

CORPORATE ADVISORY ALERT – PERMANENT ESTABLISHMENT IN INDIA

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What is Permanent Establishment (PE)?

Permanent Establishment is defined under [Article 5 of the Double Tax Avoidance Agreement](#) between India and Italy. While the relevant extract in DTAA regarding permanent establishment is quite long, the exact section which is of our interest is given below:

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of the enterprise is wholly or partly carried on.

2. The term "permanent establishment" includes especially:

- (a) A place of management ;*
- (b) A branch ;*
- (c) An office ;*
- (d) A factory ;*
- (e) A workshop ;*
- (f) A mine, an oil or gas well, a quarry or any other place of extraction of natural resources ;*
- (g) A warehouse in relation to a person providing storage facilities for others ;*
- (h) A premises 'used' as a sales outlet or for receiving or soliciting orders ;*
- (i) An installation or structure used for the exploration or exploitation of natural resources ;*
- (j) A building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities (together with other such sites, project or activities, if any) continue for a period of more than six months, or where such project or supervisory activity, being incidental to the sale of machinery or equipment, continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment :*

Provided that for the purpose of this paragraph, an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with or supplies plant and machinery on hire used or to be used in, the prospecting for, or extraction or production of mineral oils in the State.

3. Notwithstanding the preceding provisions of this Article, the term "Permanent establishment" shall be deemed not to include:

- (a) The use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise ;*
- (b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display ;*
- (c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise ;*
- (d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise ;*
- (e) The maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise.*

However, the provisions of subparagraphs (a) to (e) shall not be applicable where the enterprise maintains any other fixed place of business in the other Contracting State for any purposes other than the purposes specified in the said subparagraphs.

4. Notwithstanding the provisions of paragraphs 1 and 2 where a person other than an agent of an independent status to whom paragraph 5 applies is acting in a Contracting State on behalf of an enterprise of the other Contracting State, that enterprise shall be deemed to have a permanent establishment in the first mentioned State, if,

(a) He has habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise ;

(b) He has no such authority, but habitually maintains in the first mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise ;

(c) He habitually secures orders in the first mentioned State, wholly or almost wholly for the enterprise itself or for the enterprise and other enterprise controlling, controlled by, or subject to the same common control, as that enterprise; Or

(d) In so acting, he manufactures or processes in that State for the enterprise goods or merchandise belonging to the enterprise.

In the case of Octagona India and your company, as stated in clause 4 above, if an agent (other than an independent agent) habitually exercises a right to conclude contracts or secures orders wholly for the foreign enterprise **then that agent will be considered as permanent establishment of the foreign enterprise in India.**

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such an agent are devoted wholly or almost wholly on behalf of that enterprise itself or on behalf of that enterprise and other enterprise controlling controlled by, or subject to the same common control, as that enterprise, he will not be considered an agent of an independent status within the meaning of this paragraph.

However, as per clause 5, if a foreign enterprise carries on business in India through an agent of independent status (agent who works for other companies also such as Octagona India) **then such an agent will not be considered as permanent establishment of that foreign enterprise in India.**

What are the consequences if a foreign enterprise is considered as PE in India?

If the foreign enterprise (such as your company) is considered as a permanent establishment in India then so much of the business profits of foreign enterprise that are attributable to such permanent establishment will be taxed in India @ 41.20%. Also the permanent establishment will have to comply other compliances of Income Tax Act including but not limited filing of Income Tax Return, Tax Audit Report, TDS return.

Guidelines for representative staff in order to avoid to be considered as a PE in India

The representative staff of foreign enterprise should follow the following guidelines while communicating and conducting business in the market with local customers/companies to reduce the risks relating to permanent establishment:

1. With e-mail communication, the staff should use the signature block similar to the one as below:

XXXXX YYYYYY (**NAME OF THE INDIAN RESOURCE**)
Technical Engineer (**TITLE OF THE INDIAN RESOURCE**)

ABC ABC SRL (**NAME OF THE ITALIAN COMPANY**)
C/O OCTAGONA INDIA PVT LTD
305 DLF Tower B, Jasola Distt. Centre
New Delhi 110076 - India
tel. [+91 11 41525055](tel:+911141525055)
fax [+91 11 46536399](tel:+911146536399)
www.abcabc.it (**WEBSITE OF THE ITALIAN COMPANY**)

(LOGO OF THE ITALIAN COMPANY)

This message is intended only for the use of the addressee and may contain information that is privileged, confidential and exempt from disclosure under applicable law. If the reader of this message is not the intended recipient, or the employee or agent responsible for delivering the message to the intended recipient, you are hereby notified to delete this e-mail and all attachments from your system. If you have received this e-mail in error, please notify us immediately by return e-mail. For more information on our privacy policy you can visit our website www.abcabc.it (**WEBSITE OF THE ITALIAN COMPANY**)

It is important to note that is a solution which meets the Income Tax requirements as well as the commercial requirements of our foreign clients. However This solution may still be questioned by the Income Tax Department or by the Chartered Accountant of the local Indian customer (who prepares a certificate at the time of the company making the outward remittance to the Italian company) which can raise more questions about the fact that the company has (or doesn't have) a permanent establishment in India. In this case

Octagona India could give the support and addressing these queries, in cooperation with you.

The safest position would be that your local representative staff would use Octagona India signature block without mentioning the name of your company but as your consultant we agree that this solution may meet the requirements of the Income Tax but definitely not at all your commercial needs.

2. The visiting cards and letterheads should also be in the same way as the signature block of the e-mail.
3. It is advised for any kind of written communication such as a price quotation to local customers, they should use the letterhead of the Italian Parent company.
4. These changes should be immediately implemented to reduce the risks of queries or conclusions of a PE in India.

Disclaimer:

The subject of Permanent Establishment is an evolving discussion in India at many levels currently. Naturally, there are different viewpoints on this important matter. Effective 1st June 2015, all payments made from Indian bank accounts to foreign bank accounts require a certificate signed by a practicing Chartered Accountant for which the Chartered Accountant requires a declaration from the foreign company certifying that they have no Permanent Establishment in India.

At Octagona India, we take the best commercial interest of our clients while still keeping in mind the changing business environment and the laws of the land. Our guidelines for the representative staff, as mentioned earlier in this document, are based on the best possible safeguard for our client. However, they are not a guarantee that any customer in India shall not be questioning the presence of the representative staff as a Permanent Establishment. If the customer in India does not make the representative staff sign a non PE declaration form, it is considered a positive outcome and business goes on. If, however, they do ask the staff to sign a non PE declaration form, then we advise you to go ahead and sign the form as we (working cooperatively with you) can provide evidence of a non PE in India. Finally, if there is ever an inquiry from the Indian Government Department, then too we could render our legal and commercial support, in cooperation with you, to address these enquiries.

New Delhi, 02/12/2015