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Consideration for offshore supply of equipment not taxable in India though service consideration in-built in offshore equipment supply price to be taxed

In brief

In the case of POSCO Engineering & Construction Company Limited[1] (the taxpayer), the Delhi Income-tax Appellate Tribunal (Tribunal) has ruled on the taxation of a foreign company executing an Engineering, Procurement and Construction (EPC) contract in India. The Tribunal has ruled in favour of the taxpayer on most of the principal issues involved in the appeal made against the order of the tax officer (TO) (confirmed by the Dispute Resolution Panel (DRP)).

The Tribunal held that the consideration for offshore supplies paid by the taxpayer, under a turnkey contract was not taxable in India, because property in the supplies passed outside India. Having held this, the Tribunal further held that if a consideration for services performed in India was embedded in the consideration for the offshore supplies, that service element should be taxable in India. With respect to the onshore activities (supervisory services and supplies), offered to tax by the taxpayer in India in the year of supplies or actual rendition of services, the Tribunal held that the advance received against the onshore portion (including supplies and services) would be taxable in the year of actual delivery or performance of services. With respect to the consideration for design and

[1] POSCO Engineering & Construction Company Ltd *v.* ADIT [TS-108-ITAT-2014(DEL)]

engineering, the Tribunal held that it was taxable in India as Fees for Technical Services (FTS) on a source rule basis.

Facts

- The taxpayer was a company incorporated in Korea engaged in construction, design and service work for steel mill facilities with general civil engineering, electricity and housing projects. During the year under consideration, the taxpayer undertook a turnkey project in India from Steel Authority of India Limited (SAIL) for setting up the blast furnace complex in India, involving offshore supplies, offshore design and engineering, onshore supplies and onshore supervision of the installation work.

- During the same year, the taxpayer received an advance against the first milestone towards offshore supply, onshore supply and onshore supervision. The taxpayer did not offer a tax advance in respect of offshore supplies (including design and engineering) on the premise that the title in the supplies was transferred outside India, and for the onshore portion, the advance was not offered to tax in the year under consideration but was offered in subsequent years in which the actual activities took place.

Proceedings before the TO and DRP

- The TO/DRP held that the decisive factors for taxing offshore supplies were whether the contract was a composite contract, the place of the completion test, and the performance guarantee test. They also held that a mere title transfer in offshore supplies outside India was not relevant in determining taxability. Accordingly, they held that since the contract was a turnkey composite contract, due to completion and other tests taking place in India, the revenues relatable to offshore supplies were taxable in India. Due to these findings, they attributed 90% of the revenues of offshore supplies to the permanent establishment (PE) in India.

- With respect to the advances for design and engineering services, the TO held that such advances were taxable in India as royalties/ FTS under the Indian Income-tax Act (the Act) and also under the Indo-Korea tax treaty (the tax treaty). Having held that, the TO also held that 90% of the consideration for design and engineering was attributable to the PE in India.

- Having made a 90% attribution, the TO applied a profit margin of 30.65% on the amounts attributed to the PE in India.

- The TO also held that the advances received from SAIL for the onshore portion were taxable in India in the year under consideration, as the invoices were raised in that year.

Tribunal's ruling

- ***Income from Offshore supplies***

  – Disregarding the TO's contentions, the Tribunal held that the contract with SAIL was not a composite contract, since all components of the contract were distinctly identifiable with separate consideration, and that only the consideration relatable to activities in India would be taxable in India.

  – Furthermore, the Tribunal held that since the title transfer in the offshore supplies took place outside India, nothing could be taxed as attributable to the PE in India.

  – The Tribunal, however, observed that certain onshore services, i.e. training, testing, defect liability, liquidated damages, for which no consideration had been separately identified in the contract, formed part of the consideration for the offshore supplies. Thus, the Tribunal held that the consideration for such services needed to be apportioned from the consideration for offshore supplies, and should be taxed in India as attributable to the PE in India.

- Having held that, the Tribunal directed the TO to verify and determine the value of onshore services in the nature of training, etc.

- ***Income from the onshore portion (supplies and services)***

There was no dispute as to the taxability of the onshore portion, and the limited issue before the Tribunal was the timing of taxability, i.e., in the year of receipt of advance or in the year of actual supplies/services. The Tribunal accepted the taxpayer's contention and held that the onshore portion was taxable in the year of actual supply/ rendition of services. Yet for the sake of clarity, the Tribunal directed the TO to verify the actual dates of supplies and the rendition of services.

- ***Income from design and engineering***

The Tribunal held that income from design and engineering was taxable as FTS under the Act as well as under the tax treaty. The Tribunal dismissed the taxpayer's contention that design and engineering was an inseparable part of the supplies. The Tribunal also disapproved the TO's action of taxing design and engineering as attributable to the PE. The Tribunal held that since design and engineering was not attributable to the PE, it would be taxable on a gross basis.

PwC's observations

- The Tribunal followed judicial precedents and held that where consideration for various parts of the contract was separately identifiable, it was a divisible contract and the entire contract price could not be held to be taxable in India.

- Furthermore, following the settled principle of taxation, the Tribunal held that where the title in the supplies was transferred outside India, nothing could be held to be attributable to the PE in India. However, the Tribunal, held that if the consideration for some onshore services was embedded into the consideration for offshore supplies, the same needed to be separately identified and attributed to the PE in India.

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