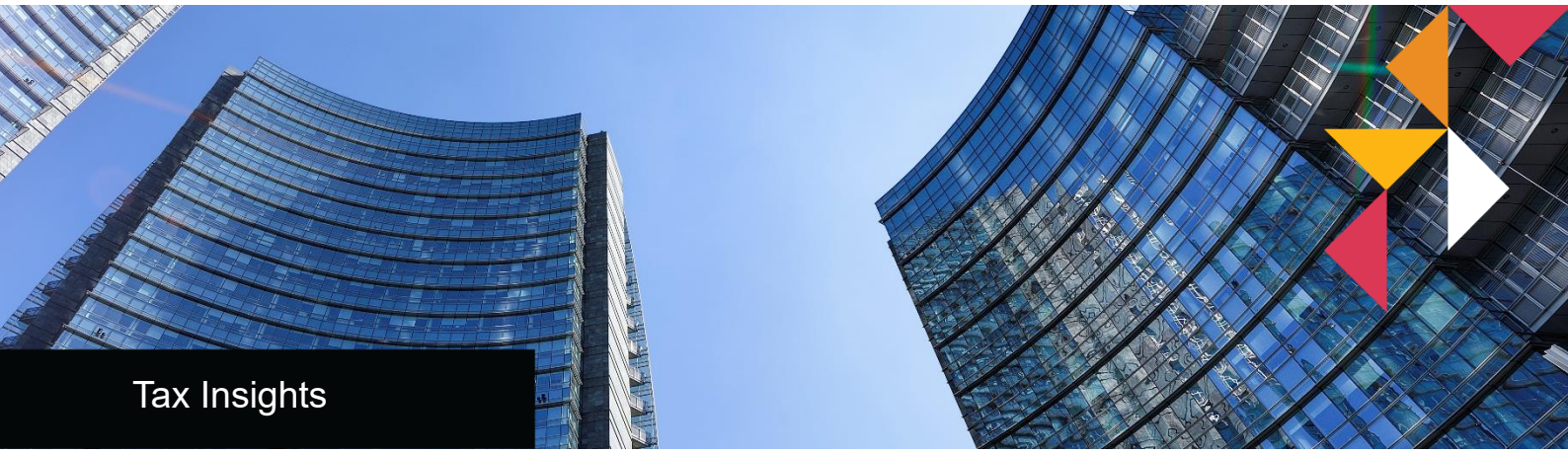

Tax Insights

6 December 2023

Receipts from offshore supply of goods or equipment cannot be clubbed with onshore supplies and taxed in India merely on account of cross-fall breach clause – Delhi bench of the Tribunal

In brief

The Delhi bench of the Income-tax Appellate Tribunal (Tribunal)[1] is of the view that receipts from offshore supply of goods and equipment are not taxable in India. The Tribunal has observed that the supply of goods took place outside India, title over the goods was transferred outside India and payment was received outside India.

The Tribunal also notes that mere existence of an Indian subsidiary would not lead to the creation of a permanent establishment (PE). This is because no material on record substantiates that the Indian subsidiary was involved in any manner in the work of design, manufacture, testing or supply of goods from China on a cost, insurance, and freight (CIF) basis. Moreover, the Tribunal has observed that a cross-fall breach clause in the onshore and offshore contracts cannot lead to these two different and distinct contracts as being composite in nature.

In detail

Facts

- The taxpayer is a non-resident corporate entity incorporated in and a tax resident of China. The taxpayer has an Indian subsidiary (I Co). During the year under consideration, the taxpayer had entered into a contract with Indian customers.
- As per the terms of the contract, the taxpayer manufactured the goods and equipment in China and supplied them to its customers in India on a CIF sale basis. Revenue earned on account of such offshore supply of goods and equipment to Indian customers was not offered to tax in India.
- The taxpayer's case was selected for assessment proceedings. During the proceedings, the taxpayer made the following arguments before the tax officer (TO).
  - As per the terms of the contract, the taxpayer was only involved in offshore supply of goods or equipment to the Indian customers.

[1] ITA No. 2290 & 2291/Del/2022

- Title over the goods or equipment was transferred to the Indian customers outside India, and the sale was completed outside India. Therefore, receipts from the sale of such goods and equipment are not taxable in India.
- I Co carried out onshore activities in India for the taxpayer's Indian customers. Moreover, I Co offered the income from such activities to tax in India.

- Based on perusal of the contract, the TO made the following factual observations.
  - In addition to the supply of goods and equipment, the taxpayer was required to provide technical knowledge, experience, skill, know-how or processes, and managerial or consultancy services.
  - I Co is fully controlled by the taxpayer and engages in the same nature of business as the taxpayer.
  - Employees of I Co worked under direct control and directions of the taxpayer. Therefore, I Co must be considered as a PE of the taxpayer.

