

Recognition of Permanent Establishment in Taxing Business Profits from Cross-border Personal Services

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要 旨

現在の国際課税ルールでは、非居住者や外国法人が得た事業利得が所得源泉地国政府の課税対象となるのは、当該非居住者や外国法人が、所得源泉地国内に「恒久的施設（事業の全部または一部がそこを通じて行われる一定の場所）」を有していた場合に限定されている。ところが、現在の国際課税ルールが設定された時代には国際的人的役務提供取引がそれほど活発でなかったため、国際的人的役務提供事業利得に対する所得課税上の恒久的施設の認定基準が必ずしも具体的かつ明確なものとなっていない。そのため、国際的人的役務提供事業に関する恒久的施設認定結果が国により異なるケースも多く発生し、このままでは国際的な二重課税を生ずる可能性が大きい。

本論文は、こうした問題に対処するために、各国共通の国際的課税ルールとして租税条約上に記載すべき国際的人的役務提供取引事業利得課税に関する「具体的で明確な恒久的施設認定基準」について検討したものである。

Keywords: permanent establishment, taxing business profits, cross-border personal services.

1. Introduction

The recent development of technology and the globalization of economy have facilitated a variety kinds of cross border personal services as business, so that such transactions have increased dramatically. On the other hand, they have caused new difficulties in interpreting and applying the conventional international tax principles to business profits from such cross border personal services.

According to the current international tax rule, business profits earned by nonresidents and foreign companies are taxable in a country where they rendered services (income source country) only when they have a “Permanent Establishment” (hereinafter referred to as “PE”) (a fixed place of business through which their business is wholly or partly carried on)¹. Otherwise the business profits should be exempted².

Therefore it is so significant in taxation whether or not a nonresident or foreign corporation taxpayer has a PE in the source country. The criteria to recognize the PE provided by the OECD Model are as follows:

1. A business took place in the country;
2. A fixed place of business was present; and
3. The business was carried on through the fixed place of business.

However, these criteria are not necessarily clear in taxation on profits from cross-border personal services.

To be regarded as “a fixed place”, it is not clear:

1. Whether a taxpayer must have a fixed place, linked to a specific geographical point or attached to the soil of source country, or whether just a particular site to conduct business is enough;
2. Whether certain permanency is necessary;
3. To what extent a taxpayer must have controlled over the business place.

For example, in case of a lawyer who spent a week to conduct business at a hotel room, can “the office at a hotel” be considered as PE? When a consultant works for a single project but is moving from one branch of bank to another in different locations for training bank employees, should the different branches of bank be considered as PE of the consultant? To these questions, even the OECD member countries are inconsistent in practice including case laws. To deal with this issue, the criteria of enabling taxation in an income source country must be articulately and concretely provided in a tax treaty.

This research paper consists of seven parts. First part explains the current issue of taxation on cross-border personal service and why it's important to study this topic. The characteristic of PE is explained short to point out the problem related cross-border setting. Part two is about the structure of international taxation based on source jurisdiction and residence jurisdiction. In part three and four, current system of PE is introduced with its historical background and basic traditional concept. Part five examined about the problem of PE with regard to personal services. Part six is the review on international case laws and how the court decisions have been made. This part examines the term PE and decisions made by courts. This part is to find the importance of the OECD Model Commentary in providing guidance to the international courts and how the court interpreted it. In this part, it is also discussed how effective the measurement of allocating of taxing rights profits from PE in each country. The conclusion is based on the analysis made above.

2. International Taxation

2.1 General

International taxation treats taxes in cross-border transaction setting. In other words, the international taxation is to settle a tax issue on a person or business subject to different country laws. It covers all tax problems arising in one country that include some activities in other countries. Income that arises from cross-border transactions both in goods and services is an important category of international tax.³ Each country has a different tax system and it's very hard that one country's system completely fits with other systems. When one person is doing a business activity in another country, that income is subject to tax or possibly left untaxed.⁴ According to Arnold and McIntyre, International tax rules have four aims:

1. Let the relevant government gets fair shares of revenue,
2. Promote of fairness,
3. Improve the domestic economy competitiveness, and
4. Neutrality of Capital-export and capital-import.

To achieve these goals, tax treaties work as a primary coordinator. The fairness and efficiency can be achieved only when one country tries to coordinate with another country. Thus both countries can gain the same tax revenue.⁵ Countries enter into a treaty to prevent double taxation. Tax treaty is a bilateral agreement in effect to adjust the domestic laws to eliminate double taxation.⁶ The convention sets up rules to classify different kinds of incomes and capital from Article 1 to 30 with respective rights to tax of the State of source or situs and the State of residence.

There are two primary goals for Income tax treaties: "to reduce the risk of double taxation to taxpayers engaged in cross-border transaction and to mitigate the risks of undertaxation of taxpayers by promoting cooperation among responsible members of the international family of nations." Treaties also have another objective which is "prevention discrimination against nonresidents and foreign nationals, exchange of information, and mutual cooperation in the resolution of disputes."⁷ Practically, OECD Model Treaty and UN Model Treaty are used in recent income tax treaties. UN Model Treaty depends most of its content on the OECD Model.

