BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME TAX)
NEW DELHI
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PRESENT
Hon'ble Mr. Mr. Justice P.V.Reddi (Chairman)
Mr. A. Sinha (Member)
Mr. Rao Ranvijay Singh (Member)
- (Member)

A.A.R. NO. 773 OF 2008

Name and Address of Applicant

M/s Hyosung Corporation
450, Gongdeok-Dong, Mapo-Gu, Seoul, Korea (121-720)

Commissioner concerned

DIT (International Taxation), New Delhi

Present for the Department

Mr. Sanjeev Sharma, Addl.DIT (Intl. Taxation) Delhi

Present for the Applicant

Mr. N.Venkataraman, Sr.Advocate

RULING

[By Hon'ble Chairman]

The applicant which is a Company incorporated in Korea having its registered office in Seoul is engaged inter alia in the business of power stations. In the year 2005, Power Grid Corporation of India Ltd. (hereafter referred to as 'POWERGRID') invited bids for the execution of the works related to 800KV / 400KV Tehri Pooling Station Package associated with Koteshwar Transmission System. For the sake of brevity, the same has been described by the applicant as "400 KV GIS Package". The applicant who submitted the bid, became the successful bidder. As per the terms and conditions of bid, the foreign bidder was authorized to assign the whole or part of the contract to an independent contractor subject to the approval of Power Grid. *In view of such provision, the applicant, pursuant to the understanding reached with L&T, requested Power Grid to award the Off-Shore Contract to it and the On-Shore Supply and Services Contract to be performed in India to L&T. This proposal was preceded by a Memorandum of Understanding dated 8/8/2005 between the applicant and the L&T. As per para 12(c) of the MOU, the applicant was permitted to assign any portion of the Contract either in full or in part to L&T, in which event L&T will be permitted to work as an independent contractor and the customer, namely, Power Grid will enter into a*

separate Contract with L&T. Thus, L&T was nominated as the assignee in respect of certain works in case the bid of applicant was accepted. L&T in its letter dated 8/8/2005 addressed to Power Grid confirmed this understanding and consented to work as an independent contractor as per the terms and conditions offered by Power Grid. By the Letter of Award dated 24th March 2006, (for short 'LOA) *Power Grid accepted the bid proposal submitted by the applicant and awarded to the applicant the Off-Shore Contract covering all the works to be performed outside India including supply of all Off-Shore equipment and materials on CIF Indian port of disembarkation basis. (vide para 2.1 of LOA). In the LOA, Power Grid referred to the applicant's bid proposal and the post-bid discussions and stated that the On-Shore supply contract and On-shore Services contract including civil works, training in India etc. has been awarded to the applicant's assignee, namely, L&T India as per its letter of the same date*. Further, it was made clear in the LOA ***: "Notwithstanding that the award of work under three separate contracts in the aforesaid manner, you shall be overall responsible to ensure the execution of all the three contracts to achieve successful completion of the entire scope of work under 800KV / 400KV Tehri Pooling Station package associated with Koteshwar transmission system and its taking over by Power Grid".*** The total contract price payable to the applicant was specified as 6,935,389 US Dollars. ***After the LOA was issued, a Deed of Assignment was executed by and between the applicant and the L&T on 8th May, 2006. A formal contract in terms of the LOA was entered into between Power Grid and the applicant on 27th October, 2006. Power Grid also entered into the contracts with L&T on the same day.***

2. It is stated by the applicant that the time for successful completion, testing and commissioning of the Power Station is 19 months from the date of LOA and the same has been extended to 24 months.

3. The questions in respect of which advance ruling is sought are the following:
i. On the facts and circumstances of the case, whether the amounts received/receivable by the applicant i.e. Hyosung Corporation from Power Grid Corporation of India Limited ("PGCIL") for offshore supply of equipments, materials, etc., are liable to tax in India under the provisions of the Act and India-Korea tax treaty?

ii. If the answer to (i) is in the affirmative, in view of Explanation (a) to section 9(1)(i) of the Act and/or Article 7(1) of the India-Korea tax treaty, to what extent are the amounts reasonably attributable to the operations carried out in India and accordingly taxable in India.

3.1. The following additional question was framed by this Authority on 19th November, 2008.
Whether the applicant together with L&T Limited can be said to constitute an

AOP and accordingly be assessed as such under the Income-tax Act, 1961 in relation to the contract referred to in the application?

4. It is the contention of the applicant that no income accrues or arises in India under section 5 of the Income-tax Act, 1961 (for short, the Act') in respect of offshore supply contract undertaken by it inasmuch as the property in the goods and title passes outside India and the payment is received outside India. Overall responsibility for the successful completion of the contract undertaken by the applicant is not incompatible with the contention that the income does not accrue or it receives in India. Reliance has been placed on the decision of the Supreme Court in Ishikawajima – Harima Heavy Industries 1 (hereinafter referred to as 'Ishikawajima'). Viewed from the angle of the Treaty provisions, the applicant has no PE in India in connection with the contract and in any case no profits can possibly be attributed to the PE in the case of offshore supply. Article 7.1 of the DTAA between India and Korea has been referred to in this connection.

5. The Revenue has taken the stand that the applicant and the L&T have executed the contracts as Association of Persons (AOP) and the amount received by L&T and the applicant from Power Grid is assessable in the status of AOP as per the provisions of the I.T. Act. Reliance has been placed on the ruling of this Authority in the case of Geoconsult – AAR/745/20072 . As regards the supply of goods, it is contended that notwithstanding the nomenclature of 'offshore supply', in reality, the transfer of property in goods took place and the sale completed within India. It is then contended that quite a number of activities related to offshore supplies have taken place in India and that part of the profits therefrom arose in India. As regards PE, it is contended that the applicant has office in India since 17th October, 2007 that the supervisory activities are of more than 9 months' duration and in any case L&T being sub-contractor of the applicant, the activities carried out by L&T should also be taken into account for counting the period of 9 months under Article 3.5 of the Treaty.

