BEFORE THE AUTHORITY FOR ADVANCE RULINGS(INCOME TAX) NEW DELHI

11th Day of September, 2009

P R E S E N T

MR. JUSTICE P.V. REDDI (CHAIRMAN)

A.A.R. NO. 790 OF 2008

Name & address of the applicant	PINTSCH BAMAG Antriebs-UND Verkehrstechnik GMBH Hunxer Strabe 149, D-46537 Dinslaken, Germany
Commissioner concerned	Director of Income-tax (International Taxation-II) New Delhi
Present for the Applicant	Mr. K. Meenatchi Sundaram, FAC
Present for the Department	Mr. Sanjeev Sharma, Addl.DIT(Int.Tax-1) Ms. Nandita Kanchan, Addl.DIT(Int.Tax) New Delhi.

R U L I N G

(By Hon'ble Chairman)

1. In this application for advance ruling by a non-resident company, the ruling is sought on the following questions:

i. Whether looking to the nature of activities to be carried on by the applicant, which is a German based company and non-resident as per the provisions of Section 6(3) of the Income-tax Act, 1961, the applicant can be held to have earned any income taxable in India as per the provisions of the Income-tax Act, 1961?

ii. *If the answer is affirmative, how the total income of the applicant as per the provisions of the Income-tax Act, 1961 should be computed?*

2. The following are the facts stated in the application and the affidavit filed subsequently :

The applicant is a company incorporated in Germany having its registered office in Dinslaken, Germany. Through the process of international bidding, the applicant was awarded a contract by M/s. Tuticorin Port Trust (hereinafter referred to as "TPT") on 28th November, 2006. The scope of work is "work design, fabrication supply, transportation, delivery, installation and maintenance of mild steel, navigational channel and fairway buoys, mooring gear and solar operated navigational lighting equipments in relation to Sethu Samudram Ship Channel Project being executed in Tamil Nadu. The applicant has sub-contracted most of the work to a third party, namely, Asia Navigation Aids, Delhi. Though the agreement with the sub-contractor was entered into in 2006, the formal permission for sub-contracting was obtained from the TPT in June, 2009. Leaving out the sub-contracted work, the following work will be undertaken by the applicant:

i. Study of the technical requirements in relation to the execution of the Contract.

ii. Designing of Fairway Buoys, Mooring Gears and Solar Operated Navigational Equipments.

iii. Supply of critical components to sub-contractors, if required.

iv. Supervision of installation of equipments and other items mentioned in the Main Contract, as and when the installation is carried out by the sub-contractor.

Activities 2 and 3 will be carried out from the applicant's office in Germany. The 4th activity i.e. supervision of installation/commissioning will be in India and for carrying out such supervision, two engineers from Germany will be deputed who will be present at the time of installation of fairway buoys, mooring gears and solar operated lighting equipment in the mid-sea. According to the applicant, this process of supervision will be for less than 60 days. The time schedule for completion of the main contract is 16 months from the date of commencement as mentioned in the Agreement. However, in view of the delay in the execution of the project, for various reasons, TPT granted extension of time, the latest extension being through its letter dated 22.12.2008. The performance guarantee was given by the applicant. On furnishing the bank guarantee, the applicant has so far received three instalments of basic price from TPT as advance. The value of the contract is about Rs.9.76 crores payable in Indian rupees. The amount payable to the sub-contractor is stated to be about Rs.5.05 crores. After awarding the sub-contract to Asia Navigation Aids, a few items were deleted and entrusted to two other parties.

