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Tax Insights

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Revisionary proceedings alleging PE of a non-resident on offshore supply of goods quashed, citing no error in the assessment order – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal (Tribunal)[1] has quashed the revisionary order issued by the Commissioner of Income-tax (CIT) for assessment year 2014–15. It holds that as the impugned transaction for offshore supply of goods was pending before the Authority for Advance Ruling (AAR) for adjudication and the Tax Officer (TO) carried out a detailed inquiry during the assessment proceedings, the assessment order cannot be held as erroneous and prejudicial to the interest of the Revenue.

In detail

Facts

- The taxpayer is a non-resident corporate entity incorporated in South Korea. The taxpayer along with its Indian subsidiary, formed a consortium to jointly bid for offshore supply of goods. This involves design verification, detail engineering, supply, installation, testing and commissioning of the environmental control system and tunnel verification system, including integrated testing, with an Indian third-party.
- The bid was successful, and two separate contracts were executed. Herein, the taxpayer's contract was to supply the plant and equipment on a cost, insurance and freight basis, including design verification and detail engineering. The Indian subsidiary was awarded the contract for onshore supply and other services.
- The taxpayer filed an application with the AAR to determine the taxability of the offshore supply of goods.
- The AAR called for a report in relation to such application from the TO. The report highlighted that the work that the Indian third party had awarded has been divided into two contracts with the intention of claiming tax benefit. After receipt of the report, the AAR admitted the application.
- During the pendency of the application before the AAR, the assessment proceedings were initiated on the taxpayer. The TO made inquiries regarding, *inter alia*, the offshore supply of goods and passed the assessment order accepting the returned income of the taxpayer.
- Subsequently, the CIT initiated revisionary proceedings under section 263 of the Income-tax Act, 1961 (the Act). The CIT held that the assessment order was erroneous and prejudicial to the interest of the Revenue

[1] ITA No. 34/DDN/2019

on account of the following:

- The contracts entered into by the taxpayer and its Indian subsidiary constitute a composite contract. Therefore, the taxpayer has a permanent establishment (PE) in India, and the income from offshore supply of goods is taxable in India.
- The receipts for fees for technical services (FTS) reported in the return of income are less than the amount the recipient group entity has reported in the filings with the Ministry of Corporate Affairs. Accordingly, the differential amount is liable to be taxed in India.
- Receipts of the nature of surety commission are liable to tax in India, which the TO has failed to examine.
- Transactions entered into by the taxpayer with the associated enterprises (AEs) have not been examined from the transfer pricing (TP) standpoint.
- An Indian group entity of the taxpayer has been paying salary to its personnel in India, which indicates the existence of the taxpayer's PE. The taxpayer was provided no opportunity to present its arguments against the CIT's findings.

Issue before the Tribunal

Whether, in facts and circumstances of the case as discussed above, the assessment order the TO had passed is erroneous and prejudicial to the interests of the Revenue, and, hence, whether the revisionary order passed under section 263 of the Act is valid?

Taxpayer's contentions

- The contracts are separate and distinct. Therefore, they cannot be clubbed together to determine the taxability of offshore supply.
- The assessment proceedings are not barred by the limitation under section 153 of the Act, as the taxpayer has sought an advance ruling on the matter. Therefore, the TO should not have completed the assessment proceedings.
- Proceedings under section 263 of the Act could not have been initiated by the CIT when the same had been pending before the AAR.
- The TO had made the necessary inquiries on the impugned transaction of offshore supply of goods. Moreover, on merits, the taxpayer submitted that the facts of the case are identical to the Supreme Court's decision in the case of Ishikawajma-Harima Heavy Industries Private Limited[2], which was ruled in favour of the taxpayer.
- Regarding the other allegations by the CIT in the order under section 263 of the Act, the taxpayer submitted the following:
  - The surety commission has been offered to tax correctly in the return of income, and the same was submitted before the TO during the assessment proceedings.
  - As regards the allegation of TP adjustment, the taxpayer submitted that it does not have any transaction with the Indian subsidiary that is alleged to be part of the consortium to render services to the Indian third party.
  - The taxpayer challenged the order under section 263 of the Act on the principles of natural justice. This is because the CIT never provided the taxpayer an opportunity to show cause on the allegation that the Indian subsidiary pays salary to the taxpayer's personnel in India. Similarly, the taxpayer challenged the allegation of different amounts of FTS reported in the return of income *vis-a-vis* the report filed with the Ministry of Corporate Affairs, as no show-cause notice was issued for the same.