6. Before considering the contentious issues, we would like to refer to some more details relating to the contract. The offshore supply contract was entered into between Power Grid and the applicant on 17th October, 2006***. It is recited therein that Power Grid agreed to the proposal of the applicant for awarding the total scope of work under three distinct contracts subject to the overall responsibility for successful performance of the project resting with the applicant***. The three distinct contracts are (a) offshore supply contract in favour of the applicant for supply of equipment and materials on CIF Indian Port of Disembarkation basis, (b) onshore supply of equipments and materials on Ex-Works basis, and (c) Onshore Service Contract for Port handling and clearance, Inland Transportation, Insurance, delivery on

FOR destination basis, storage, erection including associated civil works, testing and commissioning of all equipment and materials including offshore equipment. As per the Letter of Award dated 24.3.2006, the Special and General Conditions of Contract among others shall be deemed to form part of the Agreement.

6.1 The scope of work under the offshore supply contract as set out in the LOA is as follows:
"Design, engineering, manufacture, testing at manufacturer's works, FOB dispatch, shipment, marine transportation and insurance and CIF supply of all off-shore equipment and materials including mandatory spares from country(ies) outside India, and testing & training to be conducted outside India, required for the complete execution of 800KV (F)/400KV Tehri Pooling Station (GIS) Package associated with Koteshwar Transmission System, as set forth in the bidding documents."

The detailed list of equipment and materials to be supplied was appended to the Letter of Award.

6.2 The contract price is specified to be US # 6,935, 389 and the break-up thereof was given under four heads viz. (i) CIF price {US # 6,495,564}, (ii) Indian agent commission, (iii) type testing charges for tests conducted abroad, and (iv) charges for training imparted abroad. The break-up of contract price for the purpose of on account payments is given in Annexures to the LOA. The contract price as regards the offshore supply is payable in three instalments i.e. (i) 70 per cent of the CIF price of each shipment shall be paid through irrevocable Letter of Credit established in favour of the applicant after dispatch of the equipment/materials and on presentation of supplier's invoice, clean on board bill of lading marked 'freight pre-paid', Insurance policy certificate, test certificate, etc. (ii) 20 per cent of CIF price of each shipment of main equipment excluding mandatory spares to be made on the receipt of materials and equipment at the storage points at site after physical verification by Power Grid and (iii) balance 10 per cent of CIF price to be paid on successful completion of erection, testing and commissioning of the GIS sub-station. As far as mandatory spares are concerned, the balance 30 per cent was payable on receipt of material at destination and physical verification. It is not in dispute that the entire consideration for offshore supply of equipments was payable outside India.

6.3 The time schedule for performance of the contract is set out in an Annexure. The time for successful testing and commissioning of the Tehri Pooling Station (GIS) Package is stated to be 19 months from the date of LOA. It appears that the time was extended later on by mutual agreement.

7. In view of the stand taken by the Revenue, the first question to be considered is whether the applicant and the L&T can be legitimately treated as Association of Persons (for short 'AOP') and liable to be assessed as such in respect of the entire income received under the three contracts. The Revenue in support of its stand has relied on the stipulations in Memorandum of Understanding (MOU) between the applicant and the L&T (entered into on 8/8/2005 on the eve of submitting the bid) and the LOA read with the Offshore Supply Contract. These are referred to in the next two paragraphs.

7.1 In the MOU, it is recited that parties desire to co-operate with each other for the purpose of submitting a single bid for the project and in the event of bid being accepted by the customer, to execute the contract for the project. The applicant was nominated as 'leader' during the bidding stage and thereafter as 'team leader' during the execution of contract. The distribution of works between L&T and applicant and the respective responsibilities are specified therein. The applicant has to bear the overall responsibility for commissioning of the complete 400 KV GIS Project. As per para 3 of MOU, "the parties shall be jointly and severally responsible for the execution of the contract in accordance with the contract terms". Each party agreed to "indemnify the other party against its respective parts in case of breach or default of the respective party in performance of the contract works" (vide para 4 of MOU).

7.2 In addition to the MOU, the Revenue has drawn our attention to the following terms and conditions set out in LOA and the Deed of Assignment:

1. The overall responsibility for the successful completion of the three contracts rested with the applicant in line with the proposal in the bidding document.

2. 10% of the agreed price shall be paid only on successful completion of erection, testing and commissioning of the GIS sub-station (vide clause (iv) of para 5.1.1 of LOA).

3. A contract performance guarantee has to be furnished by the applicant to Power Grid for 10% of the value of all the three contracts, in addition to the guarantee L&T provides to Power Grid as regard the 2nd and 3rd contracts.

4. Liquidated damages (LD) are recoverable both from the applicant and L&T in case of delay in the performance of the 2nd and 3rd contracts awarded to L&T. (vide para 11.2 of LOA). If LD is charged due to reasons attributable to the applicant, the applicant will bear the LD for all the three contracts and if LD is charged due to reasons attributable to L&T, then L&T will bear LD on all the three contracts including the 1st contract (vide para 7 of the deed of assignment).

5. Each of the parties shall indemnify the other against any loss or expenses sustained or any claims from the Power Grid, by reason of the breach or delay or defect in performance of their respective obligations under the deed of

assignment (vide para 11 of the Deed).
6. Any breach under the 2nd and 3rd contracts shall automatically be deemed as breach of this contract (1st contract between the applicant and Power Grid) and the applicant will be exposed to the risk and damages and termination of the 1st contract itself. (vide para 2.4.2 of LOA).
7. Where it is necessary to apply for any extension of time for performance or seek any additional payments for extra or substituted work or to resist/defend any claim for liquidated/damages etc., the applicant and L&T shall join in making such request or claim or in defending the claim.
8. It is the applicant's overall responsibility to ensure that the equipment supplied by it under its contract with Power Grid and by L&T under the 2nd contract shall give satisfactory performance when erected and commissioned.