2.2 Source and Residence Jurisdictions

Under international setting, income tax can be imposed by two methods; residence rule and source rule. Generally, all countries have a primary right to impose tax arising within or having a source in their country. This method is known as “**Source jurisdiction.**” Income is taxable under the country tax law because of connection and activities in that country.

In contrast, the resident country also claims tax over income arising worldwide and it is known as “**residence jurisdiction.**” For example, U.S. citizens and residents are subjected to worldwide base taxation regardless of the domestic-source or foreign-source income. The right to impose tax is not only worldwide income of their resident but also to the non-resident citizens. When a resident A earns an income in country B, the government A may claim a tax over the income because of its residence jurisdiction. This claim may overlap with the country B because the income source is in their country. Therefore one income may be subject to taxes both in the resident country and the source country. A claim of tax based on resident jurisdiction also may overlap with other country based on citizenship which is called “**dual-resident taxpayers.**” If this tax burden on cross-border transaction is left unadjusted, then it will be unfair.⁸ If all the countries use the same definition of residency and source, there would be no question of double taxation. Double taxation occurs because countries have different source jurisdiction and residence jurisdiction systems and define them differently.⁹

International double taxation occurs as a result of international activities. For example, a person may have business dealings in one country while residing in another. In such a situation, he(or)she may be required to pay taxes on his(or)her business gains in his(or)her country of residence as well as in the country in which the business operates.

The common conflicts over tax jurisdiction are:

- **Source-source conflicts-** One income is claimed to tax by two or more countries because of having the source in their country.
- **Resident-residence conflicts-** Two or more countries are claimed over one income because the taxpayer is their resident. A taxpayer who has two residents is regarded as “**dual-resident taxpayers.**”
- **Residence-source conflicts-** One country claims the tax revenue because the source is in their country. At the same time another country also claims tax over the same income because the taxpayer is their resident.

Based on three conflicts mentioned above, residence-source conflict is most commonly to happen because the absence of measurement to relieve double taxation.¹⁰ Countries enter into a tax treaty to relieve double taxation. Tax treaties provide relief for main three types of international double taxation on income. The three relieves for reducing or eliminating of international double taxation are **Credit method** which allows taxpayers to pay taxes in their country of residence, after deducting the tax paid in the foreign country; **Exemption method** which allows the foreign income to be excluded from the domestic tax base; **Deduction method which** is the amount of taxable income is reduced by the amount of the foreign tax paid.¹¹

2.3 Defining Residence and Source Jurisdictions

In order to define the residence jurisdiction and source jurisdiction, a country must provide necessary rules of resident or non-resident and source.

(a) Residence jurisdiction

A rule to apply for resident must be “clear, certain, and fair.” Among these three, certainty is the most important because a person needs to know whether he(or)she is resident or non-resident of that country. The treatments of taxation for resident and non-resident are very different. In determining the residence, many countries use different approaches. One country seeks to measure on how the people are connected to the country in economic and social life, income earning activities, location of family, social network, status of visa and immigration, and actual physical presence in the country.

Other countries use an “**arbitrary test**” to determine the residence by the number of the day’s presence in the country. The common way to presume it is an individual present in a country for at least 183 days of the taxable year. This method is imperfect due to the difficulty for tax authorities to enforce it. It may be applicable for countries that have a high control over their borders. But in case of a country without border check, one can easily enter and leave the country. Unless simple presumption is applied to determine the residence, the unsatisfactory unfairness may occur. The following conditions are desirable in determining residence, to use separately in combination with a *prima facie* case;

- Presence of 183 days or more in taxable years is considered to be a resident for that year unless one states that he does not reside and is not a citizen of the country.
- One who resides in one country is a resident except he also resides in another country.

- Citizens of a country are considered to be a resident except that they have lived in another country and are usually outside the country for more than 183 days per year.
- One who has settled residence in a country can not give up their residence status until they settle residence status in another country.
- One who has either resident or non-resident status for visa or immigration purpose is presumed to have the same status for income tax purpose even though that presumption might be refutable.¹²

(b) Source jurisdiction

In international setting, a country has a right to tax an income which has its source in that country. Usually resident country is to provide the relief for double taxation in case its resident jurisdiction overlaps the source jurisdiction of another country. In most tax treaties, primary right is given to a source country with the condition that they must limit rates of **withholding tax** on some kinds of investment income and not to tax some kinds of income at all.

