms of withholding tax, while making payment to the foreign enterprises at times no PE declaration is sought. However, such declaration may not hold any significant value when the Revenue contends constitution of PE of such foreign enterprise and thus, the Indian entity making payments may be held liable for paying tax at appropriate rates along with related penalty and interest for its failure to withhold appropriate tax. In such light, once PE is said to be constituted, some of the mitigation mechanisms can be resorted to.

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