

LANDMARK MADRAS HIGH COURT RULING ON TAXABILITY OF OFF SHORE SUPPLY (TURNKEY CONTRACTS) INDIA ITALY DTAA ETC. JAN 2009

This relates to latest Madras High Court (MHC) ruling in context of taxability of Turnkey Contracts/EPC contracts (eg as entered by Power, Oil and Gas Sector Units where large/mega projects are involved), whereby detailed analysis is made by MHC for "contract splitting" in light of Supreme Court rulings in Ishikawajima and Hyundai cases.

Ansaldo Energia S.P.A Italy: In this case, MHC while affirming underlying ITAT order reported at 115 TTJ 942, in context of India Italy Tax Treaty (DTAA), and in specific relation to taxability of Erection Procurement Commissioning Contracts (EPC) in hands of foreign company, after analyzing the matter at length, has interalia concluded that:

1.1) Assessee's plea that off-shore supply made outside India is not taxable under the Act/DTAA as per SC ruling in Ishikawajima case (288 ITR 408) and Hyundai case (291 ITR 482), is sansmerit as following makes the present case distinguishable from aforesaid cited rulings:

Present Case

Ishikawa ruling/IHI (SC)

Hyundai Ruling (SC)

Contract 1 – offshore supply with Assessee Non resident

Contract 2 – offshore services with Assessee Non resident

Contract 3 – onshore supply with Ansaldo India

Contract 4 – onshore services with Ansaldo India

There is no consortium as was there in IHI case. Further, it was only on assessee's instance that Indian party/Neyveli Corpn. agreed to enter into contracts (III & IV) with Ansaldo India (subsidiary of assessee- so selected by assessee), for which assessee remained liable for performance/execution.

Contract was only awarded to Assessee. Assessee did not stop its activities after completion of Contract I & II and remained actively involved in Contract III & IV.

It is found by CIT-A & ITAT that:

1. Indian Ansaldo entity is mere alter ego/façade of Assessee and speaks Master's (assessee's) Voice and is created Ansaldo India was introduced in the III & IV contracts only on instance of assessee and contract was initially awarded to assessee only. Also there was only single bidder (assessee) in instant contracts. No separate tenders were called for.

2. There was real/intimate/continued relationship between assessee and Ansaldo India. All responsibility rested with assessee from beginning to end. (as assessee submitted all the performance and progress reports throughout the contracts and used the project site in India throughout where assessee's manager Zara was present; assessee managed Ansaldo India vis a vis Indian portion on quality control and time schedule etc)

3. All the four contracts formed a composite contract and there was complete interlacing between all the contracts (sub divided).

4. There is price imbalance in favor of off-shore contracts and price of on shore contracts has been off- loaded to off-shore contracts.

This case do not lay down an unqualified proposition that off-shore supply will always not be taxable in India and is limited to factual context where:

a) It was found that Permanent Establishment in India has no role in Off shore supply and off-shore services.

b) It was specifically found that EPC contract is not composite but divisible in nature segregating supply and service segment.

c) Equal players formed consortium.

d) There was no finding/allegati-on that; there was price imbalance in favor of off-shore part and party executing on-shore part, is mere façade.

e) SC by distinguishing its earlier rulings in Mitsui etc recognized that off-shore supply can be taxable in certain situations.

In this case, SC categorically highlighted that since there is no allegation by revenue that price for fabrication part (off-shore) included price for on-shore services and off-shore supply is not at arm's length price, there can be no taxability in India for off-shore supply of fabricated platform, delivered in Korea to agent of ONGC (Indian party). After supply of fabricated plat form, the off-shore supply concluded. Whereas in Ansaldo case , off shore supply continued in India whereby supply was modulated by non resident assessee, to suit the need of Indian site.

SC by observing that there can be no absolute rule for taxability of offshore supply made it clear that taxability of off-shore supply depends on facts.

1.2 After aforesaid factual distillation, Mad HC affirmed the ITAT's finding in following words:

"40. For the reasons given above, we confirm the findings that,

a) the foreign company and the activities rendered by it under contract No.I and the other three contracts are inextricably linked and it was a composite contract,

b) all responsibility from the beginning to the end rested on the assessee,

c) there is an intimate, real and continuous relationship with the subsidiary company and

d) that the price of the other contract was loaded on to Contract No.I.

In these circumstances, we do not think that the first question arises for consideration."

1.3 In relation to attribution of 75% of profits of Contract 1/off-shore supply to Indian taxability, MHC has remanded the matter back to ITAT for fresh consideration, to assess the profit attribution on Contract 1 (off shore supply) properly.