

# Case Study

---

Rahul Garg

**Case Study**  
**Course of Discussion**

- Part 1 Transactions
- Part 2 Contract with ICO1
  - ✓ Nature of services
  - ✓ PE
  - ✓ Taxability of income
- Part 3 Contract with ICO2
  - ✓ Nature of services
  - ✓ PE
  - ✓ Taxability of income

**Part 1**  

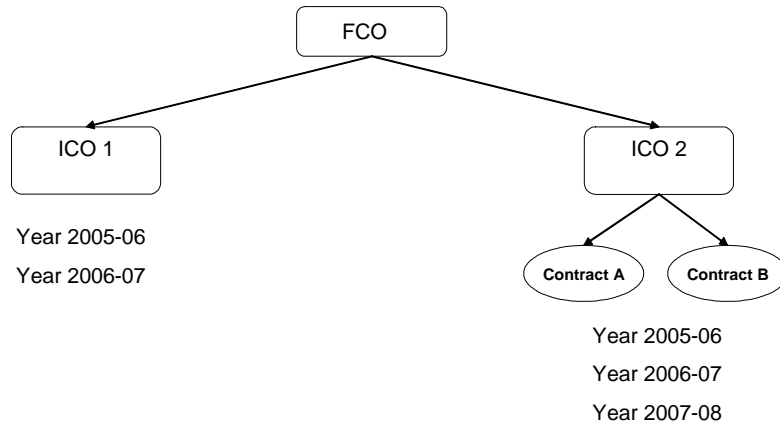
---

  
Transactions

**Transactions**

**Indian Transactions**

- FCO is a US tax resident. It has contracts with 2 unrelated Indian companies (ICO1 and ICO2) as described below :



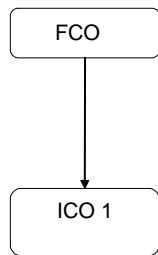
**Part 2**

---

Contract with ICO1

### Contract with ICO1 Transaction

- Contract with ICO1



Year 2005-06  
Year 2006-07  
Year 2007-08

- **Scope -**
  - Engineering – including transfer of engineering designs
  - Procurement
  - Project management
  - Construction advisory and commissioning advisory
- **Consideration -**
  - Agreement wise
- **Employees presence**
  - Year 2005-06 – 130 days
  - Year 2006-07 – 225 days

### Contract with ICO1 Facts

- Different agreements for engineering, procurement, project management etc with separate consideration
- Agreements related to various aspects of same project
- Project initially envisaged for 4 years.
- Project shelved in interim stage (within 2 years)– only engineering and part of procurement phase carried out
- Single invoice raised for work done – No bifurcation available

**Contract with ICO1**

**Issues**

**Nature of services**

- Engineering require transfer of designs – royalty income
- Agreement for procurement separate but invoices and consideration inseparable – is bifurcation possible to single out consideration for holding procurement related consideration as non-royalty ?

**Contract with ICO1**

**Issues**

**PE**

1. Service PE under treaty
  - PE if service rendered in India for more than 90 days in any 12 month period. Presence of FCO's employees for ICO1 contract during FY 05-06, 06-07 is significant
  - Project wise or aggregate ? – In absence of UN Model clause, to be seen project wise
  - Service PE provides exclusion for royalty income
  - Consideration is essentially in nature of royalty - Is no PE formed under Service PE clause?
2. Construction PE under treaty ?
  - Supervisory/ construction advisory services for the project envisaged, but no work relating to such construction and supervision carried out - Only engineering designs and some part of procurement carried out

### **Contract with ICO1**

#### **Issues**

##### **PE**

##### 2. Fixed PE under Art 5(1)

- Is fixed PE test of Art 5 met ?
  - Existence of a 'place of business' ?
  - Place of business is 'fixed' and has 'degree of permanence' ?
  - Right to use place is established ?
  - Performance of 'business activity' ?
- Can working from ICO1's office fulfill the 'right to use' test of the FCO's personnel ?

