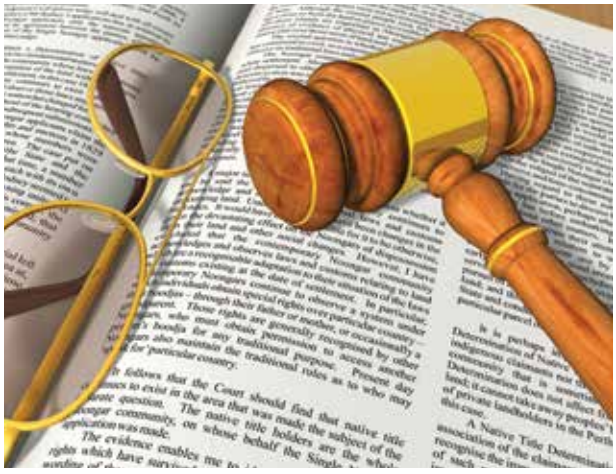
Electronic Commerce & Principle of Service PE in the International Tax Law



E-commerce has prompted an explosion in outsourcing of services and non-core processes due to the ease of data transfer and monitoring. Digital products have been an obvious focus in the discussions on taxation and e-commerce, as practically all the operations in sourcing the product and supplying to the customer are capable of being carried out electronically. Because of e-commerce almost no physical contact is made between the consumer in one country and the seller located in another country. There is no physical location to which the Source State may be able to impute the income and, accordingly, no PE could be considered to exist in those cases.[1] The Internet constantly becomes a tool to manage business without the need of a physical interface in the source country and thus avoids potential qualification of the enterprise as a PE. The challenges of applying the permanent establishment principle to e-commerce have gained special attention in the debate on e-commerce taxation and have been discussed extensively.[2] E-commerce enterprises can sell their products or services worldwide with very limited physical presence in any particular consumer's country. They can operate without agents because they can directly, easily and cheaply contact customers worldwide. Therefore, the premise of the permanent establishment rule that is, to conduct business in a country, you need a presence that does not apply to e-commerce. The concept of "fixed place" is meaningless in e-commerce business, because it can be located anywhere and can conduct business everywhere. This article analyses the concept of Service PE, the requirements, conditions with specific reference to in international taxation of e-commerce.

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I. The Concept of Permanent Establishment

Permanent establishment is one of the cardinal bases of all the DTAAs. All tax treaties are unanimous in insisting on levy of a tax on foreign enterprise only if it has a permanent establishment.[3] In the case of *CIT vs. Visakhapatnam Port Trust,* it was stated that 'The Permanent Establishment postulates the existence of a substantial element of an enduring or permanent nature of a foreign enterprise in another country which

[1] See *Chetcuti (2002), Jean-Philippe, "The Challenge of E-commerce to the Definition of a Permanent Establishment: The OECD's Response,"* Inter Lawyer, *at 3, available at http://www.inter-lawyer.com/lex-e-scripta/articles/e-commerce-pe.htm., Last visited 12th June 2012*

[2] *Barrett Schaefer (1999), "International Taxation of EC Income: A Proposal to Utilize Software Agents for Source-Based Taxation," No.16,* Computer & High Tech Law Journal, *at pp 111, 124-40*

[3] *S Sanghvi (2003), "Permanent Establishments – Some Crucial Issues Concerning Interpretation of Tax Treaties," No.133,* Taxman, *at pp16,17*

So does the fact that consumers can place orders through a foreign firm's website subject that firm to income taxes in the country where the customer lives? The answer to that question is certainly "no." To say that the ability to access a website, without some other more substantial contact, is sufficient to constitute a PE is to say that online businesses are liable for income taxes in every country where their customers happen to reside.