In spite of giving priority right to the source country, the definition of source is very hard to define in tax literatures and domestic laws. In addition, many countries provide very few rules in determining the source of income, for income from business activities. Source rules for some investments are provided in many tax treaties but mostly not include source rule application to business income.¹³

According to OECD tax treaty, business income is taxable in a source country only when it earns an income through a PE and attributable to that PE. Employment, personal service income, business income and investment incomes are usually subject to source rule.¹⁴

3. Current system of Permanent Establishment

The concept of PE has existed from early economic era. The fundamental concept is to settle the taxing right of source country where the business activities of non-resident take place.¹⁵ The general definition of PE is described in Article 5 of OECD Model in which the term “permanent establishment” means “**a fixed place of business** through which the business of an enterprise is wholly or partly carried on.”

The term of **PE** includes particularly:

1. “a place of management,
2. a branch,
3. an office,
4. a factory,
5. a workshop, and
6. A mine, an oil or gas well, a quarry or any other place of extraction of natural resources.”

Additionally, it also states that a building site or construction or any installation project establishes must last for **more than twelve months** to be considered as PE. PE shall not include the activities with the purpose of storing goods, display, delivery, auxiliary character, and collecting information. Business carried on through broker, commission agent or any independent agent should not be regarded to have a PE in other state because those agents are doing regular business unless they have the power to conclude contracts on behalf of enterprise.¹⁶

The basic concept of PE is connecting to the question of whether there is a “**fixed place of business**”. To be qualified for fixed element, three elements must apply; (1) there must be a place of business, (2) geographical place inside the jurisdiction of the treaty (3) right to use business place and there must be certain degree of permanency. In this concept, the requirement of enterprise must be “visible” in a source country; therefore it requires the objective presence of the enterprise or tangible assets.¹⁷

Article 5(4) provides the activities that should not be included in PE. These include the use and maintenance of fixed place solely for the purpose of “storage, display, maintenance, purchasing goods, collecting information, delivery of goods, and preparatory and auxiliary character.”

(a) A place of business

The place of the business must have any kind of physical location to some extent of permanency (fixed place) and business must be carried on through that fixed place. A place of business may be located in the building facilities of another enterprise. It is not important whether the place is rent or owned. Therefore if there is a certain amount of space to conduct a business at its disposal, then it’s adequate to have a place of business. An example given in the commentary as to that salesman regularly visits an office of major client to take orders and meets a director at the office. In this case, the salesman does not have any disposal therefore a fixed place of business does not exist.¹⁸ However the result will be different from case to case. There is a

difficulty to determine whether a place of business is regarded to the disposal of the enterprise even when all the criteria in the theory are met. ¹⁹Under Italian domestic laws, it concluded that Swiss company keeping a part of railway station in Italy was considered having a PE. ²⁰

(b) Fixed place

A place of business requires to be fixed. Consequently it follows that PE can exist only if there is a degree of permanency. However it also depends on the nature of business. When the nature of business requires only short time, the PE exists even if the period was short. The example refers to mine, oil well where a place of business is a single place which may move from one location to another due to the nature of the business. In case of “office hotel” where a consulting firm using hotel room as an office to conduct a business, even though a hotel is changed, it is considered to have a fixed place of business because of particular geographical location of single place of business.²¹

Time requirement for fixed place is also practiced different from country to country according to the past experiences of OECD Member countries. When the enterprise carried on business through a place of business in a source country for less than 6 months, the fixed place was not regarded to exist. Then what condition can be considered as having a fixed place of business? The commentary provides that the conditions of considering a fixed place are the recurrent nature of the activities, considering period of time and number of times where the place is being used.²² In fact, the term “fixed place” is not defined in OECD Model from the beginning as indicated to legal doctrine, case law and the revised of commentary. This may allow flexibility to adapt the change of the business place to manipulate the tax.²³

(c) Business carries on through the PE

For a business to have PE, it is essential to carry on business wholly or partly through that PE. The activity itself does not need to be of a productive character but operations are required to be carried out on a regular basis. An example case is when tangible properties as well as intangible property are leased or rented to a third party through a fixed place of business which is run by an enterprise in the other country; it is considered having a PE place of business.²⁴ Definition of PE: “...fixed place of business **through** which the business of an enterprise is wholly or partly carried on” ²⁵ is different from 1963 definition. It was defined as “... a fixed place of business **in which** the business or enterprise is wholly or partly carried on.” Change in

term of definition make the PE term wider. Current definition can apply to any case when the business activities are carried on at a particular location which is at the disposal of the organization.