2.1. The Agreement between Board of Trustees of TPT and the applicant was executed on 28th November, 2006. The work order annexed thereto sets out the scope of work as mentioned above. Apart from the essential terms of the contract, the bill of quantities and the terms of payment and the maintenance period are all given in the work order. The bill of quantities mentions 22 items. Soon thereafter, the applicant placed purchase order (supplement) on its sub-contractor. Under the general conditions of the contract, sub-contracting is not permitted without written permission of the concerned Engineer of TPT. The sub-contract was permitted by TPT vide its communication dated 18th June, 2009. In that letter there is an express stipulation that sub-contracting does not exonerate the main contractor (the applicant) from liabilities under the Contract. In the purchase order issued to Asia Navigation Aids **(ANA),** the same 22 items set out in the main contract are also set out. The applicant stated in the affidavit dated 12.2.2009 that items 4 to 9 (a) of the purchase order were deleted and the applicant appointed M/s. Chain (P) Limited, Kolkata, for the mooring chain and accessories and another concern by name Technocrafts, Faridabad, for supply of sinkers as sub-contractors in place of ANA. A copy of the Purchase Order supplement dated 20.12.2006 issued to ANA has been filed.

2.2. The payment schedule is set out in detail in the purchase order. It is seen from the schedule that the items involved are designing fabrication of Navigational Channel Buoys (altogether 65 in number), mooring gear, buoys light, delivery at site, installation and successful commissioning after completion. Payments are made in specified percentages at various stages. The sub-contractor (ANA) has to to provide “guarantee period of 12 months from the date of taking over and provide maintenance for a period of 5 years after completion of the guarantee period. Separate consideration is stipulated for maintenance. All costs which occur in India due to transportation, storage, etc. are on account of the sub-contractor.

3. It is brought to my notice by the learned counsel for the applicant that the material and equipment for the manufacture of buoys and other items had reached the work place of ANA in Delhi and the manufacturing is being undertaken by them. However, the details such as commencement of manufacturing and the stage of manufacture are not furnished in the affidavit.

4. The applicant contends that it has no PE in India and that the supervisory operations which it will have to carry out at the time of installation and commissioning by the sub-contractor would be only for 2 months and therefore no PE exists nor can be deemed to exist. Consequentially, it is submitted that under the terms of the

DTAA between India and Germany, business profits received by the applicant cannot be subjected to tax in India. Reliance has been placed on the decision of the Andhra Pradesh High Court in *CIT vs. Vishakapatnam Port Trust*[1].

5. Reliance is placed on the Treaty provision i.e. Article 7 of DTAA[2] between Republic of India and the Federal Republic of Germany. It is well settled that if the applicant is entitled to the benefit under the provisions of DTAA, the applicant can take advantage of that benefit notwithstanding the provisions contrary thereto under the domestic law i.e. Income-tax Act, 1961.

5.1. Article 7 deals with '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.*

Thus, the business profit can be taxed in India only if the applicant carries on business through the PE situated in India. In case, PE exists, only so much of the profits as are attributable to the

[1] 144 ITR 146
[2] Double Taxation Avoidance Agreement

operations of the PE are liable to be taxed. The above provision in the Treaty gives primacy to the resident State to tax the profits. The rationale of this provision is explained thus in the OECD Commentary on Article 7 of the Model Convention (2008 Publication): *"it has come to be accepted in international fiscal matters until an enterprise of one State sets up a permanent establishment in another State it should not properly be regarded as participating in the economic life of that other State to such an extent that it comes within the jurisdiction of that other States taxing rights."*

6. As already noted, it is the contention of the applicant that there is no PE in India and no PE can be deemed to exist under Article 5. Article 5 defines the PE. The relevant part thereof is extracted below:

> **Article 5: Permanent Establishment:** 1. For the purposes of this Agreement, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.
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> 2. The term "permanent establishment" includes especially, -
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> (a) a place of management;
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> (b) a branch;
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> (c) an office;
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> (d) a factory;
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> (e) a workshop;
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> (f) a mine, an oil or gas well, quarry or any other place of extraction of natural resources,

including an installation or structure used for the exploration or exploitation;

(g) a warehouse or sales outlet;

(h) a farm, plantation or other place where agricultural, forestry, plantation or related activities are carried on; and

(i) a building site or construction, installation or assembly project or supervisory activities in connection therewith, where such site, project or activities continue for a period exceeding six months.