can be attributed to a fixed place of business in that country.[4] It should be of such a nature that it would amount to virtual projection of foreign enterprise of one country into the soil of another country.'[5] It must categorically be stated at this juncture that the expression "permanent establishment" is not used anywhere in the Income Tax Act - 1961. Also, the definition of permanent establishment is not universal. To determine the precise nature of the term, one needs to peruse the relevant agreement. However, in practice, the term has a universal meaning. This is because all the agreements are based on UN or OECD model conventions.[6] The rationale for adopting the concept of permanent establishment is that it is required mainly to help determine the right of a contracting state to another contracting State's enterprise.[7] The tax treatment of cross-border commerce is the subject of bilateral tax treaties which are often negotiated versions of the OECD Model Tax Convention. According to OECD Model,[8] the source country may tax the profits arising from commercial activity carried out within its borders by a foreign entity, through a substantial physical presence in the source country. To justify source taxation, such presence must reach the level of a 'permanent establishment' by satisfying the following three prerequisites, namely that there must be a distinct place, such as premises, or in certain instances, machinery or equipment ("place-of-business test"), that this must be established with a certain degree of permanence ("permanence test"), and that business must be carried on through the place, usually by personnel of the enterprise ("business-activities test"). If the presence does not reach the level required by the OECD Model by satisfying these requirements, the source state is not entitled to charge income tax on the profits arising from the international transaction; rather, the residence country will have the right to tax the profits of its resident.

II. Historical Development of the Concept of Permanent Establishment

The growth of the international trade and investment, just after the First World War, has created a vast expansion of business across border, and it also posed a new problem to the government in taxing business.[9] Both countries where the business was established and the country where the business is conducted face the problem (which is also known as the double taxation problem) of taxing the same business activities.[10] As this new problem (double taxation) undermines the expansion of international business, it is crucial to find a solution to the problem. After a number of efforts, tax authorities finally decided that tax on profits should be based on the permanent establishment rule where the source country should tax profits derived from foreign business if the permanent establishment of the business exist in that country.[11] In 1927, a draft convention on double taxation by the League of Nations defined permanent establishment as: Real centres of management, mining and oil fields, factories, workshops, agencies, warehouse, office, and depots. Since then, permanent establishment has been used as a demarcation point to tax profits from business to overcome the problem of double taxation for non-resident taxpayers. Another group of experts, known as the Chamber of Commerce and Economist Group disagreed with the source based taxation as a solution to the double taxation problem.[12] They proposed a different solution to solve the double taxation problem where the full resident state taxation was proposed to overcome the problem.

In this system "all income wherever earned, would be defined and taxed according to the laws of the

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[4] *[1983]144 ITR 146*
[5] *Id.*
[6] *There also exist other models such as such as the U.S.A. Convention and the Andean Model. But they are not followed as widely as the other two.*
[7] *P Gopinath (2003), "Importance of Permanent Establishments and Business Connection to Double Taxation Avoidance Agreements, "No. 129,Taxman, at pp133, 137*
[8] *Article 7 of OECD Model*
[9] *Borkowski (2002), "Electronic Commerce, Trans-national Taxation and Transfer Pricing: Issues and Practices," 28(2),* International Tax Journal*, at p 36*
[10] *Cockfield (1999), "Balancing National Interest in the Taxation of Electronic Commerce Business Profits,"* Tulane Law Review*, at p74*
[11] *Id.*
[12] *Buchanan (2001), "The New Millennium Dilemma: Does reliance on the use of Computer Servers and Websites in a Global EC Environment Necessitate a Revision to the Current Definition of a Permanent Establishment,"* SMU Law Review*, at pp 2109, 2152*

taxpayers own country of residence."[13] However, the popularity of residence state taxation began to slip just after 1960. In this era, the people's choice went to the source-based taxation as residence state was seen to disturb the flow of capital where it discouraged new capital being invested abroad.[14] The outcome of the conflicts between these two schools of thoughts resulted in the introduction of the OECD model in 1963. Since then, many countries have adopted the OECD model on the determination of permanent establishment in formulating their own guidelines. Originally, the permanent establishment principle was introduced mainly to avoid conflicts between countries and to avoid companies doing business in another jurisdiction being imposed tax twice. The principle of permanent establishment has been used to justify the fact that a contracting country foregoes its right to charge income in its jurisdiction[15] and to enable the other country to practice its right of taxing the profits attributable in its jurisdiction.[16] Permanent establishment is a long established international tax concept used as an indicator by legal authorities to tax transactions between two entities. Permanent establishment means businesses will be charged to tax on the business income and capital gains attributable to the country where permanence of the business exists.