(d) Agent PE

Article 5 of paragraph 6 state that in order to consider an agent as PE, the agent must have authority to negotiate and conclude a contract on behalf of the enterprise. Whether an agent's activities can regard as a PE depends on if the agent is a dependent or an independent agent. A dependent agent usually has ability to conclude contracts, and the acting must be regularly exercised. An agent does not include broker or commission agent.²⁶ An enterprise should be regarded to have PE in a foreign country when the business is carrying on through a person with certain condition mentioned in the paragraph 5 although there may be no fixed place of business indicated in paragraph 1 and 2 of Article 5. The enterprise is considered not having PE if; (1) the person is legally and economically independent from the enterprise, (2) the person acting is not under control of enterprise and conduct business the ordinary course.²⁷

(e) Services

The term service was added to commentary in 2008 even though service clause itself is not included in Article 5. In the commentary, it provides that the income from service will not be taxable in the Source State if that income is not attributable to a PE situated therein. It is in common with the rule of Article 7 that unless the one enterprise set up PE in another country, it should not be considered as to taking part in economic life of that country to the extent that it will be subject to taxing jurisdiction of that other country. Rule of some exception will be provided for some types of service and be treated in the same manner as other incomes.²⁸

Some countries are unwilling to adopt this rule of exclusive residence taxation of services that are not attributable to PE in their territory when in fact service is performed in their territory. These countries recommend changing the Article to allocate the taxing right to Source country under certain conditions with regard to profits derived from services. Various kinds of discussion and arguments have been made to support their ideas to keep the taxing right in Source country. They argued that Source country has a primary right to tax the income arising from their country from tax viewpoints. Domestic laws of many countries provide such a rule even if the services performed in the Source country is rendered without presence of PE. Additionally,

they also states that service business usually does not need a fixed place of business to perform a business in their country.²⁹

State could keep the right to tax profit from services performed in their State even when there is no PE as stated in Article 5. But the service should be limited to perform only in the State and there should be some minimum of presence in a State to be taxable.³⁰

The example of provision that is required when a State to conclude bilateral tax treaties:

“Notwithstanding the provisions of paragraphs 1, 2, and 3, where an enterprise of a Contracting State performs services in the Other Contracting State

- a) through an individual who is present in that other State for a period or periods exceeding in the aggregate 183 days in any twelve month period, and more than 50 percent of the gross revenue attributable to active business activities of the enterprise during this period or periods are derived from the services performed in that other State through that individual, or
- b) for a period or periods exceeding in the aggregate 183 days in any twelve month period, and these services are performed for the same project or for connected projects through one or more individuals who are present and performing such services in that other States.

The activities carried on in that other State in performing these services shall be deemed to be carried on through a PE of the enterprise situated in that other State, unless these services are limited to those mentioned in paragraph 4 which, if performed through a fixed place of business, would not make this fixed place of business a PE under the provisions of that paragraph. For the purpose of this paragraph, services performed by an individual on behalf of one enterprise shall not be considered to be performed by another enterprise through that individual unless that other enterprise supervises, directs or controls the manner in which these services are performed by the individual.”³¹

Not in either case is mentioned necessity to have a fixed place of business in the source country. As an alternative, the first paragraph tends to focus on the number of days present in the source country as well as the percentage of the revenue. It can imply that if consultant who provides service at different places in the country does not have a fixed place even when he is physically present in the country for a long time. In the second paragraph, it only emphasizes duration of the activities performed by an individual in the source country.³² These alternative provisions compose the extension of the definition of PE in that they allow the Source country to tax income arising from services in order to adapt to the modern global business

development. Particularly, some business does not require a “fixed place of business” to conduct a business and can still earn significant amounts of revenue through cross-border business activities. The treaties recognize the effect of these service-related enterprises by adding this provision. It also reflects that many countries insist to keep the right to tax to the source-based States under this situation.

4. Historical background

The history of PE has started at the same time of the history of the tax treaty. In the middle of 19th century, enterprises in Central European countries expanded their business and they were subjected to tax both at their residence and source country by keeping business or trade in a form of PE in a source country. The concept of PE was started in German State in the second half of the 19th century. Basic definition was introduced in 1925 in the DTA of Germany-Italy. At that time countries like UK, France, Spain was not preferred to use the PE concept although the treaties between the other countries were based on the concept of PE. The term “trade or business” was used for international taxing jurisdiction but later the concept was replaced by PE.³³ Under the concept of PE, it defined business profits earned through PE were liable to tax where the PE was located. Features of the PE were a fixed place of business, agents, place of business maintained for purchasing purpose.³⁴

The common opinion on the problems occurred through source-state versus residence-state taxation was expressed by German scholar *Georg von Schanz* at the beginning of 19th century and by the works of US scholar *Edwin R.A. Seligman* at the end of 19th century. The opinions from the two scholars were based on the idea of source income. It stated that income and property should be liable to tax when it has economic allegiance to the taxable subjects or objects rather than the political allegiance to the subject which has been ruled by the current tax systems. The state has the right to tax an income where that income has its “origin” and economic relation to the state. The “situs” (position) of property has the strongest economic relation and therefore it has the right to tax. The residence state has less important for taxable subject. The idea was that the income tax should be taxed only once and be shared among the countries based on the taxable subjects. The idea from these two scholars strongly influenced current system of PE.³⁵

