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# TAX FLASH NEWS

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## Offshore supply of equipment by an Italian company to Indian telecom operators is not taxable in the absence of a PE and business connection in India

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Siemens Mobile Communications SPA[1] (the taxpayer) held that offshore supply of equipment to telecom operators in India cannot be brought to tax in the absence of a Permanent Establishment (PE) in India under the India-Italy tax treaty (tax treaty) and in the absence of business connection under the Income-tax Act, 1961 (the Act).

### Facts of the case

The taxpayer, an Italian company, engaged in the business of manufacture and supply of microwave transmission equipment. During the Financial Year (FY) 1997-98 (dated 1 October 1997), the taxpayer entered into an agreement with its sister concern [Associated Enterprise (AE)], whereby AE was required to carry out marketing and promotional activities, inform the taxpayer about the programs and plans of various public bodies, corporations or private entities, call for tenders, enable commercial, technical, administrative and legal support, etc. For these services, Indian company (AE[2]) was remunerated on arm's length basis. On 1 October 1997, Indian subsidiary also entered into independent contracts with the telecom operators in India for undertaking installation, testing and commissioning of the components supplied to them by the taxpayer. In addition to these activities, the scope of activities performed by AE also encompassed manufacturing, sale and trading of a wide range of telecommunication equipment, such as switching equipment, optical transmission equipment, internet broadband equipment, etc.

During the relevant years[3], the taxpayer supplied microwave transmission equipment (including both hardware and software components) to its customers in India, being independent telecom operators.

The Assessing Officer (AO) held that since the taxpayer was engaged in the activity of manufacture and supply of components as well as had other obligations including delivery, acceptance test and installation, assembly or supervision on sites, which activities continued for over 6 months, the said activities constituted installation PE under the tax treaty. The AO held that the activities relating to installation, commissioning and maintenance, which would require the presence of taxpayer in India and hence some portion of the profit relating to these offshore supplies should be brought to tax in India. The AO held that unless these activities were completed, sale cannot be said to have been concluded in India. The AO also held that the liaison office (LO) has assisted in the negotiation and signing of the contracts. The employees of the taxpayer frequently visited India for negotiations and signing of contracts which itself shows that AE had no authority to conclude contracts. The Commissioner of Income-tax (Appeals) [CIT(A)] has decided the issue in favour of the taxpayer for FY 1998-99. However, in subsequent years, the decision was held against the taxpayer.

### Tribunal's decision

#### *Fixed place PE*

The Supreme Court in the case of Formula One World Championship Ltd.[4] held that offshore supplies were not taxable in the absence of a PE of the non-resident taxpayer in India. In the present case, a PE

[1] Siemens Mobile Communications SPA v. DCIT (ITA No. 2810/Del/2003) – Taxsutra.com
[2] Associated Enterprise
[3] AY 1998-99, 1999-2000, 2000-2001, 2001-2002, 2002-2003
[4] Formula One World Championship Ltd. v. CIT [2017] 394 ITR 80 (SC) and ADIT v. E-Funds IT Solution Inc. [2017] 399 ITR 34 (SC)

could not be said to exist since the expatriate employees were coming for negotiation and signing of contracts and these activities were not revenue generating activities. Further, expatriate employees had not visited in the subsequent years. To support its case, the Tribunal relied on the decision of Ericsson A.B.[5]. The tax department contended that the taxpayer did not provide information with respect to the employees who visited India during the subject AYs which precluded the tax department to analyse whether the taxpayer has a PE in India. However, the Tribunal observed that the dates of execution of contracts from which it can be observed that almost all the contracts were signed in FY 1997-98. Since all the contracts were entered into between 26 February 1997 and 15 January 1998, there was no occasion for any employee of the taxpayer to visit India thereafter.

With respect to the LO, the Tribunal relied on the decision of the Special Bench Tribunal in the case of Motorola Inc.[6] where it was held that an LO does not tantamount to existence of a PE in terms of Article 5 of the tax treaty. Further, the decision in the case of Hitachi Hitech Technologies[7] was distinguishable on facts of the present case.

Referring to the Power of Attorney (POA), the tax department contended that contracts were not signed in Italy. The contracts were negotiated and signed in India itself. However, the Tribunal observed that signing of the contract was merely putting signature on a paper and it does not lead to an inference of PE or business connection.

The role of the taxpayer was limited to mere supply of hardware components directly from Italy in such a manner that sales stood concluded, title transferred, and consideration received outside India. Even the taxpayer was required to repair or replace faulty equipment during the warranty period. However, for this, the telecom operator was required to send the faulty equipment to the facility of the taxpayer in Italy. The onshore income from onshore services, i.e., undertaking installation, testing and maintenance was earned by Indian company through performance of marketing and promotional activities for the taxpayer and it was voluntarily offered to tax in India.

The offshore contract for supply of components cannot be read together with the onshore contract of rendering installation, commissioning and maintenance. It has to be seen in the light of the provisions of the tax treaty and tests set out[8] in the decision of the Supreme Court in the case of Formula One World Championship Ltd[9]. The business of AE was not dependent on the taxpayer as the facts show the variance in the scope of activities. Further it cannot be said that AE was at the disposal of the taxpayer.

### *Installation PE*

A perusal of the supply contracts between the taxpayer and the telecom operators in India would indicate that the role of the taxpayer was limited to mere supply of hardware components directly from Italy. The taxpayer was neither responsible for, nor undertakes installation, testing and commissioning, the same being the responsibility of the telecom operators themselves, who either undertook the same themselves or had the option of appointing AE. Relying on the decision of Nortel Networks India International Inc.[10], it was held that there was no installation PE of the taxpayer.