7. The contention of the Revenue is that the sub-contractor is undertaking various activities which constitute the core of the contract work entrusted to the applicant. All the activities undertaken by the sub-contractor are on behalf of the applicant and in connection with the execution of the contract between the applicant and TPT. It is pointed out that the sub-contractor is a nominee of the applicant and the delegation of work to the sub-contractor for its own convenience should not influence the decision on the question whether the applicant has a PE in India. In other words, the Revenue wants to treat the workshop or place of manufacture of the sub-contractor as part of the permanent establishment of the applicant itself. If the duration of the work done by the sub-contractor at the workshop or the factory is taken into account, the duration will be much beyond six months which is the period stipulated in Clause (i) of Article 5.2 of the Treaty. That is why the Revenue has taken this stand.

8. I do not find any merit in the Revenue's contention. It admits of no doubt and in fact it is not disputed that clause (i) of Article 5.2 gets attracted to the present case as the contract awarded to the applicant relates to installation and assembly project, and, therefore, the duration test of six months should necessarily be applied even if the applicant at one point of time or the other may set up a fixed place of business for the purpose of monitoring and supervising the installation. The inter-play between para 1 of Article 5 and clause (i) of para 2 of Article 5 was explained by this Authority in a recent case – *Cal Dive Marine Construction (Mauritius) Ltd.*[3]. The following passages in that ruling are relevant:

> ***"6.1**. Once clause (i) is attracted, the minimum period test will have to be necessarily applied. The fact that the applicant may have a project office or a workshop for the purpose of carrying out the contractual work does not bring the establishment of the applicant within the other clauses of para 2 to the exclusion of clause (i). On the other hand, clause (i) being a specific provision dealing with construction or assembly project, that provision prevails over the other clauses of para 2 of Art.5 which are general in nature. In other words, an office or workshop, if it is established as a part of or incidental to the execution of a construction or assembly project, it is clause (i) alone that comes into play. That is the only way to reconcile and avoid conflict between overlapping items/expressions contained in para 2 of Art.5.*
>
> ***6.2**. Now, we must consider the more controversial aspect as regards the interplay of paragraph 1 and clause (i) of para 2 of*

[3] 315ITR 334

Art.5. The question is whether paragraph 1 of Art.5 can be viewed on stand-alone basis without regard to clause (i) of para 2? If the project office and/or the Barge from which the applicant carries out its operations can be treated as a fixed place of business within the meaning of Art.5.1, is it still necessary that the business from such a fixed place should be carried on for a period of more than 9 months? These are the questions that should engage our attention. The argument in support of the contention that the minimum period of 9 months should not be imported into para 1 may be buttressed by the fact that para 2 purports to be an inclusive definition. An inclusive definition, normally speaking, will only expand rather than restrict the meaning and amplitude of the preceding general expression or term. In other words, it may be argued that the amplitude of para 1 cannot be cut-down by referring to the terminology of para 2. But, in our view, having regard to the contextual setting of the two paragraphs of Article 5, too much of emphasis cannot be placed on the fact that the definition in para 2 is apparently inclusive in nature. As observed by Lord Keith in Hemens vs. Whitsburry Farm Ltd[@]……. "there can be no doubt that in some cases, the language of an 'inclusive' definition considered with the general context can have the effect that the ordinary natural meaning of a word or expression is to some extent cut down."