III. The Rationale Behind the Permanent Establishment Principle

Historically, the concept of PE answered the internationally felt need for a quantitative criterion for ascertaining the taxability or otherwise of foreign commercial activity in the source state. The PE principle provided sufficient evidence that a foreign company's business within the source country was substantial enough to justify the imposition of fiscal compliance burdens on the foreign company in that country. This concept satisfied the requirement of certainty and predictability of tax law in that it provided multinational companies with relatively clear rules to determine in advance whether and in what way their activities abroad would be taxed by foreign tax authorities. Furthermore, the PE principle presented states with an internationally equitable rule for sharing the benefits of cross-border commerce. Source country taxation rewards importing countries for opening to foreign businesses the commercial opportunities available within their markets, while net-exporting countries obviously reap the benefits of taxing value added at the production stage.

IV. Permanent Establishment for the Purpose of Electronic Commerce

EC may pose problems for the definition of permanent establishments that existing tax treaties do not address. While as yet unforeseen questions are bound to arise, the current debate over what constitutes PE can be broadly summarised in the following questions:

- Whether a mere accessibility of a website from within a particular jurisdiction subjects the site owners to income tax in that jurisdiction?
- Whether the presence of a server would constitute a PE?
- Whether a consumer's computer constitutes a PE?
- Whether the provision of services by an Internet Service Provider (ISP) would constitute a PE?

Treaty negotiators will have to examine these questions to see how treaty concepts can be applied to new ways of doing business.

A. Website

The most obvious question concusses the ability to access a website from within a particular taxing jurisdiction. In OECD countries, a mere existence of technical equipment is insufficient for creating a PE. Article 7 of the OECD Model Treaty provides that an enterprise of a contracting state is generally exempt from tax on its profits derived from business carried on in the other contracting state unless these profits are attributable to a PE located in that other contracting State. Article 5 defines a PE. The Model Treaty also lists business premises which constitute PE and if we were to characterise these examples, it is likely that we would conclude that a physical presence of some

The Delhi Tribunal held that the assessee has a fixed place of business on the grounds that the computer was installed in the premises of a subscriber to the CRS system through which its business (partly) is being carried on and, therefore, it constitutes a PE under article 5(1) of the DTAA between India and USA. Here the view was the computer terminal was performing a core revenue generating function.

[13] *Id.,*
[14] *Id.,*
[15] *Sweet (1998), "Formulating International Tax Laws in the Age of Electronic Commerce: The possible Ascendancy of Residence-Based Taxation in an Era of Eroding Traditional Income Tax Principle," No.146 (6),* University of Pennsylvania Law Review, *at p1949*
[16] *Moran (2003), "US and International Taxation of the Internet"; Part 2,* Computer and Internet Lawyer, *No.5, at p 16*

It can be concluded that the service provided by an ISP does not constitute it to be the PE of the Non-resident. Since this specific issue has not been yet interpreted by the judicial authority or by the revenue department in India, it is still a grey area.

permanence is common to all. Does a website or home page have a physical presence of some permanence?[17]

A website has no actual physical presence, but rather is highly mobile, borrowing only the presence of the server where it happens to reside at the moment. No employees need be present in the country to maintain the site. To the extent that advertising and ordering functions are perforated, the website is analogous to mail order catalogue or a television advertisement, infomercial or home shopping channel.

