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India | Tax & Regulatory | For private circulation only | 9 August 2018

Global Business Tax Alert

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Delhi Tribunal* holds that preparatory work for the purpose of entering into a tender before entering into a contract cannot be relevant for determining Installation-PE threshold period

*ITA No.:-5759/Del/2011

Issue no: GBT/21/2018

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Facts of the case

- Bellsea Ltd. [Assessee], a non-resident company incorporated in Cyprus is engaged in the business of dredging and pipeline related services for oil and gas installations.

- During the AY 2008-09, the Assessee was awarded a contract by Allseas Marine Contractors SA [AMC] for placement of rock in sea bed for protection of gas pipelines and umbilical subsea structures in oil and gas field developed at the Krishna Godavari Basin on the east coast of India. The said contract was part of the original contract awarded to AMC by the Reliance group and Niko Resources.

- As per the terms of the contract, the effective date was 4 January 2008 (i.e. the date from which work was intended to commence) and the date of completion of contract was to be reckoned from the date of issuance of completion certificate by AMC. In the instant case, completion certificate was issued in the month of September 2008.

- The Assessing officer [AO] and the Dispute Resolution Panel [DRP] held as under in the assessment order passed under section 143(3)/144C(13) of the Income-tax Act, 1961 [the Act]:
  - The contract of the Assessee is for multifarious functions and not merely rock placement functions. Consequently, the role of the Assessee cannot be limited to fall within the ambit of Article 5(2)(g) of the Double Taxation Avoidance Agreement between India and Cyprus [Tax Treaty*];
  - Even if, Assessee's contentions are accepted, the activities under the contract constitute an Installation Permanent Establishment (PE) under Article 5(2)(g) of the Tax Treaty since the activities exceeded for more than 12 months on account of the following:
    - In respect of date of commencement of contract, the contract commenced before the effective date of the contract due to visit of an employee of the Assessee in September 2007 to collect data and information in relation to the contract; and
    - In respect of completion of contract, certain formalities were carried out even after decommissioning of the project/demobilization/issue of completion certificate (September 2008).
  - Consequently, 10 per cent of gross receipts of Rs. 58,49,67,946 is taxable at the rate of 10 per cent as per the provisions of section 44BB of the Act.

- The Assessee contended that:
  - The scope of function and work performed by AMC was wrongly considered to have been performed by the Assessee;

    The Assessee was given responsibility of only part of work which is enumerated under Section 3 of 'the Scope of work' in the contract. Assessee's scope of work was limited to carry out rock transport and delivery which included transportation and safety measures; scope of supply and construction, installation of temporary facilities and site restoration;
  - Commencement and completion date have been specifically defined under the contract and therefore, there cannot be any inference to hold that the commencement started prior to that date. Further, as per the completion certificate, the certificate issued by Customs authority, departure of vessels

from India, payment schedule, and the invoice date, it can be inferred that the project was completed in the month of September 2008.

- The employee who visited India in September 2007, had visited purely for preparatory work like collection of data and information necessary for tendering purposes and not for any kind of installation activity.

  Such kind of activities much prior to awarding of the contract cannot be treated as part of installation activity as stipulated under Article 5(2)(g) of the Tax Treaty. Assessee placed reliance on the Honorable Delhi High Court judgment of National Petroleum Construction Company v DIT (386 ITR 648).

- Aggrieved by the order of AO, the Assessee appealed before the Tribunal.

*In the instant case, the old Tax Treaty between India and Cyprus has been considered which provides for a threshold of more than 12 months for building site, construction, assembly or installation or supervisory PE. However, Article 5(3)(a) of the revised Tax Treaty which is effective from 10 January 2017 provides for a threshold of more than 6 months to constitute building site, construction, assembly or installation or supervisory PE.

Issue under consideration

Whether the Assessee constitutes an Installation PE under Article 5(2)(g) of the Tax Treaty and thereby whether income is taxable under section 44BB of the Act?

Ruling of the Tribunal

- The Tribunal perused the scope of work and accepted Assessee's contention that AO and DRP had wrongly considered the scope of work and it was purely with regard to carrying out rock transport and delivery, supply of material and equipment, construction, installation of temporary facilities, rock dumping activities etc.

- The Tribunal held that as per the factual matrix, the Assessee has not set up any kind of project office or developed a site before entering into the contract with AMC for carrying out any preparatory work.

  Further, it also held that auxiliary and preparatory activities such as pre-survey engineering, investigation of site etc. carried out by the employee before entering into contract for the purpose of tendering, without carrying out any activity of economic substance or active work qua the project, cannot be considered for the purpose of computation of Installation PE threshold of 12 months.

- The Tribunal while referring to Article 5(2)(g) of the Tax Treaty observed that the duration of 12 months *per se* is activity specific qua the site, construction, assembly or installation project. Where the contract has not been awarded, then any kind of preparatory work for tendering of contract cannot be reckoned for carrying out any activity as stipulated in this clause.

- The Tribunal placed reliance on the Honourable Delhi High Court judgment of National Petroleum Construction Company v DIT (*Supra*) wherein it was held that:

"…assembly project or installation PE can only be construed as a fixed place of business only when an enterprise commences its activity at the project site. An activity which may be related or incidental to the project but which is not carried out at the site in the source company would not constitute as PE."

Consequently, the Tribunal, in the instant case, held that the threshold period of 12 months has not been exceeded in the case of the Assessee and consequently no PE can be said to have been established in terms of Article 5(2)(g) on account of the following reasons:

- The period from which it can be reckoned that the Assessee has started to perform the activities in connection with installation project or site etc. is when the actual purpose of the business activity has started. In the instant case, it was from the effective date of the contract and not before, with respect to the preparatory work for the purpose of tendering;
- With respect to date of completion, the completion certificate mentions the date of completion as 30 September 2008 (though formalities of final completion certificate had exceeded till November 2008)
- The last barge/vessel sailed out on 25 September 2008 and Customs authorities also certified the demobilisation by this date;
- Payment in relation to the contract was received by the Assessee before the close of September 2008; and
- There is no evidence suggesting that any activity post completion has been carried out beyond 31 December 2008 or the project of the Assessee was not completely abandoned before the period of 12 months.

Conclusion

The Tribunal held that auxiliary and preparatory activities such as pre-survey engineering, investigation of site etc. carried out by the employee of company prior to company entering into contract (i.e., only for the purpose of tendering), without carrying out any activity of economic substance or active work qua the project, cannot be considered for the purpose of computation of Installation PE threshold as per Article 5(2)(g) of the Tax Treaty.

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