6.3. *In our view, the inclusive definition in para 2 should not come in the way of harmonious construction or contextual interpretation of the two crucial paragraphs of Art. 5 defining the expression 'permanent establishment'. The Article has to be read as a whole, one part of it throwing light on the other. Para 1 of Art.5 cannot be viewed as a water-tight compartment without taking colour from or shedding light on various clauses of para 2, notwithstanding the 'inclusive' pre-fix contained in para 2.*

[@] 1988(1)AII ER p.72

6.4. *The ingredient of fixed place of business in para 1 runs through the entire gamut of para 2. While the particular instances of such fixed place which are the centres of business operations are set out in the inclusive definition with a view to dispel the doubts as well as to make it more comprehensive in scope, at the same time, where the fixed place is in the nature of a building site or a place connected with construction or assembly project, the minimum duration was advisedly prescribed by the signatories to the Treaty. Such minimum period is specified in all the Treaties without exception, though the length of period widely varies in various Treaties. If the opening para of Art.5 is to be read on stand-alone basis, then clause (i) of para 2 will be rendered ineffectual and perhaps otiose. Such construction should be avoided especially while reading and understanding a Treaty provision. It is well-settled that a strict and literal construction should be avoided in interpreting a clause in the Treaty and the intention and purpose behind the provisions incorporated in the Treaty should be given due weight. As discussed earlier, the fact that clause (i) of para 2 is a part of inclusive definition whereas para 1 is the primary and main definition of PE does not mean that these two paras should be read distinctly, independent of each other. We reiterate that these two paras should be read harmoniously as part of the same concept. In relation to a building site and construction/assembly project, the prescribed minimum period should be read into the expression 'fixed place of business' occurring in para 1. As clarified earlier, it is implicit in the very concept of PE and the expression 'fixed place of business' that it should be in existence for a fairly long time and merely carrying on some activities intermittently or for a short while does not impress the place with the character of a fixed place through which the business of the enterprise is carried on."*

9. The more crucial question that needs to be considered now is whether the work place set up by the sub-contractor to carry out

the works entrusted to him by the applicant can be treated as the work place and the permanent establishment of the applicant. Does the fact that the sub-contractor is only a nominee of the applicant in carrying out the work which would have been otherwise performed by the applicant transform the sub-contractor's workshop into the PE of the applicant? In my view, the answer could only be in the negative unless the sub-contractor is treated as a dependent agent of the applicant as distinct from an independent agent. It is not possible to hold that the place of manufacture of the sub-contractor situated far away from the installation site should notionally be regarded as part of the applicant's permanent establishment. The language of the opening para of Article 5 itself furnishes a key to the correct understanding of the concept of PE. The fixed place of business referred to in para 1 of Article 5 is qualified by the words "through which the business of an enterprise is …..carried on". In the present case, the enterprise is the "applicant". On a plain reading of the opening para of Article 5 and the nature of relationship between the applicant and sub-contractor, it cannot be concluded that the business of the applicant is being carried on through the sub-contractor's workshop. The concept of PE conveys the idea that the enterprise's presence has to be "visible" through an establishment in the other country. The objective presence of the foreign enterprise in the other country

as reflected in a fixed place of business is the real criterion for determining the existence or otherwise of PE in that country. In this context, reference may be made to Mr. Arvid A. Skaar's book on Permanent Establishment, Chapter 9 (titled – "The tax-payer's physical presence: The place of business test").

10. In the case of *CIT vs Vishakhapatnam Port Turst* (Supra), the expression "Permanent Establishment" was construed in more or less similar manner. The learned judges observed that PE connotes "a virtual projection of the foreign enterprise into the soil of another country". In that case, Jagannatha Rao J. speaking for the Division Bench of the High Court, rejected the contention that the German Company to whom the contract was awarded by the Port Trust would fall under clause (bb) of Article II(1) of the Indo-German Treaty. Clause (bb) which is part of the definition of PE laid down that an enterprise of one of the territories shall be deemed to have a fixed place of business in the other territory if it carries on in that other territory a construction, installation or assembly project or the like ……..". The contention of the Revenue was that the German company carried out the work of construction, installation, etc. through its agent i.e. a Poona based company which was given a sub-contract for fabrication of certain items in India and that the German company must, therefore, be

deemed to have a PE through such agent in India. The contention was repelled thus:

> *"This submission is based on an assumption that the word "it" in cl.(bb) can be applied not only to the German company but also to its agent. It is based on a further assumption that the Poona company is an agent of the Germany company.*
>
> *In our view the Agreement has made special provision in cl. (dd) in respect of agents who satisfy certain conditions. When such a special provision is made in respect of agents in cl (dd), it is highly doubtful if the respective Governments of India and Germany intended that sub-cl.(bb) is to cover once again the case of an agent so as to render the conditions imposed in cl. (dd) otiose."*

It was then observed that the relationship between the contractor and his sub-contractor was similar to that between one principal and another. After referring to the fact that the contract contemplated the employment of a sub-contractor and the contract itself draws the distinction between local agents of the German company and the sub-contractor, it was pointed out that the dealings between the contractor (German) and the sub-contractor (Poona Company) were in the position of principal to principal and they were dealing with each other at arms-length. Further, it was pointed out that the German Company had no control nor could it

interfere with the performance of the sub-contractor by the Poona Company. Then it was concluded:

> *"We are of the opinion that the Poona company cannot, therefore, be treated as an "agent" of the German company, and, therefore, the "assembly" and "installation", in so far as the work relating to the steel-plate at Pimpri is concerned, cannot be attributed to the German company so as to attract the provisions of cl.(bb) of Art. II(1)(i)."*

10.1. The ratio of that decision substantially applies to the present case. We may point out that clause (dd) of Article II(1) of the Indo-German Treaty referred to in that case corresponds to para 5 of Article 5 of the Treaty as it exists today. The Revenue attempted to distinguish this decision on the ground that the erection and installation work was carried out by the employer (VPT) itself and that the contract was limited to the supply of equipment from Germany and to the deputation of expert engineer to supervise the installation. But, this distinction has no bearing on the principle laid down in that case, as seen from the passages cited above. While answering the third point, it was laid down that the work done by the Poona based company which was an independent sub-contractor of the German company cannot be attributed to the Germany

company so as to attract the provisions of clause (bb) of Article II(1)((i) of the Indo-German Treaty as it then stood.

11. In order to support the contention that the sub-contractor's work place can be treated as the PE of the applicant, the Commissioner has relied on paragraph 19 of the OECD Commentary on Article 5[4].

> *"If an enterprise (general contractor) which has taken the performance of a comprehensive project subcontracts parts of such a project to other enterprises (sub-contractors), the period spent by a sub-contractor working on the building site must be considered as being time spent by the general contractor on the building project. The sub-contractor himself has a PE at the site if his activities there last more than 12 months."*

11.1. The context in which the passage occurs is important. The said passage, as I understand it,covers a situation where a building site has been set up by the main contractor and the services of the sub-contractor are also deployed in aiding the execution of the building project. Apparently, it applies to a situation where there is conjoint effort of both the contractor and the sub-contractor at the building site. In such a case, the building site of the contractor and sub-contractor is inseparable. Here, the fact situation is entirely different. The entirety of work of fabrication and assembly is carried out by the sub-contractor at the workshop set up by him at a

[4] See Model Tax Convention Income and Capital (Condensed version), 2008 Publication

place for away from installation site and run by him independent of any control of the applicant. Such a place of business of sub-contractor cannot be regarded as the PE of applicant. In any case, the language of section 5(1) being clear and as the concept of PE does not take in the establishment of an independent contractor or agent, the contention of the Revenue must fail.

11.2. The fact that the applicant is not relieved of the liabilities and obligations under the contract by reason of sub-contract and the fact that the applicant has to furnish performance security to TPT does not have much of bearing on the aspect whether the sub-contractor's establishment shall be deemed to be the PE of the applicant.