Mere solicitation, without more, does not create a PE under existing principles, and it should not, when effectuated through e-commerce.[18] To the extent that a customer can view stack or data, the website is analogous to a location being maintained solely for the purposes of storage, display or delivery. Moreover, under existing principles, electronic content that resides on a server only temporarily should not be a PE. For example, the construction rules reflect this concept of duration and require the presence of project activities, including he presence of a workforce, in-country for 12 consecutive months. So does the fact that consumers can place orders through a foreign firm's website subject that firm to income taxes in the country where the customer lives? The answer to that question is certainly "no." To say that the ability to access a website, without some other more substantial contact, is sufficient to constitute a PE is to say that online businesses are liable for income taxes in every country where their customers happen to reside. A website cannot be considered as a PE and such a principle is also virtually unenforceable. It would be more useful to tie the presence of a homepage to some physical equipment, namely its host computer. And that takes us to the second debate, namely whether a server constitutes a PE.

B. Servers

A second, more complex, question arises regarding the location of computer file servers: should the mere presence of a server in a particular taxing jurisdiction be considered sufficient contact to constitute a PE? In most cases, the existence of a foreign owned server does not require employees to be present in the host country traditionally a prerequisite for PE. This issue can be analysed[19] under four sets of circumstances:

1. Where a server is used merely for advertising
2. Where the server is used for advertising and taking orders
3. Where the server is used for advertising taking orders and accepting payment
4. Where the server is used for advertising, taking orders and accepting payments and for digitised delivery of goods

In the first case, a server will not be held to be a PE. Exception 5(4)(a) of the OECD MC will be attracted in this case where the use of a facility solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise will not amount the existence of a PE. It could also be exempt under Article 5(4)(c) of the OECD MC, which exempts the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity of a preparatory or auxiliary character from the ambit of PE. In the second and third case, it may possibly be held that the server is a PE. In the last case, there is an even stronger cause to hold the server to be a PE. However, an attempt to tax the server as PE will not serve any purpose as it is very easy to shift the server to a tax haven or to a low tax country. Further, difficulty will arise where a number of mirror websites on different servers located in different countries are used so that a customer can be directed to any one of these sites. Yahoo, for example, uses a number of mirror sites so that the users can have better access to its very heavily visited site.

The Bangalore Tribunal in the case of *Wipro Limited vs. ITO*[20] opined that, "The data server is undisputedly located outside India, consequently the provision of services of offering the database to its customers is an event outside the taxable territories of India." Here the inference is that the server was performing core functions outside India. Further, the OECD commentary elucidates, the question of whether the business of an enterprise is wholly or partly carried on through equipment is a case specific one, it depends

[17] *Diana J.P. Mckenzie (1996), "Commerce on the Net: Surfing Through Cyberspace Without Getting Wet," 14 J. Marshall J.* Computer & Information Law, *at pp 247, 247*

[18] *Id.,*

[19] *Matthew R. Burnstein (1996), "Conflicts on the Net: Choice of Law in Trans-national Cyberspace", No.29* Vand Journal Trans-national Law, *at pp 75, 103*

[20] *[2005] 278 ITR 57*

on whether, because of such equipment, the facilities are at the disposal of the enterprise, where the business function are performed."

Therefore, a server can constitute a PE depending on the facts of each case. If the server performs some core functions that are revenue generating for the enterprise, it may be regarded as a PE of that enterprise in the country.

C. User's Computer as Permanent Establishment

A view could be taken that the location of a computer who initiates the contract from his computer would constitute a PE for the non-resident. However, that place is only a location from which one logs on and is unlikely to be fixed. For example, a customer may access a web site through a mobile computer. This may even be outside the country. Thus, the question of whether by simply accessing a website, a computer transforms itself into a PE of the owner of the website, is unlikely to be answered in the affirmative.