5. Problem in recognition of PE with regard to personal services business profit from personal services

PE is a fundamental concept in double taxation agreements. Existence of PE is a vital key to determine the right of source country to tax the profit of an enterprise from personal service. The deletion of Independent personal service Article and combination with the Business profit Article have raised question on how to recognize PE in service areas. If Independent personal service is to be treated with the same provision of Article 7, what criteria should be used for PE to exit for service? The OECD commentary for services was added in 2008 but Article 7 remains unchanged. Article 7, business profit is taxable in a source country only if there is PE and the income is attributable to that PE. It's compatible with the rule that an enterprise of one country must have a PE in another country to constitute a PE.³⁶ As explained previously, PE is a place of business, the place of business must be fixed, and the business must be carried on through that fixed place of business. Also PE may exist in case where the business is carried on through dependent agents who act on behalf of the enterprise and has the authority to conclude contracts in the name of the enterprise.³⁷

(a) Fixed place of business

The generally accepted basic concept of the fixed place is that the business place must be fixed. The business place does not have to be actually fixed to the soil as building or permanently fixed to a place. It's adequate if some place exists to perform business activities in a market place. The problem is the contradiction between general applicable obligation of that place of business must be fixed and acceptance of movable fixed place of business with certain.³⁸

(b) Painter

Commentary of Article 5 (4.5) of OECD provides that:

“A fourth example is that of a painter who, for two years, spends three days a week in the large office building of its client. In that case, the presence of the painter in that office building where he is performing the most important function of his business (i.e. painting) constitutes a PE of that painter.”

The example has the feature of **permanency and frequency** to constitute a PE in the source country. Even though the painter works only three days a week for two years in the same place, it can be reasonable enough

to consider a fixed PE because of the frequency of the physical presence in a source country at the same place at certain time.³⁹

Alessandro Cardi also inspects this example:

“The example sticks to the disposal test but seems to bypass what appears to be the key questioning determining whether a PE exists in the case at issue: is the business activity of the painter served by the place of business or, rather, the place of business itself is the object of the activity of the painter? In the above example, an impression is given that the place of business is simply the object of the painter’s activity, and accordingly it would not be qualified as a PE.”⁴⁰

Richard J. Vann has the same idea on this painter’s example; he stated that if the building is being used by the painter for a true place of business, he must be able to prepare his other jobs from there, invoice is issued from there and materials is being stored to be used for all his jobs. If these mentioned criteria are met, it can be assumed that the painter has a place of business at his disposal. Therefore the place is considered as PE. Based on the facts of the example, the substance of the right to use the place is not at his disposal and it can not be regarded as PE.⁴¹

The main function of the painter is service that he has a contract to paint the wall. Painting is the core of his service. Before the commentary on services was added in 2003, service was treated in the same manner as business activities in the OECD Model. In this example, even though the PE exists, it does not state clearly that whether the PE is the office building, the wall itself, or the room provided for his rest when he performed the painting. The painter may not have disposal in case the office building is considered to be PE. In what extent a painter can have right of use the office building? Whether the painter had a right of use the business place is to be determined by legal questions.

(c) Consultant

To be qualified as having PE, a consultant must have a fixed place and carry on business through it. If the consultant performs his service at a place of client, does the consultant have a fixed place of business? In most of the case, service providers have no fixed places of business in the source country and perform their service at a client office, a factory or other facilities of the customer. The fact that service providers perform their services in a Source State with certain disposal does not absolutely mean that they have a PE for consulting activities.⁴²

The important point is that the period of the time and the place of business are at disposal of the consultant. Some type of services can be performed only at the client place, such as consulting services related to software programs, financial advice, training staff, audit, and legal service etc. Clients provide some facilities in order for the consultant to perform his business in comfort for certain period of time. Criteria to determine there is a PE or not the result are different from country to country. In Thai Supreme Court case 3867/2531 regarding a fixed place; a team of engineers of a Japanese company who gave service at a factory floor of the client in Thailand was not considered to have PE in Thailand.⁴³

In spite of the case, it must be considered whether that consultant is independent or belongs to the enterprise. If the consultant is an employee of the enterprise, additional consideration becomes necessary on whether the consultant itself has the authority to conclude a contract with a customer on behalf of the enterprise to comply with the agency clause.

(d) Salesman

First case example provided in the Commentary of Article 5 (4.2) is:

“A first example is that of a salesman who regularly visits a major customer to take orders and meets the purchasing director in his office regularly visits a major customer to take orders and meets the purchasing director in his office to do so. In that case, the customer’s premises are not at the disposal of the enterprise for which the salesman is working and therefore do not constitute a fixed place of business through which the business of that enterprise is carried on (depending on the circumstances, however, paragraph 5 could apply to deem a PE to exist.)”

In this example, Munoz analyzed that there is “No link between the salesman and the premises.” A visit to a company is just as a visitor. The salesman is always with the purchasing director and he is not at his disposal and left alone. The office is not provided for him to work at or use. As a visitor what he can use is only the chair or desk of another person’s office, therefore he has no control over the office to use as he likes. Even though he may visit the purchaser’s office constantly, it does not change the fact that he is not at his disposal. From this, it can be concluded that even the regular visit can not be regarded to have PE in a Source country unless the taxpayer has some disposal of the place.