### *Dependent Agent PE*

The obligation to carry out installation, commissioning and maintenance under the services contract was by way of separate contracts between AE and the telecom operators. The contracts between the taxpayer and telecom operators indicate that the taxpayer was not even responsible for performing pre-network surveys or software updates. The taxpayer does not hold any equity capital in AE and the sphere of activities performed by AE was much broader than those envisaged under the agreement entered into between the taxpayer and AE. Therefore, AE cannot be regarded as DAPE of the taxpayer in India.

Assuming, yet not accepting that the installation activities were undertaken by AE at the behest of the taxpayer, the same would still not render the income of the taxpayer to be taxable in India, since the supply of hardware components, i.e., the taxable activity, was completed before the installation activities. The various decisions[11] relied on by the tax department were distinguishable on facts.

### *Business connection*

The Tribunal referred to the CBDT Circular[12] wherein it is stated that no liability will arise to a non-resident where transaction of sale is on principal to principal basis since the transaction of supply of components by the taxpayer are on its own account, unaffected by the services to be rendered by AE. This itself would take the transaction of supply of components outside the purview of section 9(1)(i) of the Act. Therefore, the no business connection can be said to have been established, and therefore, no further income can be attributed to India.

## Our comments

The issue of taxability of offshore supply of equipment has been a subject matter of debate before the Courts/Tribunal.

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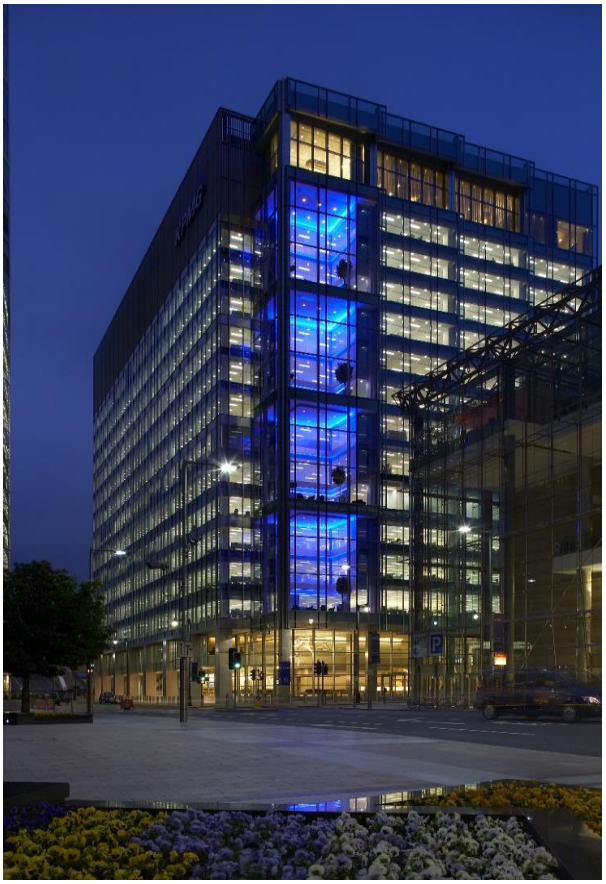
[5] DIT v. Ericsson A.B. [2012] 343 ITR 470 (Del)
[6] Motorola Inc v. DCIT [2005] 96 TTJ 1 (Del) (SB)
[7] Hitachi Hitech Technologies v. DCIT (ITA Nos. 2683 to 2688/DEL/2015)
[8] The tests are (a) place of business (b) disposal test and (c) virtual projection
[9] Formula One World Championship Ltd. v. CIT [2017] 394 ITR 80 (SC)
[10] Nortel Networks India International Inc [2016] 386 ITR 353 (Del)
[11] Daikin Industries Ltd. v. ACIT [2018] 171 ITD 301(Del), Shanghai Electronic Group Co. Ltd. [2010-2010-TIOL-79]
[12] CBDT Circular No. 23 dated 23 July 1969

The Delhi High Court in the case of LG Cable Ltd.[13] held that income from offshore supply of equipment cannot be taxed in India merely because it is interlinked with the satisfactory performance of the onshore contract. Further, the Delhi High Court also held that since taxpayer's PE was not at all involved in the transaction of the offshore supply of equipment, the existence of the PE would be irrelevant for taxing offshore supplies.

Similarly, the Delhi High Court in the case of Nokia Networks OY[14] following the decision of Ishikawajima-Harima Heavy Industries Ltd[15] 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 held that since the property in goods had passed on to the buyer outside India, said agreement would not be taxable in India.

However, in the various cases[16], the AAR relying on Vodafone International Holding B.V.[17] applied 'look at' approach and held that composite contract for installation and commissioning of project in India cannot be dissected for the purpose of taxability of the contract. Accordingly, income from offshore supply and services was taxable in India.

The Tribunal in the present case has held that offshore supply of equipment to telecom operators in India cannot be brought to tax in the absence of a PE and business connection in India.



[13] DIT v. LG Cable Ltd. [2011] 197 Taxman 100 (Del)
[14] DIT v. Nokia Networks OY [2012] 25 taxmann.com 225 (Del)
[15] Ishikawajima Harima Heavy Industries Ltd *v.* DIT [2007] 288 ITR 408 (SC)
[16] Alstom Transport SA [2012-TII-28-ARA-INTL], Roxar Maximum Reservoir Performance WLL (AAR No. 977 of 2010) (AAR)), Linde A.G. (AAR No. 962 of 2010) (AAR)
[17] Vodafone International Holdings B.V. v. UOI [2012] 341 ITR 1 (SC)

## home.kpmg/in


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

**Bengaluru**
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

**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