7.3 None of the above terms and stipulations, in our view, gives rise to formation of Association of Persons in the matter of execution of the contracts. Mere collaborative effort and the overall responsibility assumed by the applicant for the successful performance of the project is not, in our view, sufficient to constitute an AOP in the eye of law. The first and foremost feature that assumes importance is that Power Grid awarded separate contracts to both the contractors - the first to the applicant and the other two to L&T. The assignment which was in terms of the MOU paved the way for such separate contracts and the same was accepted and acted upon by Power Grid. Each party performs the obligations under the respective contracts awarded to them separately and receives the monies payable under the contracts independent of each other. L&T, which was not a party to the bid, is recognized as an independent contractor in various documents. L&T is entitled to raise the bills for the work carried out by it separately and such bills shall be payable by Power Grid directly to L&T without recourse to the applicant (vide para 3 of Assignment Deed). Thus, the individual identity of each party in doing the part of work entrusted to it is preserved, notwithstanding the coordination between the two and the overall responsibility of the applicant. It cannot therefore be said that the two contractors have promoted a joint enterprise with a view to earn income (vide the dicta in CIT vs. Karunakaran*)

7.4 The applicant being the supplier of crucial equipments imported from abroad and possessed of necessary expertise in the field was entrusted with the supervisory responsibilities especially at the stage of testing and commissioning. On the one hand, it is meant to ensure that the equipments supplied by the applicant were blemish-less. Secondly, Power Grid very much relied on the applicant to render all the necessary technical assistance and guidance to L&T – a contractor brought into the picture by the applicant and to

oversee its performance at all crucial stages. By incorporating various safeguards in the contract, Power Grid took the necessary precautions to see that notwithstanding the split up of contract into three, the applicant and L&T would act in harmony and maintain requisite coordination for the timely and successful completion of project. Such a role assigned to the applicant by Power Grid was in the overall interest of the project. It is an arrangement conceived of and agreed to by the parties keeping in view the overall objective of successful commissioning of the project. The clauses in the Agreement referred to by the Revenue will have to be viewed in that background and in that light. ***The limited involvement of the applicant in the contracts of L&T including the coordination and supervisory role entrusted to it falls short of the attributes of an AOP***.

7.5 The special stipulations referred to supra, viz applicant being required to give performance guarantee not only in respect of its own contract but also in respect of L&T's contract and the vicarious liability for breach attached to the applicant in respect of all the three contracts were not in furtherance of a joint venture and a common design to produce income. But, these obligations and responsibilities were specially introduced by Power Grid while dealing with the contracting parties on principal to principal basis in the overall interest of the Project. ***It is worthy of note that L&T in its turn gave a counter guarantee to the applicant for the reason that the applicant furnished the guarantees in respect of the contracts related to L&T also. Thus, the distinct identity of each Party was throughout maintained. The requisite cohesion, unity of action and above all, the common objective of sharing the revenue or profit are very much lacking in the present case.***

7.6 The case of Geoconsult^ decided by this Authority recently is distinguishable. The following passage at page 303 of ITR spells out the distinctive features which weighed with this Authority in arriving at the finding that there was an AOP:

Thus, it is seen that the client, HPRIDC has entered into the contract with a "consortium" of three companies, and it looks to that joint enterprise for the due execution of work and the contract price is stipulated to be made to the joint venture as a unit. The contract between HPRIDC and the joint venture gives sufficient indication of a combination of three entities into one with the common purpose of executing the work entrusted to the joint venture. That each member is made jointly and severally liable for performance of work is another important stipulation which points to the existence of an AOP."

The facts here are vastly different.

7.7 We are, therefore of the view that the applicant and L&T cannot be treated

as AOP falling within Section 2(31) of the Income-tax Act, 1961. ***Accordingly, we overrule the contention of the Revenue and hold that the applicant in conjunction with L&T cannot be treated and assessed as an 'association of persons' under the Income-tax Act, 1961.***

Question No. 1 and 2:

8. The contention of the learned senior counsel appearing for the applicant is that the title to the equipment and material passed outside India and the payment was received in foreign currency outside India and therefore the consideration was neither received in India nor did it accrue or arise in India under Section 5 of the Act. Further, it cannot even be taxed as deemed income under Section 9(1)(i) of the Act. In any case, it is submitted that profits on the sale of equipment outside India cannot be attributed to the Permanent Establishment (PE) even if it is held to exist and therefore under Art.7(1) of the DTAA, no tax is liable to be paid in India. Reliance is placed on the decision of the Supreme Court in Ishikawajima supra and the instructions issued by CBDT by its circular dated 21st Sept., 1989. First, we shall refer to the relevant extracts from the circular of CBDT.

"(b) Profits from sale of equipment and materials on FOB basis where the payments are also made outside India:
Profits from such sale of equipment would not be deemed to accrue or arise in India under section 9(1)(i) of the Income-tax Act, 1961 as the title of the goods will pass outside India and the payments are also to be made outside India. This will be so even if there is an overall agreement as mentioned above. As already indicated, no payments will be made under the overall agreement nor will the supplier of equipment etc., be a contractor for providing technical services abroad, for doing the civil works at the site or for installation, erection, testing etc. Even if the supplier's employees take part in the final erection or commissioning of the equipment supplied, the taxability will not be affected. Therefore, in respect of these sales no part of the income will be deemed to accrue or arise in India".

8.1 This circular was apparently issued keeping in view the law laid down in decided cases on the subject of taxability of such income. The circular which is binding on the Department in view of Section 115(7) of the Income-tax Act reiterates the correct legal position. **In any case, after the decision of the Supreme Court in Ishikawajima, to which detailed reference will be made later, it can no longer be doubted that the consideration received by the non-resident under a contract for the supply of goods by means of transfer outside the territory of India cannot be subjected to tax in India. The authority to tax income would be**

lacking for want of territorial nexus, as clarified by the Supreme Court in the said case.

9. Now let us look to the relevant clauses in the off-shore supply contract to which reference has already been made. The opening clause of the Agreement dated 27/10/2006 states that the off-shore contract has been entered into "for supply of equipment and materials at CIF Indian Port of disembarkation basis for 800 KV/400 KV Tehri Pooling Station (GIS Package) in the sum of US Dollar 6,935,389."

9.1 The relevant stipulations in the Letter of Award dated 24th March, 2006 which is deemed as part of the Agreement are :

"2.4.4 The transfer of title of the equipment and materials to be supplied by you shall pass on to POWERGRID at FOB Port of shipment with negotiation of shipping documents. This transfer of title shall not relieve you from the responsibility for all risks of loss or damage to the equipment and materials until taking over, as specified in the bidding documents."