11.3. On the existence of PE the Revenue has taken the extreme stand that the applicant's effective presence in India will date back to the point of time when it had to undertake technical studies by intermittent site inspection for the purpose of designing and acquiring necessary data and therefore the PE must be deemed to have come into existence even at that stage and moreover it is submitted that in order to supervise the fabrication work being done by the sub-contractor and to submit progress reports to TPT in terms of the agreement, the applicant's personnel will have to be present in India. It is pointed out that the applicant has not furnished the details of visits or stay of its personnel from Germany.

I do not think that such activities which have taken place at the preliminary stages or the work of overseeing the fabrication activity required regular and constant presence of the applicant's staff and for that purpose the applicant has to necessarily set up a fixed place of business. No doubt, the applicant has not furnished the details of visits. However, taking a realistic view and having regard to the ordinary course of events, it is difficult to infer that a fixed place of business existed throughout, with the applicant's personnel making use of the same with frequency and regularity. Occasional or brief visits by some of the employees of the applicant right from the beginning does not give rise to inference of the existence of PE. Taking an overall view, it appears the need for setting up the PE would arise sometime before the installation and commissioning operations begin. For instance, as per the terms of payments stipulated in the Tender document, the chain pendants for channel and fairway buoys, channel buoy lights solar panel and batteries are to be made available at the Contractor's yard for the purpose of claiming 6th and 7th installments and the 8th installment is payable on arrival of all channel and Fairway buoys with accessories at Sethu Samudram Ship Channel. It pre-supposes a yard being set up near the channel site. If at all, it is at that stage or perhaps from the stage of transportation of buoys etc. that the starting point of six month period would set in but not

earlier. Even then, going by the applicant's version which accords with probabilities, the duration of the applicant's activities at the site/yard as well as the supervisory activities at the stage of installation and commissioning would not exceed six months.

11.4 I am, therefore, of the view that on the facts as presented in the application and at the present juncture it is not possible to hold that the applicant has or will have a PE in India. Hence, its business profits arising from the periodical payments made by TPT as a consideration for the contract cannot be subjected to tax under the Income-tax Act, 1961 in view of Article 7.1 of DTAA between India and Germany.

12. However, I would like to make it clear that the ruling is based on the fact situation as it exists today and as presented by the applicant. It is open to the Department to take stock of the actual state of affairs from the stage of transportation of equipments upto the date of successful commissioning of project so as to cross-check whether the applicant's activities at the fixed site/place of operation would be within the prescribed time-limit of six months. But, it is made clear that the sub-contractor's workplace cannot be treated as the applicant's and the duration of fabrication and other work done by the sub-contractor cannot be attributed to the applicant.

13. A contention was raised in the comments that the services rendered for designing are taxable as fees for technical services under the Indo-German DTAA. Article 12.4 defines "FTS" as payments made in consideration for the "services of managerial, technical or consultancy nature including the provision of services by technical or other personnel". Designing as a prelude to fabrication and installation of buoys and other equipments does not amount to rendering services of technical nature within the meaning of that Article. That apart, Explanation (2) to clause (vii) of Section 9(1) of the Income-tax Act, 1961 militates against such contention because it exclude the consideration for any construction, assembling, mining or like project undertaken by the recipient. The component of technical or consultancy services incidental to the execution of project cannot be segregated and brought within the scope of FTS. This is apart from the question whether the designing activity undertaken outside India will be taxable in view of the decision of Supreme Court in *Ishikawajima*[5] case. I have no hesitation in rejecting this contention.

Ruling

14. The 1st question is answered in the negative. The applicant is not liable to be taxed under the I.T. Act, 1961, having regard to the factual position as presented and as exists today.

[5] 288 ITR 408

15. The 2nd question need not be answered.

Accordingly, the ruling is given and pronounced on this 11th day of September, 2009.

Sd/-
(P.V. Reddi)
Chairman

F.No. AAR/790/2008/ 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-II), New Delhi.

(Batsala Jha Yadav)

Addl. Commissioner of Income-tax, AAR.