



CBDT withdraws instruction which provided benefits to non-residents engaged in the execution of turnkey power projects

- Instruction no. 1829, dated 21 September 1989 was issued by Central Board of Direct Taxes ('CBDT') which laid down guidelines for determining the taxability of income arising to non-residents from execution of power projects on turnkey basis to be carried out in India as well as outside India.
- CBDT has now issued Instruction no.5, dated 20 July 2009 withdrawing the above referred Instruction.

Highlights of Instruction no. 1829 dated 21 September 1989 ('the Instruction')

The Instruction dealt with the taxability of income arising to non-residents from execution of turnkey projects which involved complete responsibilities for commissioning the project.

- The Instruction envisaged that separate agreements may entered into by public sector companies in India with consortium of foreign companies for the following purposes:
 - a) Planning, design and engineering services;
 - b) Supply of equipment and materials on FOB basis at ports outside India;
 - c) Execution of civil works at the project site;
 - d) Erection, testing and commissioning of the machinery and equipment purchased outside India on FOB basis as well as equipment purchased in India and for transportation of equipment and materials to India by air/sea.

- Further, the Instruction envisaged that an overall co-ordination agreement may be entered into between the public sector company and the foreign contracting parties for ensuring guaranteed performance of all the contracts. For this purpose, one of the companies would act as a leader to ensure supervision and co-ordination of inter-related tasks. Under the overall agreement, the Indian concern will not make any payments to any foreign company.
- The Instruction was applicable to contracts entered into after 1 April 1989.
- The taxability of various items of income, as discussed in the Instruction, are summarised below:

– ***Status of the consortium for tax purposes***

The foreign company forming consortium will not constitute an Association of Person ('AOP') under the Income-tax Act, 1961 (the Act). Each foreign company will be individually liable for tax as a separate entity.

– ***Profits from sale of equipments and materials on FOB basis where the payments are also made outside India –***

Profits from such sale would not be deemed to accrue or arise in India irrespective of the fact that the supplier's employees take part in the final erection or commissioning of the equipment supplied. However, the supplier of equipment should not provide technical services abroad [i.e. (a) above] or execute civil works at the site [i.e. (c) above].

– ***Payments for planning, design and engineering services***

The same will be taxed as fees for technical services and will not partake the character of royalty.

– ***Profits in respect of civil work contracts executed in India and contracts for erection, testing or commissioning of plant and machinery***

The same would be taxed at a presumptive rate of 10 percent under Section 44BBB of the Act. Further, erection of plant and machinery or testing or commissioning thereof will also include laying of transmission units.

– ***Chargeability of receipts on account of transportation of equipment and material to India by air / sea –***

The same would be taxed at the presumptive rates specified in section 44B and Section 44BBA of the Act only if the charges payable for transportation are clearly distinguishable in the agreement.

Withdrawal of above referred Instruction vide Instruction no. 5 dated 20 July 2009

- The CBDT has withdrawn the Instruction with immediate effect due to following reasons:
 - In practice, the taxpayers rely on the Instruction for power projects as well as for other projects.
 - A singly project was split into various components like offshore supply of equipments / services, onshore supply equipments and onshore services.
 - At times, the contract was split into various components to be executed by the bidder and its associate concerns. Thus, consortium of foreign companies, which was not in existence, was created to take advantage of the Instruction.
 - Most of the profit was loaded in the offshore supply and the payments for the Indian portion of the contracts barely meet the expenses resulting into either losses in India or very low profit.
 - The assessing officer's attempt to apportion profit correctly into various components of the overall project on the basis of functions, risks and assets was often resisted by the taxpayer taking recourse to the Instruction.
 - Even if it is proved that a part of the operations relating to supplies have taken place in India or the permanent establishment of the taxpayer had a role in offshore supply, the profit from offshore supply is claimed to be exempt under the Instruction.
- The CBDT has clarified that withdrawal of the Instruction will not prejudice the plea of the tax authorities in any appeal, reference or petition, that the Instruction does not apply to a particular case even though it was in force at the time of making the assessment.

Our comments

- The CBDT has withdrawn the Instruction on the ground that the same has been misused by the taxpayers by using it for the non-power projects also.
- The instruction was applicable to the taxpayer having power plants. Since it has now been withdrawn under the above mentioned reasons, henceforth such taxpayers have to present their cases on the basis of facts and merits.
- The taxpayers who were using it for non-power projects were in any case not covered under the withdrawn instruction and therefore even they have to present their cases on the basis of facts and merits.
- After the withdrawal of the Instruction, in case of power or non-power projects, the tax authorities may treat the consortium of companies as an AOP and tax it accordingly unless the merits of the case may prove otherwise.
- However, for oil and gas companies we would like to bring to your attention that section 293A of the Act already provides for not treating such companies as an AOP by way of determining their status in a different manner.
- For any pending matters before any authorities, it may not be possible to contend that the income earned by such non-residents is covered by the Instruction.
- We would like to bring to your attention that the instructions issued by the tax department are only binding on the department and not on the courts.

Disclaimer

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

**For further information about KPMG in India and our services,
please contact:**

Bangalore

Maruthi Infotech Centre, 11-12/1
Inner Ring Road
Koramangala, Bangalore 560071
Phone: + 91 80 3980 6000 Fax: +91 80 3980 6999

Chennai

KPMG House
No.10, Mahatma Gandhi Road,
Nungambakkam High Road,
Chennai 600034
Phone: +91 44 39145000 Fax: +91 44 39145999

Delhi

DLF Cyber City, Building no. 10, Block B, Phase II
Gurgaon, Haryana 122 002
Phone: +91 124 307 4000 Fax: +91 124 254 9195

Hyderabad

KPMG, 8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad - 500 034
Phone: +91 40 66305000/23350060 Fax: + 91 40 6630 5299

Kolkata

KPMG Infinity Benchmark
Plot No. G-1, 10th floor Block - EP & GP,
Sector – V, Salt Lake City
Kolkata - 700091
Phone: +91 33 4403 4000 Fax: +91 33 4403 4199

Mumbai

KPMG House, Kamala Mills Compound, 448 Senapati Bapat Marg
Lower Parel, Mumbai 400 013
Phone: +91 22 39896000 Fax: + 91 22 39836000

Pune

703, 7th Floor Godrej Castlemaine, Next to Ruby Hall Clinic,
Bund Garden Road, Pune 411001
Phone: +91 20 30585764/65 Fax: +91 20 3058 5775

Kochi

4/F, Palal Towers, M. G. Road,
Ravipuram, Kochi 682016
Phone: +91 (484) 305 9000 Fax: +91 (484) 305 9001