"4.3 Indian Customs duty or levies including the Stamp Duty and Import License Fee levied by the Government of India or any State Government in India on the equipment, materials and spare parts covered in the Contract to be imported into India and which will become our property under the Contract, shall be to our account and shall be paid directly by us to the Government of India or concerned authorities."

Para 22.0 of the General Conditions of Contract, which is also an integral part of the Agreement, speaks of "transfer of titles". The relevant provisions are :

"22.1 Transfer of the title in respect of Goods supplied by the Supplier to the Purchaser pursuant to the terms of the Contract shall pass on to the Purchaser with negotiation of shipping documents at foreign port of embarkation of that Goods in case of Goods supplied from outside the Purchaser's country and on negotiation of despatch documents (Ex-works basis) in case of Goods supplied from within the Purchaser's country.

22.2 This transfer of title shall not be construed to mean the acceptance and the consequent "Taking Over"/"Final Acceptance" of Goods. The Supplier shall continue to be responsible for the quality and performance of such goods and for their compliance with the specifications until "Taking Over"/"Final Acceptance" and the fulfillment of warranty provisions of this Contract.

22.3 This Transfer of title shall not relieve Supplier from the responsibility for all risks of loss or damage to the Goods as specified under 7.0 (Insurance) of SCC."

Para 25 of GCC deals with insurance:

"25.1 All the works being supplied by the Supplier shall be kept completely insured by the Supplier at his cost from the time of despatch from the Supplier's works, up to the completion of field demonstration at Site and taking over of the works by the Purchaser.
25.2 It will be the responsibility of the Supplier to lodge, pursue and settle all claims (for all the works) with the insurance company in case of any damage, loss, theft, pilferage, fire etc. and the Purchaser shall be kept informed about it."

As per para 9.4 of LOU, the insurance cover shall be taken in the joint names of applicant and Power Grid.

9.2 The payment terms incorporated in the Letter of Award have already been referred to. To recapitulate, 70% of the CIF price of each shipment shall be paid through irrevocable L/C established in favour of the applicant after despatch of the equipment and on presentation of the documents, viz., bill of lading, insurance and test certificates etc., 20% payable on receipt of goods at the storage sites in India on physical verification thereof by Power Grid's Engineer and the balance 10% is payable on successful completion of erection/testing and commissioning of the GIS sub-station and the issuance of Taking Over Certificates.

9.3 One more clause in LOA that deserves reference is that contained in para 2.4.3. It says :
"It is your overall responsibility to ensure that the equipment/materials being supplied by you under this Contract and by L&T INDIA under 'Second Contract', when erected and commissioned under 'Third Contract' by L&T INDIA, shall give satisfactory performance in accordance with the provisions of the Contract(s)."

10. The applicant has furnished a chart sequencing the events in relation to a typical transaction along with written submissions filed on 16/12/2008. They are as follows:

Particulars		
Letter of Credit ('LC') opened	24 April 2007	LC opened in India by Power Grid with Indian Overseas Bank
Commercial invoice	30 July 2007	For determination of price for custom clearance
Insurance policy	10 August 2007	Marine Cargo Insurance Policy taken for goods to be exported by Hyosung from Korea. PowerGrid named as the beneficiary in the policy
Bill of lading (BOL)	14 August 2007	BOL naming Power Grid as the consignee issued an acknowledgement of receipt of goods shipped by Hyosung from Korea

Actual date of negotiation (i.e. date on which documents was handed by Hyosung to Woori Bank) 16 August 2007
Actual date of transfer of funds by Woori Bank to Hyosung 16 August 2007
Bill of entry (BOE) 31 August 2007 BOE, naming Power Grid as the importer, issued acknowledging shipment of goods by Hyosung, Korea

10.1 The above events would indicate that the title to goods stood transferred to Power Grid outside the territory of India. The title passed on to Power Grid well before the goods reached the Indian Port or the territorial waters of India. The bill of lading contains the name of Power Grid as the consignee. The documents were presented to the applicant's banker for negotiation soon after the goods were shipped FOB and bill of lading was issued. Two days later, the amount equivalent to 70% of the value was transferred to the applicant's account on the same day. This modus operandi is in accordance with para 2.4.4 of the LOA. The bill of entry which was prepared about 15 days after shipment also shows Power Grid as the importer. Even in the insurance policy taken by the applicant Power Grid has been named as the beneficiary. The customs duty was paid by or on behalf of Power Grid before the goods were taken delivery. These facts unerringly lead to the conclusion that in accordance with the contractual stipulations, the transfer of title to the equipment and materials took place while the goods were outside the territory of India. The events match with the nomenclature - "off-shore supply contract" and the express stipulation that the transfer of title to equipment and materials shall pass on to Power Grid at FOB Port of shipment with the negotiation of shipping documents. It is worthy of note that the applicant has not reserved the right of disposal during transit or otherwise. The fact that the applicant is not relieved of the responsibility for loss or damage to the goods until the final take over and acceptance of the goods and that the goods are left in the custody of the applicant till the stage of erection and installation are not inconsistent with the Power Grid having already become the owner of equipment well before the goods reached the Indian Port. These are special safeguards which Power Grid wanted to have keeping in view the operational exigencies and overall obligations of the applicant under the contract. It is trite that risk need not pass simultaneously with the title to goods. There could be special stipulation between the parties in this behalf. As rightly pointed out by the learned counsel for the applicant, the applicant, by taking care of goods at the site in India till installation, assumed the capacity of a bailee. As regards the stipulation that the supplier shall continue to be responsible for the quality and performance of the goods until the final take over on testing of the equipment, it cannot be construed to be a condition which postpones the transfer of title to the goods till that time. It is more in the nature of warranty provision in the contract.

10.2 As seen earlier, the Agreement dated 27/10/2006 refers to supply of equipment on "CIF Indian Port of disembarkation basis". The letter of award also refers to "CIF supply of all off-shore equipment and materials". The price

is also noted as 'CIF Price' (vide para 3.1 of LOA). ***The Supreme Court in the case of Mahabir Commercial Co. Ltd. vs. CIT, West Bengal* discussed the features and legal incidents of a CIF contract. The following statement of law is quite apposite, - especially on the aspect of passing of property in goods***.