In the case of Galileo Intl. vs. DCIT[21] the Delhi Tribunal held that the assessee has a fixed place of business on the grounds that the computer was installed in the premises of a subscriber to the CRS system through which its business (partly) is being carried on and, therefore, it constitutes a PE under article 5(1) of the DTAA between India and U.S.A. Here the view was the computer terminal was performing a core revenue generating function. In the case of Galileo, the business was partly carried out through the computers, and thus they were held to be PE of the foreign enterprise in India.

Further in *Rolls Royce Plc vs. Deputy Director of Income tax*[22] "A place of business may also exist where no premises are available or required for carrying on the business of the enterprise and it simply has a certain amount of space at its disposal." Thus, having legal ownership of the fixed place has been held to be immaterial for the establishment of a PE in a country. Finally it would lead to a situation where everyone with a web page would have a PE in every country.[23] Further, the question of enforcement would remain unanswered.

D. Can the Services of an Internet Service Provider Constitute a Permanent Establishment?

Agency issues may also be clarified as they relate to the conduct of e-commerce. For example, some national governments will likely argue that a domestic ISP, by connecting consumers to a foreign business's website, acts as an agent for the purposes of determining the existence of PE. The ISP merely acts an intermediary between a non-resident seller and the customers in the source country. Therefore, the ISP will not qualify as the agent of the non-resident seller. Since the ISP acts on behalf of several website owners, even if it is treated as an agent, it would be an independent agent. Therefore, it will not constitute a PE. Even if it acts for only one website owner, it does not have the authority to conclude contracts on behalf of the website owner, which is an essential pre-requisite before it can be considered to be the owner's PE. In view of the above discussion it can be concluded that the service provided by an ISP does not constitute it to be the PE of the Non-resident. Since this specific issue has not been yet interpreted by the judicial authority or by the revenue department in India, it is still a grey area.

The provision of Services PE should, as a general rule, be treated the same way as other business activities and, therefore, the same permanent establishment threshold of taxation should apply to all business activities, including the provision of independent services. There is no need to diverge from usual PE concepts and requirements, as long as they fit the service's nature.

V. Types of Permanent Establishment

Even though the basic concept of PE revolves around the fixed place of business, it may also extend to include an agent who is legally separate from an enterprise and also rendering of services in India by a foreign entity. The Double Taxation Avoidance Agreements entered into by India recognises the following main types of PE for a foreign enterprise in India:

- Fixed Place PE
- Agency PE
- Service PE

Fixed Place PE

A fixed place of business PE exists where an enterprise carries on business in a country through a fixed location, such as an office or store, its definition codified in Article 5(1) of the OECD Model Convention, which provides that — for the purposes of this Convention, the term permanent establishment means a fixed place

[21] *[2008] 19 SOT 257*
[22] *[2008] 19 SOT 42 DELHI*
[23] *David R (1996), "Law and Borders-The Rise of Law in Cyberspace", No. 48* Stanford Law Review, *at p 1367*

of business through which the business of an enterprise is wholly or partly carried on.

The definition put forward in the UN Model Convention is essentially similar to the one above.[24] This apparently relatively straightforward definition encapsulates three requirements in order for a PE to be present, notably: (1) the existence of a place of business at the disposal of the enterprise; (2) the place of business must be of a fixed nature (geographical and temporal permanence); and (3) the enterprise being carried on is required to be carried on through the fixed place of business.[25]

Agency PE

An agency PE exists under the OECD MC Article 5(5) when an agent acts on behalf of a foreign principal and habitually exercises authority to conclude contracts in the name of the principal.[26] The OECD MC provides an exception for an independent agent acting in the ordinary course of its business, since in this case it is obvious that there is no binding contract between the foreign company (non-resident) and the independent agent (resident). Thus, it would be impossible for the foreign company to have a PE regarding the enterprise of a third party (the independent agent).

