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TAX FLASH NEWS

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Payment for offshore supply of equipment is not taxable in India under the Income-tax Act as well as under the India-Japan tax treaty

Recently, the NCR Bench of the Authority for Advanced Ruling (AAR) in the case of Nippon Steel Engineering Co. Ltd[1] (the applicant) dealt with the issue of taxability of offshore supply of equipment in India. The AAR held that payment for offshore supply of an equipment is not taxable in India under the Income-tax Act, 1961 (the Act) as well as under the India-Japan tax treaty (tax treaty) since the delivery of the equipment took place outside India and the title of equipment was transferred outside India.

Facts of the case

The applicant, a Japanese Company, engaged in the business of steel and environmental plants. The applicant has a strong presence in steel plant business sector and has delivered a number of Coke Dry Quenching (CDQ) units worldwide. The applicant entered into two contracts with the Indian purchaser for supply of equipment for Japan portion and China portion. The contract provided that carriage of equipment from port of shipment to Indian port shall be the purchaser's responsibility (Indian party) on its own account. Additionally, the applicant entered into separate contracts with Indian purchaser for supply of drawings, offshore training, supervision services, in connection with the offshore supply of equipment's and materials. The taxpayer filed an application before the AAR seeking ruling in connection with the offshore supply of equipment and material.

Tax department's contentions

Whether 'a transaction' means one transaction

The tax department contended that the applicant can raise question in respect of only one transaction as the word used in the Act is 'a transaction'. However, in the present case the applicant had raised question in respect of two transactions, which was not permissible within the scope of the provisions of the Act.

Offshore supply of equipment

The tax department contended that all contracts with Indian purchaser were related contracts and the contracts for supply of equipment cannot be seen in isolation as they were entered into just to split consideration into offshore and onshore components. The contract for supply of equipment has to be read along with the other contracts of drawings, training and supervision as the equipment cannot be installed without involvement and supervision of the applicant and the offshore supply contract was inextricably linked with the other training and supervision contracts and thus all four contracts constituted a composite contract.

Permanent Establishment

The tax department contended that for such intensive projects the applicant must have done elaborate pre-bid spade work involving site visit, surveys and inspection of various places through its employees, which would result in fixed place PE exposure for the applicant. Therefore, the income of the applicant arising out of these contracts was liable to be taxed as business income under Article 7 of the tax treaty. The applicant also had a business connection as stipulated under section 9(l)(i) of the Act. The profit directly or indirectly attributable to the PE is taxable in India. Further, the employees of the applicant company also created a Dependent Agent Permanent Establishment (DAPE) as per Article 5(4) of the tax treaty.

AAR ruling

Whether 'a transaction' means one transaction

The AAR observed that the word used in Section 245N(a) of the Act is 'a transaction'. The word 'a' has not been defined in the Act and hence one may refer to General Clauses Act, 1987. On reference to General Clauses Act it has been observed that if there

[1] Nippon Steel Engineering Co. Ltd v. CIT (AAR No. 1303 of 2012) – Taxsutra.com

is nothing contrary provided in relevant statute, then the provision of General Clauses Act prevails and therefore, a singular word has to be considered as including plural and vice versa.

Rule 44E(4) of the Income-tax Rules, 1962 (the Rules) prescribe the fee payable along with the application for advance ruling. The said rule stipulates that the fee payable has to be worked out on the basis of amount of one or more transactions entered into or proposed to be undertaken by the applicant. It is thus evident from the above Rule that more than one transaction is envisaged in the application of an applicant. The AAR relied on various decisions[2]. The AAR also relied on CBDT Office Memorandum[3] wherein it is clarified that the use of words 'a transaction' in sub-clause (iia) of clause (a) of Section 245N does not preclude multiple transactions from the scope of 'advance ruling' as defined in Section 245N(a) of the Act. In view of the above interpretation of a singular word as given by the various Courts under Act as well as under other Acts, it has been held that 'a transaction' appearing in Section 245N(a) of the Act would include more than one transaction.