"In a c.i.f. contract the seller has first to ship at the port of shipment goods of the description contained in the contract. He must then procure the shipping documents (contract of affreightment) as contemplated by the contract upon the terms current covering the whole transit of the goods. He must arrange for an insurance for an amount equal to their reasonable value of shipment upon the terms current in the trade which will be available and it should be for the benefit of the buyer. He must also make out an invoice which is a written account of the particulars of goods delivered to the buyer with value of the goods or their price and charges, etc. annexed. This invoice is made out debiting the buyer with the agreed price and giving him credit for the amount of freight which he will pay the ship-owner on actual delivery. And, lastly, the shipper should tender the shipping documents to enable the buyer to deal with the goods in the usual way of business. He is also required to tender such other documents as are specified in the contract and if the contract is silent, it is sufficient if the seller tenders the bill of lading, policy of insurance and invoice. All these documents must be valid on tender. Under the c.i.f. contract, prima facie, the property in the goods passes once the documents are tendered by the seller to the buyer or his agent as required under the contract. But, where the seller retains control over the goods by either obtaining a bill of lading in his name or to his order, the property in the goods does not pass to the buyer until he endorses the bill to the buyer and delivers the documents to him."

"The appropriation of the goods to the contract by itself would not be such as to pass the property in the goods if it appears or can be inferred that there was no actual intention to pass the property. But, if however, the seller's dealing with the bill of lading is only to secure the contract price not with the intention of withdrawing the goods from the contract, and he does nothing inconsistent with an intention to pass the property, the property may pass either forthwith subject to the seller's lien or conditional on performance by the buyer of his part of the contract."

10.3 Thus, viewed from any angle, the title to and property in the goods shipped by the applicant at the foreign port stood transferred at the port of shipment or while the goods were on high-seas. The event of sale took place clearly outside the territory of India. The income arising out of such sale cannot be said to have accrued or arisen in India. The accrual of income derived from the sale price of the off-shore supplies cannot be attributed to any operation in India. It is not possible to accept the contention of the Revenue that the transfer of title/property in the goods must be deemed to have taken place in

India on testing and successful commissioning of the project cannot be upheld.

10.4 We are fortified in our view by the decision of the Supreme Court in Ishikawajima case. The legal position stated and the reasoning adopted therein applies a fortiori to the facts of the present case. In Ishikawajima, a similar question arose whether the amounts received / receivable by the applicant – a foreign company, for the off-shore supply of equipment and materials supplied to Petronet L&G Ltd. (Indian Company) was liable to be taxed in India under the provisions of the Act or the India-Japan Tax treaty. That was a case of a turnkey contract consisting of off-shore supply and services and on-shore supply and services. The break-up of contract price for each of the segments i.e., for supply, services and construction and erection were separately given in the Agreement.

10.5 The two issues in Ishikawajima were about the consideration received by the non-resident for offshore supply and offshore services, both of which were held to be taxable in India by this Authority (AAR). The relevant clauses in that contract are substantially similar to the present one. Clause 22.1 laid down:
"22.1. Title to equipment and materials and contractor's equipment: The contractor agrees that title to all equipment and materials shall pass to the owner from the supplier or sub-contractor pursuant to section E of exhibit H (general project requirements and procedures). Contractor shall, however, retain care, custody and control of such equipment and materials and exercise due care thereof until (a) provisional acceptance of the work or (b) termination of this contract, whichever shall first occur. Such transfer of title shall in no way affect the owner's rights under any other provision of this contract."

Further, in the notes contained in Annexure A, the following is stated:

Notes

General 1. .....
2. Offshore supply (exhibit D-2.1) is the price of equipment and material (including cost of engineering, if any, involved in the manufacture of such equipment and material) supplied from outside India on CFR basis, and the property therein shall pass on to the owner on high seas for permanent incorporation in the works, in accordance with the provisions of contract.

10.6 The Supreme Court having held that for the purpose of taxability, the entire contract need not be considered as integrated one and different segments in the contract are separable, held thus in relation to the offshore supplies:
"It is not in dispute the title in the equipment supplied was to stand transferred upon delivery thereof outside India on high-sea basis as provided for in Art.22.1. Similarly, Art. 13.1 provides for a lumpsum contract price, whereas Art. 13.3.2 specifically refers to the cost of offshore supplies". [vide page 430]
The entire transaction having been completed on the high-seas, the profits on

sale did not arise in India as has been contended by the appellant. Thus, having been excluded from the scope of taxation under the Act, the application of the double taxation treaty would not arise..... [vide page 444]."
Then, in the concluding part of the judgment, the following propositions concerning 'offshore supply' have been stated at page 446:
Re: Offshore supply:

(1) That only such part of the income, as is attributable to the operations carried out in India can be taxed in India.

(2) Since all parts of the transaction in question, i.e. the transfer of property in goods as well as the payment, were carried on outside the Indian soil, the transaction could not have been taxed in India.

(3) The principle of apportionment, wherein the territorial jurisdiction of a particular State determines its capacity to tax an event, has to be followed.

(4) The fact that the contract was signed in India is of no material consequence, since all activities in connection with the offshore supply were outside India, and therefore cannot be deemed to accrue or arise in the country.

(5) xx xx xx xx xx xx xx xx

Earlier, at page 445, while dealing with 'offshore services,' it was observed: "in a case of this nature, interpretation with reference to the nexus to tax territories will also assume significance ..... Whatever is payable by a resident to a non-resident by way of fees for technical services, thus, would not always come within the purview of section 9(1)(vii) of the Act. It must have sufficient territorial nexus with India so as to furnish the basis for imposition of tax."

10.7 It may be noticed that the clauses in the contract considered by the Supreme Court also contained an obligation on the part of the contractor to retain custody and control of equipment and to take due care thereof until provisional acceptance of the work. Moreover, installation of equipment was also to be carried out by the contractor. In spite of these features, the Supreme Court came to the conclusion that the offshore supply of goods which took place outside India does not give rise to any taxable income in India under the provisions of the Act. The applicant's case even stands on a better footing inasmuch there is a separate and exclusive contract with the applicant for the supply of goods offshore.