Three conditions[27] are required to be satisfied in order that an agent may be said to be an independent agent: (1) he should be acting in the ordinary course of his business; (2) his activities should not be devoted wholly or almost wholly on behalf of the foreign enterprise for whom he is acting as agent and (3) the transactions between the foreign enterprise and the agent should be at arm's length.

Service PE

The OECD model defines[28] a permanent establishment (PE) as a fixed place of business through which the business of an enterprise is wholly or partially carried on. There are, however, subtle differences in the definition of a PE under various DTAAs. Service PE is attracted by the foreign enterprise in India if the employees of foreign enterprise furnish or perform services in India, other than services covered under Royalties or Fees for Technical Services, for a specified period of time. "Furnishing of Services" is the most important check for attraction of Service PE. For example in Indo-US Double Taxation Avoidance Agreement, the specified period is ninety days within any twelve-month period. The employment lien with the foreign enterprise has to be established for the employees providing services, to constitute a Service PE.

The Service PE rules will continuously give rise to more discussions regarding the source tax rules and, according to some, current wording may create uncertainty to taxpayers, [giving] looser rules to tax authorities and can greatly increase the compliance and administrative burden of both the taxpayers and tax authorities.

VI. Service Permanent Establishment Rule under OECD

In 2008 the taxation of services was added to the OECD Commentary[29] in accordance with a report released as a public discussion draft in 2006.[30] The previous Commentary Article 5 barred the option of a Source State taxing the profits received from the delivery of services in their territory. Thus, to equally tax profits from services and other business activities, some States voiced their wish that Article 5 be changed to allow a Source State the right to tax profits from services even if they were not ascribed to a PE in that State.[31]

Under the current PE definition, a resident of one State engaged in an extensive provision of services within the other state, without doing so through a physical or project PE, usually will not be taxed in the other state; providing services usually does not involve acting as an agent.[32] To the extent there is a physical

[24] See generally *United Nations Model Convention for Tax Treaties Between Developed and Developing Countries (1980),* available at *http://www.un.org/esa/ffd/ documents/Double Taxation. pdf; article5 at p 10 Last visited 12th June, 2012*

[25] *Tiiu Albin, "Problems with Permanent Establishments: Problems in Determining Permanent Establishment on the Basis of Article 5(1) OECD MC 2," TTN-TAXATION.NET, http://www.ttn-taxation.net/pdfs/prizes/TiiuAlbinEssay.pdf, last visited 12th June, 2012*

[26] *OECD Model Convention, article 5, at 25. Article 5(5) states, in relevant part: [W]here a person . . . is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise.*

[27] *Article 5.4 of OECD Model Convention*

[28] *Article 5 of OECD Model Convention*

[29] *OECD 2008 Model Convention, 42.11-42.48, at 100-10; For a review of the changes made to the Article 5 Commentary, see OECD, CTR. For Tax Policy & Administration., The 2008 Update to the OECD Model Tax Convention 9-17, 42.11-42.48 (2008),* available at *http://www.oecd.org/dataoecd/20/34/41032078.pdf,Last visited 12th June 2012*

[30] See generally *OECD, CTR. For Tax Policy & Administration., The Tax Treaty Treatment of Services: Proposed Commentary Changes (Dec. 8, 2006),* available at *http://www.oecd.org/dataoecd/2/20/37811491.pdf., Last visited 12th June 2012*

[31] See also *OECD 2008 Model Convention, 42.13-42.14, at 101*

[32] See *OECD 2008 Model Convention, 42.18, at 101-02*

PE, little service income will be attributable to that PE.[33] Therefore, service income will not give rise to substantial tax liability unless an additional type of PE is included in the PE definition.