Tribunal's ruling

- There is no dispute that the title over the goods has been transferred outside India, and the payments have

[2] Ishikawajma-Harima Heavy Industries Private Limited *v.* DIT [2007] 288 ITR 408 (SC)

been made in foreign currency. Moreover, the TO has carried out a detailed inquiry by calling for copies of the contract, invoices, nature of work executed under the contract, details of AEs or subsidiaries, and details of work executed by the AEs or subsidiaries.

- The specific issue before the AAR is whether the offshore and onshore services can be treated as a composite contract. Even after being aware of the matter's pendency before AAR, the TO proceeded to complete the assessment. This appears to be a misconception on the TO's part along with ignorance of the provisions of section 153 of the Act.
- The report filed by the TO before the AAR suggests that the TO was aware of the taxability of the receipts from offshore supply contract. However, the TO did not make any adjustment in this regard, likely on account of the following:
  - Pendency of the issue before the AAR.
  - Supreme Court's decision in the case of Ishikawajma-Harima Heavy Industries Private Limited[2].
- The issue in relation to the composite contract in the given facts is highly debatable; thus, it cannot be considered for exercising jurisdiction under section 263 of the Act.
- The CIT has not demonstrated how the project office of the taxpayer is linked to the offshore supplies and how this results in satisfaction of the conditions triggering PE in India. One cannot establish PE merely based on a conjecture, surmise or suspicion.
- By issuing the revisionary order under section 263 of the Act, the CIT has initiated two parallel proceedings against the taxpayer on the same issue, which should not have been initiated.
- Regarding the other allegations, the Tribunal has held the following:
  - The CIT's allegation is unfounded as the surety commission has been offered to tax correctly.
  - From the observations of the CIT in the revisionary order, it appears that the CIT was oblivious of the fact that the TP report has been furnished. Accordingly, the Tribunal holds the same to be in the nature of a roving and fishing inquiry, which does not satisfy the conditions to assume jurisdiction under section 263 of the Act.
  - Other issues regarding payment of salary to personnel by the Indian subsidiary and the difference in amounts reported with different government bodies are quashed on the principle of natural justice.

The takeaways

The Tribunal has observed that the TO had conducted a detailed inquiry; therefore, the assessment order cannot be considered as erroneous and prejudicial to the interest of the Revenue. It also holds that the issue of the two separate contracts being treated as a composite contract is highly debatable and cannot be considered for exercising jurisdiction under section 263 of the Act. One cannot establish PE merely based on suspicion.

The Tribunal highlights certain deficiencies in the assessment proceedings, such as the TO's misconception in treating the proceedings as being barred by limitation and issuance of a favourable assessment order even where a negative finding was given to the AAR on the same issue. Nevertheless, the Tribunal does not explicitly deal with the point of why such findings do not indicate any error or failure to make a proper inquiry on the part of the TO.

Moreover, the Tribunal made remarks that initiation of two parallel proceedings by the CIT is unsustainable. This statement may require further evaluation as sections 263 or 245RR of the Act (relevant for resident applicants) does not bar the CIT from initiating parallel revisionary proceedings.

The courts[3] have held that where the TO has not applied its mind or has not carried out detailed inquiry, the CIT can assume jurisdiction under section 263 of the Act. Therefore, one needs to carefully ascertain the facts of the case to determine the ruling's applicability.

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3 Gee Vee Enterprises *v.* ACIT [1975] 99 ITR 375 (Delhi); CIT *v.* Infosys Technologies Limited [2012] 17 taxmann.com 203 (Karnataka)

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