10.8 It deserves mention that in Ishikawajima case, AAR had taken a different view in the matter. The AAR held at page 206 of 271 ITR that "in a case of transaction of sale of goods by the non-resident to an Indian resident which is a

part of a composite contract involving various operations within and outside India, income from such sale shall be deemed to accrue or arise in India if it accrues or arises through or from any business connection in India."

Obviously, the above proposition stated by AAR was not accepted by the Supreme Court.

10.9 In a recent case, the ITAT Delhi Bench-I had an occasion to consider the same issue in relation to the contract between Power Grid and another Korean Company. The learned Members of the Tribunal, after a thorough discussion held that in view of the decision of the Supreme Court in Ishikawajima, the receipts from offshore supply contract cannot be taxed under the Income-tax Act and that a percentage of income cannot be subjected to tax by reason of the fact that certain operations - post-supply of goods, took place in India.

There were two contracts in that case – one was for offshore supply of equipment and the other was for onshore erection contract. The onshore operations relating to erection of equipment were carried out in India and the entire income on account of that contract was subjected to assessment in India. The department took the stand that in view of the close connection between two contracts, 10% of the income from offshore supply of equipment can be reasonably attributed to the operations carried out in India and to that extent, it was liable to be taxed under section 9(1)(i) of the Act. The department also took the stand that the transfer of property in the goods supplied under the first contract took place within India in view of the stipulations similar to those contained in the contract with which we are concerned. These contentions were rejected by the Tribunal. As regards the passing of property, the Tribunal observed thus:
"Under the Sales of Goods Act, the property in goods will pass to the buyer as per the intention of the parties. Such intention is to be gathered from the facts and circumstances of the case. In the present case as per para 31.2 quoted above, there is specific agreement between the parties that property would pass to the buyer as and when the assessee loads the equipment on to the mode of transport to be used to convey from the country of origin. There is no other term, which would convey a contrary intention. It is, therefore, clear from above that ownership is intended to pass to PGCIL as soon as goods are loaded and in this case were put on the ship and documents were handed to the nominated bank where letter of credit was opened. "

It was further observed:
"The irrevocable letter of credit in the present case after which delivery was made by the seller to the ship, is clear indication of transfer of property in goods from the seller to the buyer. None of the circumstances referred by the revenue and noted above can lead to an inference that transfer of title to the

buyer was conditional or there was intention on the part of the seller retain the right of disposal of equipment. Certain circumstances like insurance of the goods, unloading of the goods, fixation of goods are only to square the contract and its performance. There is no term in the contract, which is inconsistent with the intention stated clearly in para 31.2 of the contract to pass the property in goods. Some terms intended to protect the buyer's interest cannot be construed to hold that property in goods have not passed or that it had passed conditionally. "

Dealing with the aspect that the supply of equipment carried with it the obligation to erect testing and commissioning of the plant and, therefore, 10% of the income ought be reasonably attributed to the operations in India, the Tribunal rejected the contention by observing thus:
"In the first place, we have already held that obligations fixed under the second contract are obligations to be discharged by the appellant for a separate consideration. There is no dispute that income arising from activities performed in India is taxable in India. Those activities are separate and distinct and cannot be clubbed with obligations of the supplier or passing of property in the equipment. These stipulations are retained in favour of the purchaser to ensure that the equipment supplied give satisfactory performance."

As the onshore erection contract was separate in that case and the income attributable to those operations in India was offered to tax, that decision does not apply in all fours to the present case. But, to the extent it held that under the offshore supply contract, the sale was completed outside India and there was no accrual or deemed accrual of income in India, the decision of the Tribunal is directly in point. We share the same view as the Tribunal has taken on this aspect.

Question No.2
11. Now we turn our attention to the question whether any part of the income could be attributed to the operations carried out and the activities undertaken in India pursuant to the terms of the contract. There are two ways of looking at it : (i) from the stand point of section 9(1)(i) and the Explanation thereto, and (ii) from the point of view of the provisions in the DTAA. We may refer to those provisions in the Act and DTAA for ready reference:
Section 9 of the Income-tax Act, 1961 (the 'Act')
9. Income deemed to accrue or arise in India.
(1) The following incomes shall be deemed to accrue or arise in India.
(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.
Explanation: For the purposes of this clause –
(a) in the case of a business of which all the operations are not carried out in

India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India;

xx xx xx xx xx

Article 7 – Business profits
1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph (3), where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

3. In the determination of the profits of a permanent establishment, there shall be allowed as deductions expenses which are incurred for the purposes of the permanent establishment including executive and general administrative expenses so incurred whether in the State in which the permanent establishment is situated or elsewhere, which are allowed under the provisions of the domestic law of the Contracting State in which the permanent establishment is situated.

4. No profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

5. For the purposes preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

6. Where income or profits include items of income which are dealt with separately in other articles of this Convention, then the provisions of those articles shall not be affected by the provisions of this article.

11.1 The applicant does not invoke Section 9(1)(i) read with its Explanation. The applicant proceeds on the premise that the receipts under the contract

constitute deemed income within the meaning of clause (i) of section 9(1). Assuming it to be so, the applicant argues that no tax liability can be fastened under the Act by virtue of Art. 7 of the Treaty read with Art. 5. Under Art. 7, the business profits can only be taxed in Korea which is the State of residence unless the business is carried on through a PE in India. If the enterprise carries on business through the PE, then the profits can be taxed in India to the extent they are attributable to the PE. The applicant seeks to draw support from the first part of Art. 7(1) and contends that it has or will not have a permanent establishment in India. Therefore, we must focus our attention on the question whether the PE exists or will come into being at the appropriate time. In this connection, we have to refer to the definition of 'permanent establishment' in Art. 5 of the Treaty. The relevant extracts from that Article are as under:

Article 5: Permanent Establishment:

1. For the purposes of this Convention, the term permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term permanent establishment shall include especially

(a) a place of management;
(b) a branch;
(c) an office;
(d) a factory;
(e) a workshop; and
(f) a mine, an oil or gas well, a quarry or any other place of extraction of natural resources.