### **Contract with ICO1**

#### **Issues**

##### **Taxability of income**

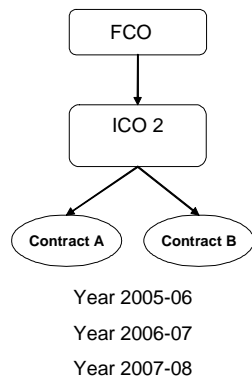
1. Entire unbifurcated income (with some procurement function income which is non-royalty ) to be treated as royalty income ?
2. If no PE under other clauses, can royalty income, excluded under Service PE clause be taxed on gross basis under the treaty?
3. If PE, as per Art 12(4), where the royalties are effectively connected with a PE, the provisions of Art7 are applicable
  - As per Art 7, only profits which is attributable to the PE be taxed as business profits in accordance with the Indian domestic tax laws ?
  - Is balance Royalty, not connected with the PE not chargeable to tax ??

### Part 3

#### Contract with ICO2

#### Contract with ICO2 Transaction

- Contract with ICO2



#### Contract A

- **Scope -**
  - Design and optimisation of new factory
    - Advise structural configuration of super structure
    - Advise suitable material for construction
- **Consideration -**
  - Lumpsum
- **Employees presence**
  - Year 2005-06 – 30 days

#### Contract B

- **Scope -**
  - Review of engineering designs prepared by another contractor for another factory
- **Consideration -**
  - Lumpsum
- **Employees presence**
  - Year 2006-07 – 90 days
  - Year 2007-08 – 20 days

### **Contract with ICO2**

#### **Facts**

- Different contracts entered with ICO2 at different time intervals
- Contracts obtained independently (projects in themselves) for different scope of work
- But, projects can be related to be part of the same larger mega-project
- Contract A
  - for design of a factory including structural configuration
  - Services performed from US with minimal Indian presence.
- Contract B
  - Review of engineering designs prepared by another contractor of another factory
  - Services performed from US and India

### **Contract with ICO2**

#### **Issues**

##### **Nature of services**

##### Contract A

- Engineering definition study - require design of a new factory involving transfer of designs – royalty income

##### Contract B

- Review of engineering designs prepared by another contractor for another factory – no right to use any patent, design, model, plan technical know, skill transferred – Not Royalty
- Can review and revision of existing design be said to create a new design that is transferred, and hence make income in nature of royalty ?

**Contract with ICO2**

**Issues**

**PE**

1. Can no. of days of Contract with ICO1 and ICO2 (Contracts A & B) be aggregated to constitute PE in Contracts A & B with ICO2 ?
2. Service PE for Contract B
  - Service (no royalty) rendered in India for more than 90 days in any 12 month period. Presence of FCO employees for Contract B during FY 06-07, 07-08 is significant
  - Can no. of days of Contract A & B be aggregated to constitute PE in Contract A as well (assuming fulfills 90 days in any 12 month period)?

**Contract with ICO2**

**Issues**

**Taxability of income**

1. If Contracts A and B be considered as same projects and PE for both in India, then
  - Taxability of royalty income (of Contract A) as attributed to the PE ? Taxability of balance royalty not attributable to PE?
  - Taxability of business profits (of Contract B) as attributed to the PE ? Taxability of balance business profits not attributable to PE ?
2. If Project A&B considered 2 separate projects, will services of Contract A & B considered same or similar to apply force of attraction clause ? Manner of taxability of Contract A, under Art 7 or 12 ? – Force of attraction may theoretically apply, as services may be considered similar, however, taxability of income from Contract A specifically covered by Art 12

**Contract with ICO2**

**Issues**

**Taxability of income**

3. Whether profits of Contracts A taxed as royalty on gross basis at treaty rate ?
4. From profits of Contract B having a PE in India,
  - Only business profits as attributed to the PE taxable ?
  - Balance business profits not attributable to PE not taxable?

PRICewaterhouseCOOPERS 

Your worlds



Our people\*