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TAX FLASH NEWS

10 February 2021

Offshore supply of equipment under the composite contract is not taxable in India, however, offshore services are taxable in India

Recently the Authority of Advance Rulings (AAR) in the case of Technip France SAS[1] (the taxpayer) dealt with the issue of taxability of a composite contract for offshore supply of equipments and services in India. The AAR held that consideration received for offshore supply of equipment is not taxable in India. However, the consideration received for basic engineering design services and offshore advisory services in relation to the construction, erection, installation, commissioning and testing of the plant are taxable in India. Such services were inextricably connected with the setting up of the plant and were rendered through a PE in India. Thus, such profits are taxable in India as per the provision of Article 7(1) of the India-France tax treaty as business income.

Facts of the case

The applicant is a non-resident entity engaged in the business of Engineering, Procurement and Construction (EPC) for oil production i.e. offshore and onshore refining, petrochemicals, fertilizers, chemicals, pharmaceuticals, non-conventional energy, sub-marine pipes, etc. An Indian company (I. Co) floated a tender to set-up a Plant on a turnkey basis inviting bids for designing, engineering and construction of the Plant at site. The applicant submitted its interest in execution of the scope of work mentioned in the tender. Subsequently, the bid of the applicant was accepted by an Indian entity and the contract was awarded to the applicant. The Plant was to be set-up using proprietary technology owned by a non-resident which was an international provider of established technology to the hydrocarbon industry.

The applicant's scope of work was divided into two parts i.e. (i) the offshore scope included offshore supply of equipment, offshore services for basic engineering design in relation to setting up of the Plant site, assistance in detailed engineering and technology licensing and (ii) Onshore scope of work included onshore supply of equipment, third party inspection and onshore services for detailed engineering, procurement, construction, erection in relation to setting up of the Plant at site, start-up commissioning and post commissioning service. At the bid stage the taxpayer undertook offshore scope of work and its Indian subsidiary would undertake the onshore scope of work. The applicant filed an application before the AAR seeking a ruling on whether any part of the offshore work was liable to tax in India under the provisions of the Act or tax treaty. Further whether basic engineering design services and offshore advisory services are taxable in India.

AAR ruling

Taxability of offshore supply of equipment

It was agreed in the contract that the ownership of offshore equipment and materials will be transferred to the I Co. upon FOB shipment for the imported supply. Though, the taxpayer was responsible for insurance of all the materials including cargo transit insurance as well as for transportation and safe storage of the equipment and materials to the contract site, these obligations had no impact on the transfer of ownership of the imported materials.

It is apparent from the terms of the contract that ownership of the equipment and materials under offshore supply part of the contract was transferred outside India. Further, contract document prescribed that progressive payment for the part of the work executed shall be made on the basis of work completed as certified by Indian company as per the milestone formula provided in the contract. The payment outside India was remitted through electronic fund transfer to the contractor's bank account.

The invoice and the bill of lading in respect of offshore supply was in the name of I Co. and not in the name of the taxpayer or any other agent. Therefore, the title to and property in the goods shipped by the taxpayer at the foreign port was transferred at the port of shipment itself. This event took place outside the territory

[1] Technip France SAS (AAR No. 1413/2012) – Taxsutra.com

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 Mahabir Commercial Company Limited[2].

As per terms of contract, the entire project was insured in the joint name of the contractor and the I Co. Even if the goods were in the custody of the applicant for the purpose of erection and installation, I Co. has already become the owner of equipments and materials well before the goods had reached the Indian port. The condition that the performance guarantee tests shall be performed by the contractor, who will be responsible for the quality and satisfactory performance of the equipments, also cannot be considered as a condition which postpones the transfer of title to the offshore equipments and material till that time. This stipulation was in the nature of warranty provision in the contract, and it cannot be deemed that the transfer of title of the property has taken place in India on satisfactory performance guarantee test. In Ishikawajma-Harima Heavy Industries Ltd.[3], the Supreme Court had held that no part of profit arising from the offshore supply of equipment outside India would be chargeable to tax in India.