3. The term permanent establishment likewise encompasses a building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only where such site, project or activities continue for a period of more than nine months.

4. Notwithstanding the preceding provisions of this article, the term permanent establishment shall be deemed not to include

(a) xx xx xx xx xx xx xx
(b) xx xx xx xx xx xx xx
(c) xx xx xx xx xx xx xx
(d) xx xx xx xx xx xx xx
(e) the maintenance of a fixed place of business solely for the purpose of advertising, the supply of information, scientific research or any other activity, if it has a preparatory or auxiliary character in the trade or business of the enterprise;
(f) xx xx xx xx xx xx xx

11.2 It is the contention of the applicant that if at all, it is clause (3) of Art.5 that is attracted in the instant case. It is pointed out that the duration test will not be satisfied for the reason that the supervisory activities in connection with the assembly or installation will not extend over a period of 9 months or more. It is submitted that going by the experience in similar projects, such activities in relation to the present contract will go on for a period of 74 days approximately. It is clarified in the written submissions filed on behalf of the applicant that the plant has not yet reached the stage of testing and commissioning and the contract period has been extended.

11.3. On behalf of the Revenue it is contended that in order to count the nine month period specified in Art.5.3, the period of supervision requires to be counted from the date the equipments reach India to the final testing and commissioning of the plant. It is pointed out that all the equipments that were received in India in or around September, 2007. According to the original stipulation, the work had to be completed by 23rd October 2007. However, the time for completion has been extended upto 31/3/2009. There might have been further extension also. It is submitted that in conformity with the overall responsibility cast on the applicant for the timely and successful commissioning of the project, the applicant is bound to supervise the transportation/storage of equipments in order to comply with the terms of the contract. The minutes of meeting dated 25/12/2007 reveals that there were space constraints at the Koteshwar GIS-site and there was delay in transportation of equipments stored at Rishikesh storeyard of Hyosung. Moreover, as seen from the record notes of post-bid discussions on technical and other issues held on 16th and 31st January 2006*, the soil investigation work was also within the scope of the applicant's contract. The applicant was further required to furnish the monthly Engineering and progress reports by 10th of every month till the commissioning of sub-station. The Revenue then pointed out, while referring to the documents appended to MOU between the applicant and L&T, that L&T will do the system testing under the supervision of the applicant and the commissioning assistance will be provided by L&T. 26 tests have to be conducted at site out of which for 6 tests, even the testing equipment has to be arranged by the applicant. The supervision of testing is the responsibility of the applicant. Therefore, having regard to the enormity of testing and commissioning work involved, there is every possibility of the duration of the project and the activities of the applicant going beyond 9 months. It is submitted that there is no basis for the assumption of the applicant that the supervisory activities of the applicant in connection with the project would be for duration of 74 days only. In this regard, we would like to mention that the statement of the applicant in the written submissions filed on 16th December, 2008 that it has already furnished the complete information as regards the time duration of the supervision work is not correct. No such specific details have been filed apparently because the work of erection has not been completed and the process of testing and

commissioning has not begun.

12. It must be noted that there are two limbs to para 3 of Art.5. The first limb is – "building site, construction, assembly or installation project" and the second limb is supervisory activities in connection therewith. Both should extend over 9 months in order to constitute a PE. The applicant's case cannot be brought within the first limb because the construction and installation work is being undertaken by L&T. The question then is whether the duration test of 9 months vis-à-vis supervisory activities is satisfied.

12.1. The applicant has overall responsibility and in particular it supervises the testing and commissioning operations through its technical and managerial personnel. Further, it is seen from LOA that a specific responsibility is also cast on the applicant to ensure that the equipment and materials supplied by L&T give satisfactory performance. Therefore, even at the stage of erection/installation the applicant's supervision and monitoring is required. Thus, the tangible supervisory work begins at the stage of erection by L&T and of course at the stage of testing and commissioning, its supervisory role assumes wider magnitude and perhaps reaches the peak. ***If we take into account only these three stages viz. erection, testing and commissioning and the periods specified in Implementation Schedule, we are inclined to accept the contention of the applicant that the duration may not reach anywhere near the 9 month threshold period set out in Art.5.3. Of course, it is subject to verification by the Department in the light of subsequent events. It is the contention of the Revenue that the applicant's supervisory role starts from the date of clearance of the equipment from the port as it is necessary to supervise the transportation and storage of equipment in order to ensure that no damage takes place. We do not think that this contention can be accepted. The applicant, in carrying out the equipment to the work site and in safeguarding the same from any damage, is only carrying out the contractual obligations incidental to the offshore supplies of goods. It cannot be considered to be a supervisory activity contemplated by Art.5.3 of the Treaty***. Then, the Revenue's representative has drawn our attention to the stipulation in the minutes of meeting held in January 2006 that the applicant has to submit the monthly engineering and progress reports (vide para 18.0 of post-bid discussions). We do not have clear facts to know the precise role of the applicant in this behalf and the starting point of such activity. This aspect is subject to verification by the Department, if considered necessary. On the point of PE, there are two more aspects which remain in the grey area and that is about the soil investigation and revising civil foundations on the basis of soil data*. In the post-bid discussions, there is also a reference to the fact that detailed engineering work in respect of GIS Pooling Station will be done by the

applicant based on the drawings prepared by PowerGrid**. It is not clear how the applicant is concerned with these items of work. In the absence of relevant details, it is not possible to say to what extent it has bearing on the aspect of PE.

13. Another contention raised by the Revenue in an apparent bid to make out a case of PE is that the applicant has undertaken a project of similar nature i.e. Maharani Bagh sub-station as per the contract awarded by Delhi Transco. Ltd. to the Power Grid and the applicant. It is further pointed out that as per the information received from L&T, the employees of the applicant were present at the Maharani Bagh site for erection and testing work between July and October 2008. However, the commissioning is yet to be done. ***The Revenue contends that all the projects of the nature described in Art 5.3 which are being carried out by the applicant should be seen together for the purpose of determination of PE in India. If so, the duration of supervisory activities in connection with both the projects shall be aggregated for the purpose of arriving at the period of 9 months. In order to rebut this contention, the applicant's counsel has relied on para 18 of the OECD commentary on Art 5 of Model tax convention which reads thus:***
"The twelve month test applies to each individual site or project. In determining how long the site or project has existed, no account should be taken of the time previously spent by the contractor concerned on other sites or projects which are totally unconnected with it. A building site should be regarded as a single unit, even if it is based on several contracts, provided that it forms a coherent whole commercially and geographically".