6. International Case laws

6.1 General

The case law will be vital in finding for characteristic of PE in personal service. In determining whether there is a PE for personal service, tax courts have made different decisions vary on case by case. The important concept of judgment is ‘at disposal’ of the taxpayer over the place. Skaar⁴⁴ and Vogel named it ‘right of use’ and ‘power of disposition’.

(a) Fixed place of business for service PE

Recently, the Bombay High Court made a decision on *Clifford Chance* case⁴⁵ about taxation on a non-resident on UK based law firm. The firm provided services to India on various power projects which are a joint venture established between Indian and foreign companies. The service fees are paid based on the time of actual service given. The firm does not possess offices or fixed bases in India. During the taxable year, the number of days present in the India exceeded 90 days. The questions arose on whether the service income in India is taxable wholly or only the portion that is attributable to its operation in India. The court held that the income was taxable based on the hourly service rendered and to extent of the income which was attributable to that service while in India.

In considering this case, the court referred to Article 15 of the India-UK Double Taxation Avoidance Agreement (hereinafter referred to as “DTAA”), where the professional income is taxable only if the service is rendered in India and that income is attributable to such service rendered in India.

The case of the UK based law firm⁴⁶ provided service functioning project PE in India. In this case, UK law firm did not possess any offices in India to provide service but instead they sent some partners and employees to India to render services. During the taxable year, the taxpayers were physically present in India for more than 90 days. The taxpayer filed a tax return to Indian Tax Authority and claimed that they had no PE in India according to the India-UK treaty of Article 5 (1) of DTAA.

Tax Department insisted that there was service PE or fixed place in India. Entire incomes should be taxable in India including the previous service that was provided from the UK office. In determining this case, the tax officer considered that the income was taxable under the Article 7 of India-UK Treaty because the taxpayer rendered services in India for more than 90 days; therefore it has PE under the Article 5(2) of the DTAA. In the court of appeal, the court made a decision that the service PE rule was applicable but taxable

income should be only to the extent of service rendered in India. The tribunal held that the term ‘profits indirectly attributable to PE’ gives substance of the force of attraction rule which is provided in Article 7 (1). Additionally, it stated that income arisen from rendering services in India was taxable in India if that service was related to the Indian projects or similar to service provided by the PE regardless of whether that service was performed through PE or not. It observed that any professional service performed in India at least constituted indirect attribution according to the provision of the India-UK tax treaty. That provision is sufficient enough to make the service income subject to Indian tax.⁴⁷

Income from service performed by non-residents is taxable in India when the service is rendered in India as a part of a business or profession carried on by that professional in India. There must be a territorial nexus, application of treaty, attribution of profits and taxation of related profits.

In 2007, Indian court held the case of whether there is a service PE in Morgan Stanley.⁴⁸ Morgan Stanley & Co (MS) is a US investment bank providing diversifying advice on financial service. MS & Co are a world leader in term of lending financial service, corporate lending, and securities underwriting services. MS & Co set up MSAS private limited company in India to support the group member office and infrastructure in global operations. MSAS rendered service such as information, technology support, account reconciliation, research support, and so on. MS & Co sent steward to control quality standard and supervised the MSAS. The visit was last more than 90 days.

In this case, the Supreme Court held that MSAS did not constitute PE for stewardship because its activities were only for outsourcing, development and back office operation as a whole. The Court watched each outsourced case attentively to consider whether there was a PE. The Supreme Court held that the service carried on by MSAS was the nature work as back office in nature which failed to fulfill the Article 5(1) of the India-US. In addition, the Supreme Court also stated that MSAS can not be regarded as agency PE of MS & Co in India because MSAS has no power to enter or conclude contract on behalf of MS & Co. The Supreme Court also considered that contract was possibly concluded in United States and only carries out those contracts in India.

Concerning the services performed by personnel of MS & Co that represented MSAS, the Supreme Court stated that the deputation might constitute a PE under Article 5(2) (1) of the India-US treaty. Article 5(2) (1) states that a service performed by employees of a nonresident enterprise of a related enterprise through a fixed place in India can constitute a PE even though the performance was only one day. But the stewardship was especially engaged in supervision activity over the operation of enterprise with the

aim of ensuring quality control and risk control imposed by its customer, therefore the control was for benefit of MS & Co. It could not be regarded that the service was rendered to MSAS. The Supreme Court commented that “MS& Co is merely protecting its own interests in the competitive world by ensuring the quality and confidentiality of MSAS services.” The Supreme Court also noticed that “economic nexus is an important aspect of the principle of attribution of profits” and “situation would be different if the transfer pricing analysis does not adequately reflect the functions performed and the risks assumed by the enterprise”. It stated that if the arm’s length price was applied to a nonresident enterprise’s PE in India, nothing more can be attributed to the PE. In case of service, the Indian tax authorities need to examine whether the cost applied by the enterprise is higher than the arm’s length cost or not in comparison with income.