A. DIT Mumbai vs. Morgan Stanley and Changes in the OECD Commentaries

This modification in the OECD Commentaries came right after an Indian case involving Morgan Stanley & Co. decided by the Supreme Court of India in 2007.[34] In this case, Morgan Stanley U.S. was involved in the rendering of financial advisory services, corporate lending, and the underwriting of securities.[35] It outsourced a wide range of its support services to its group company, Morgan Stanley Advantage Services Private Limited (Morgan Stanley India).[36]

The Indian Authority held in an Advanced Ruling that Morgan Stanley U.S. did not have a PE in India.[37] This was on the basis that Morgan Stanley India was not considered to be a fixed place of business, and that Morgan Stanley U.S. was not considered to be carrying on business in India.[38] In addition, Morgan Stanley U.S. would not have been considered to have an Indian PE due to the fact that Morgan Stanley India did not have the ability to conclude contracts on behalf of Morgan Stanley U.S.[39] Since some service businesses do not require a fixed place in their territory in order to carry on a substantial level of their activities therein, the fixed place of business requirement existing for PEs under Article 5, evidently, could not be duly applied to services.

B. Supreme Court in Morgan Stanley & Co. Inc Case[40]

Morgan Stanley & Co. Inc sends its employees to its associated enterprise in India namely, Morgan Stanley Advantages Services Pvt. Ltd for undertaking stewardship activities which included activities performed to monitor the quality and confidentiality of the outsourcing work. Further, Morgan Stanley & Co. Inc also sends its employees on deputation for different periods, even extending more than one year at the request of Morgan Stanley Advantages Services Pvt. Ltd. The deputed employees had a lien on his employment with Morgan Stanley & Co. Inc by virtue of which Morgan Stanley & Co. Inc retained control over the employee's terms and employment.

C. Activities which will attract Service PE

The Supreme Court ruled that the stewardship activities constituted activities to protect the internal interests of Morgan Stanley & Co. Inc in relation to the quality and confidentiality of work done and do not include *'furnishing of services'* to the Indian associated enterprise. Since *no services* were rendered through stewardship activities, there would be no Service PE for Morgan Stanley & Co. Inc in relation to its employees performing stewardship activities. Further the Apex Court noted that employees deputed by Morgan Stanley & Co. Inc for more than the specified period of time as given in the Indo US Double Taxation Avoidance Agreement would attract Service PE in India and thus Morgan Stanley Advantages Services Pvt. Ltd. would be the Service PE for Morgan Stanley Inc in India. It is interesting to note that the Indian company is referred as the Service PE by the Supreme Court and not the employees of the foreign enterprise. The reasons stated for the constitution of Service PE in India for Morgan Stanley & Co. Inc are:

- Morgan Stanley & Co. Inc is responsible for the work of the deputed employees.
- Morgan Stanley & Co. Inc retains the lien over the deputed employees.

After this land mark Judgement OECD's 2008 Model Tax Convention created new and specific rules for a characterisation of a Service PE.[41] According to such rules, if a non-resident entity provides services within the other Contracting State for a period of 183 days or more within a 12 month period, and more than 50% of the gross business revenues of the enterprise consists of income derived from the services performed in that State by the individual, a permanent establishment is deemed established in the Contracting State; this is known as a Service PE.[42]

In the alternative, a Service PE may exist where services are provided in that other Contracting State

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[33] See *OECD 2008 Model Convention, 42.18, at 101-02*
[34] *DIT (Int'l Tax'n), Mumbai vs. Morgan Stanley and Co., (2007) Civil Appeal No. 2914 of 2007 (arising out of S.L.P. (C) No. 12907 of 2006) and Civil Appeal No. 2915 of 2007 (arising out of S.L.P. (C) No. 16163 of 2006).*
[35] See id*., at 3.*
[36] *Id.*
[37] See generally id*., at 33-35.*
[38] See id*., at 12*
[39] See id*., at 9*
[40] *2007-TIOL-125-SC-IT*
[41] See generally *OECD 2008 Model Convention, 42.11-42.48, at 100-10*
[42] *OECD 2008 Model Convention, 42.23(a), at 102*

for 183 days or more in any 12-month period, and the activities are performed for a project or set of connected projects for customers who are either residents of that other State or who maintain a permanent establishment providing such services in that other State.[43]

In this regard, the Business and Industry Advisory Committee to the OECD (BIAC)[44] said that those proposed rules and conditions were created to help countries that wanted to put a special deemed permanent establishment threshold for services taxation in their tax treaties, but the new rules did not justify moving away from the OECD's fundamental principles on PE already in the model convention[45] (i.e., classical requirements and the negative and positive example list, all mentioned and maintained in Article 5 of the OECD MC).