Offshore supply of equipment

The AAR observed that the comprehensive scope of supply in the Letter of Intent (LOI), issued by Indian purchaser suggests that it was segregated into seven different contracts w.r.t manufacture, supply, supervision of erection, testing, commissioning and training etc., with specific costs being assigned to each contract. The AAR observed that the terms and conditions for supply of equipment for Japan portion and China portion were identical except for the contract prices. On reference to the scope of supply contract agreement, it has been observed that these two contracts were for supply of equipments along with spare parts. The contract price for supply of equipment was on FOB berth term, Japanese, Korean, Chinese and/or other international seaports basis in accordance with the terms. As per the terms of the supply contract all taxes, levies dues, duties, fees, license and other charges of whatever nature levied in India, in connection with execution of the contract shall be wholly borne and paid by the purchaser. Further, the responsibility of the marine insurance for the equipment supply under the contract was on the purchaser itself and not on the applicant. In fact, the responsibility of erection of the equipments and preparation for various performance tests was on the purchaser.

Accordingly, the title to the goods supplied by the applicant was transferred outside the territory of India upon loading of the equipments. The invoice was generated by the applicant in the name of Indian purchaser, who was also the consignee in the Bill of Lading. The Bill of Entry was also found to be in the name of Indian purchaser. These facts clearly establish that the supply of equipment and material was made outside India and thus the transfer of title to the equipment and materials also took place while the goods were outside the territory of India. The payment for the offshore supply of equipment's was also made outside the country in foreign currency as per the terms of contract.

The AAR relied on Supreme Court decision in the case of Mahabir Commercial Company Limited[4] wherein it was held that the property in the goods, passes once the documents are tendered by the seller to the buyer or the agent, as required under the contract. It was held that where the seller retains control over the goods by either obtaining a bill of lading in his name or to his order, the property in the goods does not pass to the buyer until he endorses the bill to the buyer and delivers the document to him. In the instant case, the seller did not retain control over the goods as the invoice and the bill of lading was in the name of Indian purchaser and not in the name of the applicant or any other agent. Therefore, the title to and property in the goods shipped by the applicant at the foreign port was transferred at the port of shipment itself. This event took place outside the territory of India and the income arising out of such sale transaction cannot be said to have accrued or arisen in India.

The AAR relied on the decision of the Supreme Court in the case of Ishikawajima- Harima Heavy Industries Ltd[5] wherein there was a clause which contained an obligation on the part of the contractor to retain custody and control of the equipment and to take due care thereof until provisional acceptance of the work and the installation of equipments was also to be carried out by the contractor. In spite of these features the Supreme Court had concluded that the offshore supply of goods had taken place outside India and did not give rise to any taxable income in India under the Act. In fact, that case was a case of composite contract, whereas in the present case there is a separate and exclusive contract for supply of goods offshore.

Explanation 1(a) to Section 9(l)(i) of the Act stipulates that where all the operations are not carried out in India, only that part of income which can be reasonably attributed to the operations in India, would be deemed to accrue or arise in India. In a composite contract where only a part of the operations is to be carried out in India, the taxpayer would not be liable for part of income that arises from operations conducted outside India. In such a case, income from the contract has to be appropriately apportioned.

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[2] CIT v. D. Ananda Basappa [2009] 309 ITR 329 (Kar), CIT v. Smt. KG Rukminiamma [2011] 331 ITR 211 (Kar), CIT v. Sony Ericsson Mobile Communication India Private Limited [1979] 374 ITR 118 (Del), Collector of Customs Bombay v. United Electrical Industry Limited. [1993] 999 taxmann.com 1348 (SC), Fidelity North Star Fund [2007] 228 ITR 641 (AAR)

[3] Dated 28 August 2019

[4] Mahabir Commercial Company Limited v. CIT [1972] 86 ITR 417 (SC)

[5] Ishikawajima- Harima Heavy Industries Ltd v. DIT [2007] 158 taxmann 259 (SC)

Accordingly, it has been held that no income would arise in the hands of the applicant from the off-shore supply of equipments and it cannot be held to be chargeable to tax in India under the Act as the sale was completed outside India and there was no accrual or deemed accrual in India.