13.1. In reply to this submission, the Revenue's representative submits that this opinion of the OECD has not been accepted by the Govt. of India and therefore much reliance cannot be placed on it. The Indian Govt's stand is that a series of consecutive short term sites or projects operated by a contractor would give rise to the existence of PE. The applicant in turn comments that the reservation expressed by the Govt. of India does not hold good here.

13.2. The factual position regarding the Maharani Bagh contract, which even according to the information obtained by the Revenue, has been substantially completed, is far from clear. It is not known whether there was any operational link and functional connection between the two project works which are located at different and distant places. ***If the establishment that is being maintained for the purpose of executing a different contract with a different party is separate, distinct and independent of the other contract work being executed by the applicant, it is not in our view permissible to combine the establishments of two different***

projects of fairly long duration for the purpose of arriving at the threshold period of 9 months. Moreover, even going by the facts placed by the Revenue in regard to Maharani Bagh sub-station project, prima facie it appears that even if both projects are taken together, the duration of supervisory activities are not likely to exceed 9 months. In the absence of better particulars, we are not inclined to delve into this aspect further.

14. In the light of above discussion, it cannot be ruled at this stage that the applicant has a PE falling within the specific description of Art.5.3 of DTAA. Though we have given a tentative finding that on the facts presented by the applicant, a PE does not exist, the factual aspects adverted to above which give rise to some doubts can be probed by the appropriate authority, if considered necessary. The department cannot, however, indulge in a roving inquiry into the existence or otherwise of PE, without regard to the observations made and news expressed in this order. Subject to this rider, we reach the conclusion that the applicant has no permanent establishment in India. If in the light of further inquiry that may be made, the Department comes to the conclusion that there is a PE, the income to the extent it is attributable to the operations of the PE can be subjected to tax in the hands of the applicant as per the 2nd sentence of Art. 7.1 of DTAA.

14.1. No doubt, the contract does not specify the consideration payable for the supervisory activities to be carried out by the applicant especially at the stage of testing and commissioning. But, that does not mean that attribution of profits is not possible or permissible. A reasonable quantum of income attributable to such operations intimately connected with the PE (if any) has to be arrived at on an estimated basis.

15. The counsel for the applicant contended rather faintly that the activities by way of supervision of testing and commissioning of the plant are auxiliary in character and, therefore, the maintenance of fixed place of business for that purpose cannot be regarded as PE in view of clause (e) of Article 5.4. of the Treaty. We find no substance in this contention. The term 'auxiliary' means something which aids or is subsidiary to the main thing or act. The supervisory activities which the applicant had undertaken in terms of the contract are quite independent of offshore supply/sale of equipment. They cannot be considered to be incidental to the supply of equipment. The equipment sold by the applicant as well as the equipment locally procured by L&T will go into the erection of the plant by L&T. The work of erection and installation is the responsibility of L&T. The applicant is concerned only with the supervisory part of it and the said activity cannot be said to be aiding or incidental to the supply of equipment as such. It is an independent activity specially undertaken

by the appellant as a part of overall responsibility cast on the applicant by Power Grid.

16. We shall now briefly refer to the other contentions raised by the Revenue on the point of existence of PE. It has been clarified by the applicant that the liaison office set up on 17/10/2007 with the permission of the Reserve Bank is not engaged in any business activity much less in the operations related to the present contract. ***Then, in regard to agency PE, it has been clarified by the applicant that the Indian agent Alpasso Industries Pvt. Ltd., is an independent entity working for various clients and is not a dependent agent. In the affidavit filed on behalf of Alpasso Industries Pvt. Ltd., it is stated that the company is engaged in the business of rendering consultancy / marketing services and the relationship between the applicant and the said company is purely on principal to principal basis and that of a service provider and client. On the facts stated, it is not possible to infer an agency PE***. The other contention that L&T is a sub-contractor of the applicant is an extreme contention and we have no hesitation in rejecting the same. ***This contention has been raised by the Revenue to put forward a case that in computing the 9 month period, whatever work is done by L&T should also be taken into account. There is no legal or factual basis for branding an independent contractor described as such in the contract document as a sub-contractor of the applicant.***

Conclusion:

17. In conclusion we record the answers to the questions as follows:
Addl. Question

17.1. The applicant together with L&T Limited cannot be treated as AOP for the purpose of assessment under the Income-tax Act, 1961.

17.2. Question 1 is answered in favour of the applicant. We hold that under the terms of the contract, the sale of equipments and materials took place outside the territories of India and the income in relation thereto cannot be said to accrue or arise in India and, therefore, not liable to be taxed under the Income-tax Act, 1961.

17.3. As regards the 2nd question, we hold that on the basis of facts presented by the applicant, the applicant cannot be said to have a Permanent Establishment within the meaning of Art. 5.3 of DTAA. However, if it is found on the basis of further inquiry that may be made by the assessing authority (for which the liberty is given to a limited extent as indicated supra) that a PE exists, then the profits attributable and confined to the operations of PE have to be estimated and subjected to income-tax in India. ***It is made clear that the activities incidental to the supply of imported goods such as***

transportation, storage and delivery ought not to be attributed to the PE.

Accordingly, the Ruling is given and pronounced on this 17th day of June, 2009.

Sd/-	**Sd/-**
(A. Sinha)	**Sd/-** **(P.V. Reddi)**
Member	**(Rao Ranvijay Singh)**
Chairman	**Member**

F.No. AAR/773/2008 **dated ……**

This copy is certified to be a true copy of the Ruling and is sent to:

1. The applicant
2. The Director of Income-tax (International Taxation), Mumbai.

(Sanjay Puri)
Secretary, AAR(IT)