Therefore, the provision of Services PE should, as a general rule, be treated the same way as other business activities and, therefore, the same permanent establishment threshold of taxation should apply to all business activities, including the provision of independent services.[46] There is no need to diverge from usual PE concepts and requirements, as long as they fit the service's nature.

D. Calculating Aggregate Periods for Service PEs

For the purpose of calculating the aggregate period of 183 days for the application of the Service PE rule, the overall period shall be counted based on the total number of days the services are rendered in the other Contracting State upon effectiveness of the service agreement.[47] Thus, the period for residency or for any kind of endeavour not connected with the services to be rendered shall not form part of the reckoning period. Also, in the event there is an automatic renewal or continuance of the same service agreement, it shall be regarded as being the same or connected project for the purpose of counting the aggregate period of 183 days.[48] Moreover, it is preferred that the personnel and employees are classified as the ones rendering services, considering that an artificial entity cannot act without the people representing it. Precisely for that reason, some scholars say that the Service PEs have been introduced to the OECD MC to compensate for the deletion of Article 14 of the MC in 2000, which is a reasonable justification.

E. Current Service Permanent Establishment Language and Issues

The current wording of the Service PE clause has been summarised as:

- A PE is deemed to exist irrespective of the short duration of business activities;
- The number of contracts or clients is irrelevant;
- It is important where the services are performed, not where the services are consumed or used;
- The amount of gross revenue is determined on the basis of the domestic laws of the Contracting States, because it has not been specified in the Articles of DTCs;
- In situations other than one-man enterprises, it may be difficult to determine the percentage of the entity's gross revenue derived from the services performed by a particular individual.

Conclusion

The Service PE rules will continually give rise to more discussions regarding the source tax rules and, according to some, current wording may create uncertainty to taxpayers, [giving] looser rules to tax authorities and can greatly increase the compliance and administrative burden of both the taxpayers and tax authorities. One of the main problems currently facing the Service PEs is the conflict on qualification of the income derived from employees on a company that may be regarded as having a PE in the Source State, due to the fact that its employees meet the requirements stated in that type of provision or particular treaty. When the source of the income is a third country, and when part of the compensation is paid directly from the client in the Source State, some double taxation may occur; the crucial point is to avoid defining under the Service PE clause if there is a PE in that case. This issue, however, is not mentioned or even slightly resolved by the OECD Model Convention or the Commentaries, and these things should be addressed by the international community in the near future. ■

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[43] *OECD 2008 Model Convention, 42.23(b), at 102-03*

[44] *The Business and Industry Advisory Committee to the OECD;* available at*: http://www. biac.org/ , Last visited 12th June 2012*

[45] *"Permanent Establishment is Key to OECD Revisions," International Tax Review. (12th June, 2008),* available at *http://www.tpweek.com/Article/1945259/Permanent-establishment-is-key-to-OE CD-revisions.html., Last visited 12th June 2012*

[46] *OECD 2008 Model Convention, 42.11, at 100*

[47] See *OECD 2008 Model Convention, at 211; OECD, Committee on Fiscal Affairs, Commentary on Article 15 concerning the Taxation of Income from Employment, 5, at 252,* available at *http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/model-tax-convention-on-income-and-on-capital-condensed-version-2010_mtc_cond-2010-en. , Last visited 12th June 2012*

[48] See *OECD 2008 Model Convention, 42.41, at 107.*