Permanent Establishment

Fixed place PE

The applicant does not have any fixed place of business through which its business was wholly or partly carried on.

Supervisory PE

There was no dispute to the fact that the applicant had a supervisory PE which was in respect of contract for supervision services and the income in respect of this supervisory PE had already been offered to tax in India. The tax department contended that supervisory PE was also involved in offshore supply contract for equipments. However, the AAR observed that the supervisory PE would have been established much later at the time of supervision, after the offshore equipments would have reached the site. Therefore, Supervisory PE does not have role play for offshore supply of equipment.

Dependent agent PE

The employees of the applicant who have signed the contracts cannot be held as a dependent agent. When the contract is required to be signed by a company, it is imperative that a responsible person of the company have to sign the contract on its behalf. In the present case, the contract was signed by General Manager of the applicant, who cannot be held as a dependent agent of the applicant. The responsibility of erection of the equipments and preparation for various performance tests was on the purchaser and the applicant had only supervisory role therein. The contract for installation of offshore equipment was assigned to some other entity in India wherein the applicant had no role at all. From the details as made available, the AAR did not find stay of employees of the applicant for a period exceeding six months after the issue of Letter of Intent. Therefore, it did not constitute PE in India.

Fees for Technical Services

Further, there is no element of Fee for Technical Services (FTS) involved in the contracts for offshore supply of equipment's. There cannot be any question of FTS involved in these contracts for offshore supply. There were separate contracts for engineering, training and supervision services and as stated by the applicant in the course of this proceeding, the proceeds received under those contracts were already offered to tax in India under supervisory PE.

Our comments

The issue with respect to taxability of offshore supply and services has been a subject matter of debate before the Courts.

The Delhi High Court in the case of Nokia Networks OY[6] following the decision of the Supreme Court in the case of Ishikawajma-Harima Heavy Industries Ltd., had held that in case of one composite contract, supply has to be segregated from the installation and only then the question of apportionment arises under the Act. The High Court observed that since the property in goods had passed on to the buyer outside India, said agreement would not be taxable in India.

Similarly, the AAR in the case of SEPCO III Electric Power Construction Corporation and CTCI Overseas Corporation Ltd[7] relying on the decision of Ishikawajima held that payments received by a foreign company for offshore supply of equipment were not taxable under the Act.

However, the AAR in the cases of Alstom Transport SA[8] and Roxar Maximum Reservoir Performance WLL[9], relying on the Supreme Court decision in the case of Vodafone International Holding B.V.[10] applied 'look at' approach and held that composite contract offshore supply of equipment and for installation and commissioning of project in India cannot be dissected for the purpose of taxability of the contract. Therefore, offshore supply of equipment was taxable in India.

The AAR in the present case has held that that the offshore supply of an equipment is not taxable in India under the Act as well as under the tax treaty since the delivery of the equipment took place outside India and the title of equipment was transferred outside India.

Even though the decision of the AAR is legally binding only on the parties involved in a particular case, the ruling would have a persuasive value in similar matters before the Indian tax authorities and Courts.

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[6] DIT v. Nokia Networks OY [2012] 25 taxmann.com 225 (Del)
[7] SEPCO III Electric Power Construction Corporation (A.A.R. No.1008 of 2010, dated 31 January 2012), CTCI Overseas Corporation Ltd v. DIT (A.A.R. No.854 of 2009, dated 1 February 2012)
[8] Alstom Transport SA [2012] 208 Taxman 223 (AAR)
[9] Roxar Maximum Reservoir Performance WLL [2012] 207 Taxman 293 (AAR)
[10] Vodafone International Holdings B.V. v. UOI [2012] 341 ITR 1 (SC)

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Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road,
Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000