The taxpayer's PE was not involved in offshore supply of equipments and materials. The entire requirement of imported components of supply was identified at the time of preparation of bid document itself and included in the contract document. It is not that the imported components of supply were identified in the course of execution of the contract and ordered at the instance of the PE. The principle of apportionment of income on the basis of territorial nexus is well accepted. Explanation 1(a) to Section 9(1)(i) 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. The decision of the Supreme Court in the case of Ishikawajma-Harima Heavy Industries Ltd. relied upon. Accordingly, the AAR held that income from off-shore supply of equipments 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.

Taxability of offshore services

As per Article 13(4) of the tax treaty payment of any kind in consideration for services of a managerial, technical or consultancy nature qualifies as FTS. There is no doubt that the basic engineering design services and offshore advisory services rendered by the taxpayer were in the nature of FTS as per Article 13(4) of the tax treaty. However, by virtue of MFN clause in the tax treaty, the taxpayer claimed the benefit of make available clause available in the India-Finland and India-Portugal tax treaties.

In the present case, the major component of detailed engineering was Indian component and proportion of imported component was only nominal. From the terms of the Contract, it indicates that the basic engineering design and detail engineering services, even if developed in France, were not final and could not have been rendered directly from France without the involvement of the PO in India and also without prior consultation with Indian company. It was contemplated in the Contract that I Co. will review all facets of design including design calculations in order to ascertain compliance with design criteria, specifications and conceptual design. The basic engineering design, even if developed in France could not have been provided directly without verification, review and approval by I Co. Thus, the taxpayer was required to furnish all the design information, calculations, drawings etc. along with the methodology of computation for review by I Co. In this process, the taxpayer was not only making available the design services to I Co. but the design, even if prepared in France, were not being rendered directly from France. Thus, the rendering of actual service was in India and not in France. Similarly, review and approval of I Co. was contemplated in the case of engineering reviews, design verification and construction drawings and specifications. It was thus, apparent that the basic engineering design and all detailed engineering design were not only made available to I Co. but they were also reviewed and approved before the actual utilisation of these services. Further, the process of review and approval of these services also satisfy the condition of 'make available' of these services.

All preliminary drawings and specifications were provided by the taxpayer and I Co. had reviewed these drawings and specifications and advised the Contractor with its comments or suggestions and had returned a marked-up drawings print with corrections to be made by the Contractor. These services enabled the recipient of these services to perform the same services, in the future, without recourse to the taxpayer. Thus, the condition of make available' of the services is found satisfied from the terms of the contract. Thus, the reliance on the MFN clause in the Protocol to tax treaty the becomes redundant. As the basic engineering design services and offshore advisory services were rendered in India and these services were also made available to I Co., they are taxable not only in accordance with the provisions of the Act but also under the tax treaty.

Permanent Establishment and attribution

Though the contract was signed on 21 November 2011, the effective date of contract was 15 April 2011. Even if the PO was set up after the effective date of contract, the taxpayer had the services of its subsidiary

[2] Mahabir Commercial Company Limited (86 ITR 417)
[3] Ishikawajma-Harima Heavy Industries Ltd. v. DIT [2007] 158 ITR 259 (SC)

at its command. The personnel of subsidiary were involved in the bidding process of the taxpayer from the very beginning from the purchase of tender document, attending techno-commercial and price bid opening and bid clarificatory meetings, etc. Further, the deployment schedule of supervisory personnel for the contract as filed by the taxpayer had CVs of the key personnel and most of the key supervisory personnel were employees of Indian subsidiary. Thus, Indian subsidiary was not only involved in the project from the very beginning, but its key personnel were managing the affairs of the taxpayer which makes them PE from the effective contract date. These employees not only had a secured right to use their office space, but they were carrying on the business of the parent enterprise and in this sense the taxpayer had a fixed place of business. Therefore, the taxpayer had a PE from the effective date of contract.