As a conclusion, this judgment was a positive result regarding to international tax decisions made by the Indian courts over the past years. It distinctly showed that the mere presence of a fixed place of business is not enough to constitute a PE; furthermore the important thing is to examine whose business is being carried on through that fixed place: by resident enterprise or the nonresident enterprise. The Supreme Court clearly defined the tax treatment between Stewardship and Deputation where the difference is the stage of control authorized by the employer. As a result of Morgan Stanley judgment, it showed that the Supreme Court showed it openly accepted the single entity approach which was not common in India.⁴⁹

(b) Independent personal service

German lower court case law cited by Skaar explained the recognition of the PE in midwives case⁵⁰ where she moved around from place to place to perform her service to mothers to be client was found to have a fixed place of business at her own house. The court stated that she had a room at her house to receive clients and gave advice to pregnant women. Her place is regarded as her center of business activity.

Another case cited by Skaar was a case of Norwegian and Danish practice and doctrine case. This case was to consider whether the different location of business place within the certain area can be sufficient to constitute PE. Danish contractors who performed his repair service work for the different Norwegian clients and whose performance of job were held at the similar place for less than 12 months were not found to have PE. The authority concluded that PE can exist only if the work lasts more than 12 months at the same place or if it could identify the geographic place under the construction clause. In contrast, another constructor case was found to have PE because he conducted the business through an agent in Norway. In Danish case, the view of tax authority seems to be that on different location constitutes PE. The example

given is a carnival or circus performed at different places for substantial of time that will constitute PE in Denmark. This case is compatible with the commentaries of OECD in 1977 where the merely requisite is a specific location.⁵¹

The Supreme Court of Canada made a decision on *Dudney* case⁵² in 2000 where non-resident consultant who provided services to his client at his client place in Canada constituted a fixed base. *Dudney* was an engineer who resided in the U.S. and hired to perform his service in Canada to train personnel at the client's office during business hour on weekdays. Nothing was provided for him to operate business such as letterhead or business cards or office.

The Canadian Supreme Court concluded that *Dudney* did not have a fixed place of business in Canada; therefore his income was not taxable in Canada. In determining this case, the Court of Appeal stated that there are three factors to be taken into account: "the actual use made available of the premises that are alleged to be his fixed base, whether and by what legal right the person exercised or could exercise control over the premises, and the degree to which the premises were objectively identified with the person's business. This is not intended to be an exhaustive list that would apply to all cases but it's sufficient for this case."

In this case, the court held that the taxpayer had the PE and carried on business at that location. In considering whether there is control over a place of business, the Court evaluated on the importance whether the taxpayer had the space at his disposal and was allowed to use an office in the place where the business was going on for a relevant time, in order to be a fixed base. In *Dudney* case, the court emphasized the fact that the taxpayer had to use the offices of the client during office hour with limited access. The taxpayer did not have his control over the space to use it as he likes because the hour to access is limited to business hour and the use is only for the service to the client.⁵³

Other case cited by *Bruggen*, a consulting enterprise can have a PE at the client in another country. There is an international case law on service provider that affirmed having a PE in the premises of another enterprise. In Belgium case⁵⁴, the use of office held by Dutch company at the disposal of Belgian consultant was found to have a fixed base of Dutch company under the treaty. Infamous case decision was the "Hotel-management case"⁵⁵ where the German Bundersfinanzhof concluded that UK service performer had a PE in the German client's place if the nature of the control over some office space existed, even though the consultant may not have a legal right on that office.⁵⁶

In 2004, the Bundesfinanzhof⁵⁷ held that U.S. enterprise providing training service to U.S army personnel located in U.S. army base in Germany found to have PE in Germany. The training service had been rendered over several years. The court found that the U.S. enterprise had certain control over the places therefore it constituted PE there.⁵⁸

Contrary to the case of NATO air base,⁵⁹ a Dutch enterprise provided cleaning service to NATO airbase in Germany. The Dutch enterprise was subcontracted by G Co. The cleaning service was to clean building, machines, and equipments and so on at the hangar usually under direction of G Co. The cleaning equipments and materials to be used in performing service were provided by NATO. The employees of Dutch enterprise were allowed to access to the air base in Germany and they were provided key to use recreation room where the room accessible to telephone and fax. The question here is whether cleaning service activity of the Dutch's personnel had PE in Germany.