Tribunal's observations and ruling

- On perusal of the offshore contract agreement, the Tribunal has observed the following terms in the contract.
  - Goods or equipment will be supplied on a CIF sale basis from a port in China.
  - Of the CIF price, 90% will be paid progressively through an irrevocable letter of credit in favour of the taxpayer after dispatch of goods and on submission of the documents, such as the bill of lading, invoices, insurance policy, guarantee certificate, material inspection, clearance certificate, testing certificate, certificate of origin, etc.
  - Balance of the CIF price will be paid to the taxpayer on receipt of goods at the site after provision of an acceptance certificate by the purchaser's representative.
- Considering the above, the Tribunal has observed that the above terms only ensure that the goods and equipment are free from any defect. Moreover, I Co was responsible for inland transportation, insurance and other services, such as clearance, handling at port, etc. However, the entire cost of such clearance was reimbursed to I Co.
- Terms of the contract clearly demonstrate that not only was the title of the goods transferred outside India with all the associated risks and liabilities, but the payments were also made outside India.
- In fact, as per the specific terms of the contract and understanding between the parties, ownership over the goods to be imported to India will be transferred to the purchaser upon (a) loading on the mode of transport to convey the goods from the country of origin, and (b) endorsement of the dispatch documents in favour of the purchaser.
- Additionally, the Tribunal has observed that the bid data details forming part of the contract clearly mention the following: As per the purchaser's understanding and extant provisions, Indian income-tax is not payable on the sale of goods if the contract is on a principal-to-principal basis and title of the goods is transferred to the purchaser outside India.
- By relying on certain clauses of the contract in isolation and out of context, the TO had concluded that the amount received by the taxpayer towards the supply of goods is related to the activities of the PE and therefore taxable in India.
- The TO arrived at the above conclusion without any rational basis or backed by evidence. Merely the fact that the taxpayer has a subsidiary or related entity in India that has performed some onshore activities under a distinct and separate contract with the very same Indian customers would not make the offshore and onshore contracts composite.
- The Tribunal has also observed that even though I Co has received commission from the taxpayer for doing certain work related to the supply of goods, I Co does not become a dependent agent PE of the taxpayer. Additionally, no material on record even remotely indicates that I Co is involved in any manner in the work of design, manufacture, testing or supply of goods on a CIF basis from China. Merely because there is a

cross-fall breach clause in the contract to ensure seamless execution of the contract, one cannot say that two different and distinct contracts are composite in nature.

- Moreover, the Tribunal has agreed with the reliance the taxpayer had placed on various Tribunal rulings and court decisions. Accordingly, the Tribunal has observed that merely because there is a cross-fall breach clause in some contracts, it does not mean the contract is a composite one or that the income accruing outside India is taxable in India.
- The Tribunal also is of the view that when there is no dispute over the fact that title over the goods was transferred outside India, the receipts cannot be taxed in India.
- In addition, the TO's action of attributing 60% of the receipts towards fees for technical services (FTS) and 40% towards supply of goods and equipment is totally irrational and perfunctory. This is because the basis on which the TO bifurcated the receipts between FTS and business income is unknown. Hence, this artificial segregation of receipts between supply of goods and FTS is unacceptable.
- The TO's attempt to link the supply of goods to the alleged PE in the form of I Co is not based on any evidence at all. Nothing on record suggests that I Co has undertaken or was in any way involved with the design, manufacture and testing of the supplied goods. Thus, even if it is assumed that I Co constitutes a PE, it is in no way involved with the supply of goods or equipment from China.
- Considering the above, the Tribunal concludes that receipts when the (a) supply of goods is completed outside India, and (b) title over the goods has been transferred from the taxpayer to its Indian customers outside India as per terms of the contract cannot be made taxable in India. Accordingly, the Tribunal has deleted the addition made by the TO.

The takeaways

The Tribunal has once again reiterated the position that, to establish the existence of a PE, mere assumption or inference by the tax authorities that an Indian subsidiary's existence constitutes a PE is not sufficient. The tax authorities should substantiate with supporting evidence that the Indian subsidiary was in fact involved in the sale of goods by the non-resident taxpayer. This ruling also highlights the importance of maintaining the records of relevant factual documentation on the issue of taxability of income earned on account of offshore supply of goods.

Moreover, while adjudicating the issue, the Tribunal has gone through each term of the contract to evaluate the roles of the taxpayer and the Indian subsidiary. This shows that each clause of the contract also plays a key role.

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