The basic engineering design services and offshore advisory services as rendered by the taxpayer were not stand-alone services but were intrinsically connected with setting up of Plant. The contract was not for these design services, but these were only small components of the turnkey contract. It was a composite contract for carrying out all activities and services for setting up the Plant and the payment received by the taxpayer was for construction and erection at site within the territory of India and for performance of the contract as a whole in India. There was no exception in the contract for accrual of any part of the contract outside India except in respect of offshore supply of equipments and hence it indicates that the consideration paid to the taxpayer in respect of 'Basic Engineering' and 'Detailed Engineering' services had accrued in India. These services were part and parcel of the contract and could not have been rendered divested from the execution of the contract.

The engineering design had to be customised and prepared vis-a-vis the location of the site and taking into account the local factors and could not have been delivered exclusively from France. The involvement of the PE of the taxpayer in such designing process was inevitable. The taxpayer has contended that such services were not attributable to the PE of the taxpayer in India. However, the service pertaining to construction, erection, installation, commissioning and testing of the plant could not have been rendered from France without the involvement of the PE. In fact, the taxpayer has also admitted in the application that all such engineering, drawings, designs, etc. will only be used by the PO of the taxpayer for setting up a Plant at site, I Co. will not be able to independently use the technology that goes in the drawings, design documents, etc. Thus, even if the part of design services were developed in France such engineering, drawings, designs, etc. were used by the PO for setting up the Plant at site. Thus, the actual rendering of the basic engineering design service as well as offshore advisory services was done not directly by the taxpayer from France but by its PO in India. As rendering of the services was done by the PE of the taxpayer, the same is found covered under Article 7 of the tax treaty.

As the services were inextricably connected with setting up of the plant and were rendered through this PE, the profit of the PE is required to be taxed in India as per the provision of Article 7(1) of the tax treaty in respect of these services.

Our comments

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

The Courts/Tribunal in various cases[4] have held that the payment for offshore supply of equipment is not taxable in India since title to the goods have been passed outside India and the payment was also received outside India. It was 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.

However, the AAR in the cases of Alstom Transport SA[5] and Roxar Maximum Reservoir Performance WLL[6], relying on the Supreme Court decision in the case of Vodafone International Holding B.V.[7] 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 consideration received for offshore supply of equipment under the composite contract was not taxable in India.

With respect to the taxability of offshore services, the Mumbai Tribunal in the case of IHI Corporation[8] held that the income from offshore services related to the EPC and commissioning contracts in India, is taxable as Fees for Technical Services (FTS) under Section 9(1)(vii) of the Act. However, such services are neither taxable as FTS nor as business income under the India-Japan tax treaty.

However, the Delhi Tribunal in the case of Shanghai Electric Group Co. Ltd.[9] held that the taxpayer was having a supervisory PE in India. Profits from offshore and onshore services in respect of Indian projects were attributable to the supervisory PE of the taxpayer in India since they were effectively connected with each other.

The AAR in the present case has held that the consideration received for basic engineering design services and offshore advisory services in relation to the construction, erection, installation, commissioning and testing of the plant are taxable in India. Such services were inextricably connected with the setting up of the plant and were rendered through the PE in India, therefore, the profits are taxable in India as business income.

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[4] DIT v. Nokia Networks OY [2012] 25 taxmann.com 225 (Del), POSCO Engineering & Construction Company Ltd. v. ADIT (ITA No. 5787/Del/2013), 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)

[5] Alstom Transport SA [2012] 208 Taxman 223 (AAR)

[6] Roxar Maximum Reservoir Performance WLL [2012] 207 Taxman 293 (AAR)

[7] Vodafone International Holdings B.V. v. UOI [2012] 341 ITR 1 (SC)

[8] IHI Corporation v. ADIT [2015] 63 taxmann.com 100 (Mum)

[9] Shanghai Electric Group Co. Ltd. v. DCIT [2017] 84 taxmann.com 44 (Del)

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