The court ruled that the only use of premises by Dutch enterprise only to carry out their service was not sufficient enough to constitute a PE. In order for Dutch enterprise to have PE, the premises must be at the disposal of taxpayer. Additionally, such premises were not owned or rent they had a legal position that withdrawal would be possible only with consent of taxpayer. Even though the service was continued over a long time, it does not create a nexus to constitute PE. The use of the premises was related to performed service and the taxpayer did not have disposal over the premises.⁶⁰

(c) Agency

Two remarkable cases⁶¹ related to the interpretation of PE were concluded by the Tax Court of Canada in 2008. Both cases were decided by the same judge Honorable Justice C.J Miller in which the judgment was favorable to the taxpayers. In this case, Insurance Company *Knights of Columbus*, a resident of the United States sold insurance products to Canadian clients through Canadian sales agent based on commission. Usually, the Canadian agent obtained application forms from Canadian clients and then submitted the application forms to Knights in the U.S. for consideration. The agent generally worked at home offices and visited prospective client's home to obtain the insurance applications. The issue in *Knights of Columbus* was to decide whether the business income of Knights in Canada was subject to Canadian tax. Theoretically under the Canada-US tax treaty, business income derived by non-residents of Canada is taxable only if there is a PE and those incomes are attributable to that PE. The Court concluded that the *Knights of Columbus* was not found to have PE in Canada and the business income was not subject to Canadian tax.

In considering this case, the judge referred to Article 5 and 7 of the Canada-US tax treaty. A non-resident taxpayer shall have PE in Canada if the agent in Canada has authority to conclude the contract on behalf of the taxpayer. Consequently the taxpayer shall not have PE if their agent is not authorized to conclude the contract. The Knights of Columbus conducted its insurance business in Canada through various agents such as Chief Agent, General Agents and Field Agents. The Court stated that mentioned agents were independent agents and none of agents conclude contracts on behalf of the Knight Columbus. Even though the Field Agent sought permanent insurance contracts in Canada, those contracts could become complete by being approved in the U.S. The Court rejected the argument that Field Agents could regarded as concluding contracts and stated that it was only the negotiation process and did not finalize the agreements.

Additionally, the Court also determined whether the Knights of Columbus held PE in Canada, according to the Article 5(1) of the treaty. Article 5(1) provides that “a permanent establishment is a fixed place of business through which the business of a taxpayer is wholly or partly carried on.” This article emphasizes that a place of business must be fixed and the Knight of Columbus must carry on business through that fixed place. The Minister of National Revenue debated that the home office of Field Agents could be regarded as a PE of the Knights of Columbus. The Court said that the home office was permanent and were places of business but regarding to what extend business was being carried on through that home office. Judge Miller J. made comments that “For the Field Agents” residences to be considered fixed places of business of the Knights of Columbus, the Knights of Columbus must have a right of disposition over these premises.” As a result, the Court concluded that the home office did not regard as a fixed place of business, so that there was no PE in Canada and the Knight of Columbus was not subjected to Canadian tax.⁶²

The fact of second case was the *American Income life insurance Company vs. The Queen*⁶³ which was similar to *the Knight of Columbus case*. The taxpayer was US life insurance company that having commission agents in Canada. The Court concluded the same result that the taxpayer did not have PE in Canada and the income was not taxable in Canada.

7. Conclusion

As clear in the case law analysis, the interpretation of PE differs case by case. The case of agency seems preferable to the taxpayer and PE usually is not found because of the lack of authority to conclude the contract or because the premises is not the disposal of the taxpayer. In contrast, the service PE case seems to

have PE more than those of agency PE even though in some case the premise is not at the disposal of taxpayer. The legal right to use the place is also an important issue in determining the service PE because in some case the taxpayer does not have the legal right or the disposal. The result is likely to be different from case to case country to country, unless some criteria or additional clause are added to the commentary.

Endnotes

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- 6 Alex Easson, 'Do we still need tax treaties?' at 621 (2000).
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- 34 Michael Kobetsky, *International Taxation of Permanent Establishments*, at 110-111 (2011).
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- 36 Commentary of Article 5, § 42.11, OECD (2008).
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- 40 See, Alessandro Caridi, "Proposed Changes to the OECD Commentary on Article 5: Part I The Physical PE Notion," *Eur'n Tax'n*, Vol.43, No.1, (2003), at 12.
- 41 Richard J. Vann, "Tax Treaties: The Secret Agent's Secrets" no. 3 *British Tax Review*, at 375 (2006).
- 42 See Edwin van der Brugger, "International Tax Aspects of Providing Consulting Services on the Premises of the Client." *ABAC Vol 21, No.2*, 2001. A fixed base alone is not sufficient to have PE. The business of the consultant must be carried on through that fixed base.

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- 47 See, *Offshore services caught in the Indian tax net: the death of territorial nexus doctrine*, A recent ruling by the Mumbai Income Tax Tribunal (the “**Tribunal**”), in *Linklaters LLP v. ITO1*, has completely changed the rules of the game for offshore service providers providing services to Indian residents or services with respect to Indian projects. The Tribunal has dealt with a number of significant issues, such as the requirement of territorial nexus for taxation, eligibility of treaty benefits to a fiscally transparent entity, constitution of service PE and attribution of profits. We discuss some of the important aspects of the ruling here and briefly analyse the effect of this ruling. (Visited Oct 1, 2012).
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