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International Tax

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Apex Court demolishes Revenue's "Permanent Establishment" contention for Indian "Project Office", reiterates relevance of facts

Snapshot

Observing that the Samsung Heavy Industries Co. Ltd.'s Project Office ('PO') merely had two non-technical employees and was established merely to co-ordinate and execute delivery documents in connection with construction of offshore platform modification of existing facilities for ONGC, the Supreme Court held that the activities undertaken by the PO were akin to that of a Liaison Office.

The Supreme Court further held that the manner of maintenance of books of account would also be an important criteria to determine the character of a Permanent Establishment ('PE') and also held that the existence of a PE, if any, was to be proven by the tax authorities.

Facts of the Case ¹

Samsung Heavy Industries Co. Ltd ('SHI' or 'the Taxpayer') entered into a turnkey contract with ONGC through a consortium with Larsen & Toubro Limited for surveys, design, engineering, procurement, fabrication, installation and modification at existing facilities, and start-up and commissioning of entire facilities covered under the 'Vasai East Development Project'.

While the contract was concluded in February 2006, SHI had set up a PO in India in May 2006. Platforms were brought into India from November 2007 for installation. For AY 2007-08, the Taxpayer had filed a tax return in India by offering, what was considered as the India specific income (income in respect of onshore activities) by applying percentage completion method and claimed expenses incurred viz. insurance premium, hook-up and commissioning expenses and pre-engineering and survey expenses. However, no income from offshore activities was offered to tax in India on the premise of the same not being taxable. Pursuant to directions of DRP, the AO taxed the offshore supply by attributing 25% of the value of offshore supply to Indian operations.

¹ *DIT v. Samsung Heavy Industries Co., Ltd.*
(Civil Appeal No. 12183 of 2016)

On appeal, the ITAT undertook a detailed exercise and upheld the AO's order of taxing offshore supply in India on account of PE of the Taxpayer in India by relying upon the Resolution passed by Board of Directors which referred to setting up of the PO for execution and co-ordination of the project for ONGC and RBI approval which provided for no restriction in terms of activities.

However, it restored the matter to AO for computing the profits attributable (25%) with a proper reasoning. It is worth noting that the Taxpayer had put forth the argument of non-existence of PE in India and also argued that even if the Taxpayer had earlier filed a tax return in India on a wrong premise of existence of PE, it could always correct its position before the AO or before the Appellate authorities. The Taxpayer also argued that installation PE, if at all, came into existence from November 2007 and not in the year under consideration. Further, it was also argued that the exclusion clause provided in Article 5(4) of India-Korea DTAA would get attracted in any case as the activities undertaken by the PO were merely "preparatory or auxiliary" in nature.

The Taxpayer preferred an appeal with the High Court which held that considering that the Taxpayer had itself filed a tax return and offered India specific income to tax, there was no question to verify existence of PE. However, it held in favour of the Taxpayer stating that attribution of 25% was arbitrary and without any basis and could not result in a tax liability in the hands of the Taxpayer without clearly establishing that income from offshore supply was attributable to PE of the Taxpayer in India.

Supreme Court Ruling

Revenue preferred an appeal with the Apex Court and the Apex Court has now held in favour of the taxpayer by holding that the Board Resolution of the Taxpayer was misconstrued and read and interpreted incompletely by the ITAT. It observed that the Board Resolution clearly mentioned about the limited activities of the PO viz. co-ordinating and executing delivery of documents in connection with construction of offshore platform modification of existing facilities for ONGC.

The Apex Court accordingly observed that the role of the PO was nothing more than mere liaising activities and hence, could not be considered as a PE during the year under consideration. On Revenue's contention that the books of account prepared by the Taxpayer (that only considered Indian specific income and not offshore income) could not be relied upon as preparation of the same was totally in the hands of the taxpayer, the Apex Court ruled the finding as perverse.

The Apex Court also negated the Revenue's contention that the onus of whether a PE exists or not was on the Taxpayer by relying upon its judgment in the case of **E-funds IT Solutions Inc. (2018) 13 SCC 294**. The Apex Court also relied heavily on the fact that the PO merely had two non-technical employees who couldn't perform any core activity in India. The Apex Court finally held that the Taxpayer had no PE as per Article 5(1) of India-Korea DTAA and also accepted the Taxpayer's contention of applicability of exclusion clause Article 5(4)(e) thereof.

KCM Note

Profit attribution in case of Turnkey projects has remained a rather litigative issue under the Indian Tax system. There is a plethora of rulings on the issue, **Ishikawajima Harima Heavy Industries Ltd. v. DIT (2007) 3 SCC 481** and **CIT & Anr. v. Hyundai Heavy Industries Ltd. (2007) 7 SCC 422**, etc. being the ones relied upon and discussed by Apex Court in this judgment.

To determine the role of the PO, importance has been accorded to the initial Board Resolution passed by the Taxpayer for setting up the PO. Worth noting that the same Board Resolution was read differently by the ITAT and the Apex Court to arrive at completely different conclusions. The Resolution read as under:

"RESOLVED:

1. That the Company hereby open one PO in Mumbai, India for coordination and execution of Vasai East Development Project for Oil and Natural Gas Corporation Limited ("ONGC"), India.

2. That the Company hereby does make and constitute Mr. Sangsoon Park Yard General Manager of the Company, as the Company's true and lawful representative with full power and authority for the purpose of establishing a PO and coordinating and executing delivery of documents in connection with construction of offshore platform modification of existing facilities for ONGC above.

While the ITAT relied upon Para 1 of the Resolution to conclude that the role of the PO was to undertake co-ordination and execution of the entire Project, the Apex Court relied upon Para 2 of the Resolution

to conclude that the role of the PO was to merely co-ordinate and execute delivery of documents in connection with the Project.

Accordingly, the Apex Court held that the ITAT had jumped to a conclusion only based on Para 1. However, in our view, Para 2 merely refers to the role / authority of the signatory and not that of the PO and the main role of the PO is defined by Para 1 (if Board Resolution is to be referred to and relied upon).

The fact that the Taxpayer had sub-contracted fabrication work for the project to third parties outside India during the year under consideration was considered a relevant factor by the ITAT while holding that the taxpayer had a PE in India as it was a composite contract. However, the same has not been given importance by the Apex Court while holding non-existence of PE as per Article 5(1) of India-Korea DTAA.

The current Apex Court decision lays down certain very important principles for determination of taxability of offshore supplies:

- a. Existence or non-existence of a PE is very much a fact driven exercise. For example, a Liaison Office undertaking functions which are more than mere liaison activities could also constitute a PE. Similarly, a PO not undertaking core activities and limiting its role to mere liaising activities may not constitute a PE
- b. Factors like Board Resolution for set up of a PO / Liaison Office, RBI approval, number of employees in India, financial statements in India, etc. could have a bearing on the existence of a PE and taxability of offshore supplies

- c. Even in case of composite contracts, mere existence of a PO in India should not make the Offshore supplies taxable unless the Revenue is able to demonstrate that the Offshore supplies are attributable to a PE existing in India

Apart from the above, an interesting aspect to be noted is that though the Taxpayer had filed a tax return in India by offering Indian income on a net basis, it later on put forth an argument of non-existence of PE which has now been accepted by the Apex Court.

This judgment will be very relevant for overseas suppliers who undertake Turnkey projects with customers in India, either divisible or composite, as it lays down key principles while determining existence of a PE in India and taxability of income in India attributable thereto, especially, for offshore supplies from outside India.

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