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Does Delhi HC 'virtual shop' concept under IP laws affect 'virtual PE' test?

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In the recent case of *World Wrestling Entertainment, Inc. (WWE)* (“**Appellant**”) v. *M/s Reshma Collection &Ors.*[1], the Delhi High Court (“**Delhi HC**”) held that it had the jurisdiction to entertain a suit filed by the Appellant for copyright and trademark infringement because the Appellant had been carrying on business[2] in Delhi as required under Section 62(2) of the Copyright Act, 1957 (“**Copyright Act**”) and Section 134(2) of the Trade Marks Act, 1999 (“**TM Act**”) through its website on which customer transactions were being concluded at Delhi.

While confirming that it had the jurisdiction to admit the suit, the Delhi HC made certain observations including that the *“availability of transactions throughthe website at a particular place is virtually the same thing as a sellerhaving shops in that place in the physical world”.* Such observations raise questions about whether the principles laid down by the Delhi HCshould carry any persuasive valuein cases requiring a judicial determination of the territorial jurisdiction of India to tax such profits of a person as may be attributable to a permanent establishment (**“PE”**) in India.

At the outset, the Delhi HC acknowledged that the Appellant did not have either a physical presence or an agent in Delhi. Nevertheless, relying on the principles laid down by the Supreme Court in *Dhodha House v. S.K. Maingi*[3](***“Dhodha House”***), it held that whether the Appellant has*“an interest in a business at a place, a voice in what is done, a share in the gain or loss and some control there over”*and is hence carrying on business in that place, can be determined on the basis of whether an essential part of the business is required to be performed in that relevant territory.

According to the Delhi HC, this test of the essential part of the business being performed in Delhi may be satisfied if customer contracts are actually being concluded and money is actually being received by the Appellant in Delhi; and not where, for instance, Delhi serves merely as the point for collection of orders, which are subsequently processed and serviced outside of Delhi.

It may be noted that this test is not very onerous. Even the Delhi HC acknowledged that the expression ‘carries on business’*“is much wider than what the expression in normal parlance connotes, because of the ambit of a civil action within the meaning of section 9 of the Code of Civil Procedure”.* Indeed, the Appellant’s customers accessed the website at Delhi; communicated their acceptance of the offer of merchandise advertised on the website at Delhi; and ultimately had such merchandise delivered at Delhi. On this basis, the Appellant can be considered to be carrying on business within the territorial limits of the Delhi HC even if the servers for the Appellant’s website are not located in Delhi.

The legislative intent behind the phrase ‘carries on business’ has previously been examined by the Supreme Court even in *Exphar SA and Anr. v. Eupharma Laboratories Ltd. and Anr.*[4]:

“It is, therefore, clear that the object and reason for the introduction of sub-section (2) of Section 62 was not to restrict the owners of the copyright to exercise their rights but to remove any impediment from their doing so. Section 62(2) cannot be read as limiting the jurisdiction of the District Court only to cases where the person

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instituting the suit or other proceeding, or where there are more than one such persons, any of them actually and voluntarily resides or carries on business or presently works for gain. It prescribes an additional ground for attracting the jurisdiction of a court over and above the "normal" grounds as laid down in Section 20 of the Code." [Emphasis Supplied]

Therefore, keeping in mind that both Section 62(2) the Copyright Act and Section 134(2) of the TM Act intend to enable an aggrieved party to initiate civil action, the phrase 'carries on business' is required to be construed as widely as possible and in favor of the Appellant.

On the other hand, given that tests for determination of a PE in India impose an additional burden on the taxpayer carrying on business in India, such provisions are required to be given a restrictive interpretation and the tests to be satisfied tend to be far more onerous. In the absence of facilities such as premises or equipment establishing a certain degree of permanence in a particular territory, a mere conclusion of a customer contract in that territory may not constitute a PE in India[5]. Under the OECD Model Tax Convention[6], computer equipment may not constitute a fixed place of business unless the web server is located in that specific territory for a sufficient period of time.

It is acknowledged that the Government of India has expressed its reservation on the issue of whether a fixed server should be required in order to constitute a PE stating that a *"website may constitute a permanent establishment in certain circumstances"*. However, Indian courts[7], having taken this into consideration, have observed that the effect of these reservations is merely to reserve a right to set out the circumstances in which a website alone can be treated as PE; and have therefore, reiterated the OECD principles on PE. Even in such Indian cases where the location of the servers was not the primary test being applied by the courts, a degree of permanence of the source of revenue in India[8] was established based on facts before the courts ruled that a PE was constituted in India.

Some jurisdictions like Spain[9] have tested the idea of 'virtual PE', which emphasizes the economic significance of the sales and deliveries in the territory rather than the location of servers or a similar physical presence in the territory. Theever expanding scope for innovation in business models has compelled the recent Base Erosion and Profit Shifting ("**BEPS**") Action Plan report released in September[10] (and the discussion drafts released previously) to revisit the nexus rules contained in the extant definition of PE under the tax treaties.For instance, where the decision making capabilities, personnel, IT infrastructure and the customers are allowed to spread out among multiple jurisdictions; or where warehousing and similar activities which may be considered preparatory or auxiliary activities under the existing PE definition assume a more central position in a business, the current definition of PE may not suffice[11].While no strong recommendations in favor of a virtual PE have been made in the BEPS Action Plan report, nexus rules based on significant digital presence[12] have also been contemplated, which may capture such cases where a significant number of contracts have been concluded online between an enterprise and a customer. However, pending an expansion in the definition of 'PE' under the tax treaties concluded by India, a test that is not reflective of the permanence of the business operations being carried out in a particular territory should not suffice for determining PE in India.

Therefore, the threshold for invoking jurisdiction of a court for the institution of a suit for copyright and trademark infringement is and should be much lower than the threshold for determination of PE; for the simple reason that cause of action may arise even from a single transaction, whereas a PE requires a degree of permanence in the business carried out in a specific location. Section 62(2) the Copyright Act and Section 134(2) of the TM Act are intended to provide relief to aggrieved parties intending to approach the court. The possibility of expanding the currently accepted nexus rules to address the taxation of the digital economy remains an interesting question.However,it may be far-fetched under current law to interpret the principles followed by the Delhi HC to preserve the interests of the Appellant out of context and to apply suchprinciples in the context of a PE case.

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[1] FAO (OS) 506/2013 and CM Nos. 17627/2013 & 18606/2013, decided on October 15, 2014.

[2] Section 62(2) of the Copyright Act and Section 134(2) of the TM Act require that a person instituting a suit

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under either the Copyright Act or the TM Act 'carries on business' within the local limits of the district court in which the suit has been instituted.

[3] 2006 (9) SCC 41

[4](2004) 3 SCC 688.

[5]Para. 2 *OECD Model: Commentary on Article 5* (2010)

[6]Para. 42.4 *OECD Model: Commentary on Article 5* (2010)

[7]*Income Tax Officer v. Right Florists*, [2013] 25 ITR(T) 639 (Kolkata - Trib.).

[8]*Amadeus Global Travel Distribution SA v. DCIT,*[2011] 11 taxmann.com 153 (Delhi)

[9] *Dell Spain v. AgenciaEstatal de la AdministraciónTributaria*, case 00/2107/2007, Tax Treaty Case Law IBFD

[10] OECD (2014), *Addressing the Tax Challenges of the Digital Economy,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, http://dx.doi.org/10.1781/9789264218789-en. Last accessed: November 13, 2014

[11]*Ibid.*

[12]OECD (2014), *Public Discussion Draft, BEPS Action 1: Address the Tax Challenges of the Digital Economy,* OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, http://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf. Last accessed: November 13, 2014