**REPORTED**

*** IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No. 703/2009**

DIRECTOR OF INCOME TAX, NEW DELHI ..... Appellant
Through: Mr. Sanjeev Sabharwal, Advocate

versus

LG CABLE LTD. ..... Respondent
Through: Mr. N. Venkatraman, Sr. Advocate with Mr. Satish Kumar, Advocate

% Date of Decision : December 24, 2010

**CORAM:**
**HON'BLE MR. JUSTICE A.K. SIKRI**
**HON'BLE MS. JUSTICE REVA KHETRAPAL**

1. Whether reporters of local papers may be allowed to see the judgment?
2. To be referred to the Reporter or not?
3. Whether judgment should be reported in Digest?

**: REVA KHETRAPAL, J.**

1. This is an appeal under Section 260-A of the Income-Tax Act, 1961 ('the Act') admitted on the following substantial questions of law:-

> (1) Whether the Income Tax Appellate Tribunal is justified in not holding that the contract in question is not a composite one and, therefore, the assessee is not liable to pay tax in India in respect of offshore service?
> (2) Whether the levy of interest under Section 234B for short deduction of TDS is mandatory and is leviable automatically?

2. Briefly the factual matrix giving rise to the present appeal is as follows. The respondent LG Cable Ltd. ("LGCL") is a company incorporated under the laws of South Korea having its registered office

at ASEM Tower (19-20F), 159 Samsung Dong, Gangnam-gu, Seol 135-090 Korea. LGCL was awarded two contracts on February 26, 2001 by the Power Grid Corporation of India Limited ("PGCIL"). The first was for onshore execution of the Fibre Optic Cabling System Package Project under the System Coordination and Control Project for the Eastern Region involving onshore services, including erection/installation, testing and communicating, etc. of the fibre of the cabling system. The second contract was for offshore supply of equipment and offshore services. During the financial year 2001-02, LGCL had set up a "project office" in India after obtaining requisite approval from the Reserve Bank of India. The services under the onshore contract were rendered by LGCL through its project office in India for which separate books of account were maintained by the assessee. The income attributable to the activities carried out in India in connection with onshore contract was offered to tax on a net income basis in the return of income filed by the assessee in terms of Articles 5 and 7 of the Double Taxation Avoidance Agreement ("DTAA") between India and Korea. As regards offshore supply contract, however, it was claimed by the assessee that this income was not liable to tax in India as the income wholly accrued or arose in Korea. It was also claimed that the entire contract was carried out in Korea and was subject to income-tax in Korea. The transfer of title along with the attendant risks had entirely passed on to PGCIL outside India.

3. Thus, the return filed by the assessee on October 31, 2002 showed a loss of ₹ 85,69,828/- for the assessment year 2002-03 and was only in respect of the onshore contract. The said return was processed under Section 143(1) of the Act and refund of tax deducted at source along with interest under Section 244A of the Act was granted. Subsequently, the return was taken up for assessment under Section 143(3) of the Act by the Deputy Director of Income Tax, Circle 1(1), International Taxation, New Delhi ('AO').

4. In the course of the assessment proceedings, the contention of the LGCL, as stated above, was that income from the offshore supply was not taxable in India. Several judicial precedents and circulars of the Central Board of Direct Taxes ('CBDT') in support of the said contention were cited. The AO, however, did not accept the claim of the assessee relating to offshore supply of equipment in the light of the decision of the Authority for Advance Ruling in the case of ***Ishikawajma-Harima Heavy Industries Co. Ltd., 271 ITR 193***, wherein it was held that such offshore supply of material resulting from engineering procurement and construction contract is taxable in India. The AO according held the income accruing to LGCL from the offshore supply contract with PGCIL to be taxable in India. The AO found that the total revenue from the offshore supply contract in the relevant year was US $ 73,25,665. Since the assessee did not produce the profitability statement for the offshore supply as the assessee was not maintaining

separate books of account for the same, the AO held that for deciding the profitability of the project, recourse could be taken to Section 44BBB of the Act, which examines the profits arising from contracts of more or less similar nature. Ten percent of the amount paid was deemed to be the gains of such business chargeable to tax. Hence, using this criterion, the AO held that it would reasonable to fix the profit element from the offshore supply contract at 10% of receipts, i.e., at US $ 7,32,567. The AO further held that since the bulk of activities, including manufacturing, were taking place outside India, it would be reasonable to attribute 30% of these profits to India. Hence, the income chargeable to tax in India was worked out at US $ 2,19,770, i.e., at ₹ 1,05,48,950/-. The above amount was added to the income of the assessee in the assessment order. The AO also levied interest under Section 234B and 234C of the Act.

5. The assessee impugned the above assessment in appeal before the CIT(A), reiterating its submission that the transfer of title in the equipment supplied by it had taken place in favour of PGCIL outside India and hence income of offshore supply equipment could not be said to accrue or arise in India. After comparing and contrasting both the agreements and in particular Article 6 thereof, the CIT(A) held as under:-

> *"4.1 From the combined reading of Article 6 of both the agreements, the following facts emerge:*
>
> *(1) Notwithstanding the award of work under two separate agreements, the contractor (the*

*appellant) has the overall responsibility for the execution of all the work right from the beginning till the end.*

*(2) Notwithstanding the award of work under two separate agreements, in case of default or breach under one contract the same shall automatically be deemed to be a default or breach under both the contracts. This means that if there is a default in any part of one contract by the appellant, both the contracts are liable to be cancelled.*

*(3) Notwithstanding the award of work under two separate agreements, it was agreed by the appellant that the equipment/material supplied by it to PGCIL under the first contract, when erected and commissioned by the appellant under the second contract shall give satisfactory performance in accordance with the provisions of the contract. This condition has been specified in Article 6 of the Onshore erection contract. This clearly shows that even in the Onshore erection contract it is the responsibility of the appellant that the materials/equipment supplied by it under the offshore equipment supply contract shall give satisfactory performance. The same responsibility has been cast on the appellant in Article 6 of the Offshore supply of equipment also.*

*(4) Notwithstanding the award of contract under two separate agreements, the contractor (appellant) shall achieve successful completion of the project under both contracts and successful taking over the project by PGCIL."*

6. The CIT(A) held that it was clear from the foregoing that the two contracts were not independent of each other as claimed by the assessee, that there was inter-relation and inter-dependence between the two agreements and that one could not exist without the other. Thus, the CIT(A) concluded that though there were two agreements, in fact, it was

a composite contract for supply of equipment as well as execution, erection and installation of equipment in India. He further observed that a colourable device had been adopted by the assessee to conceal its real tax liability. The supply of offshore equipment was inextricably linked with the operations to be carried in India. He, therefore, held that the decision of the Authority for Advance Ruling in the case of ***Ishikawajima-Harima Heavy Industries Co. Ltd. (supra)*** was applicable to the facts of the case. Applying Article 7 of the DTAA, the CIT(A) held that the income from the offshore sale of goods could be deemed to be accrued to assessee in India and was taxable in India in terms of Section 9(1)(i) of the Act. The computation of income of the assessee at ₹ 1,05,48,950/- made by the Assessing Officer as well as the levy of interest under Section 234B and 234C by the Assessing Officer was also upheld. Resultantly, the appeal filed by the assessee was dismissed.

7. Aggrieved by the aforesaid dismissal of its appeal, the assessee preferred a second appeal before the Appellate Tribunal. The Tribunal after a detailed consideration of the matter held that the income from the offshore contract taken at ₹ 1,05,48,950/- was not taxable in the hands of the assessee and directed the deletion thereof. The Tribunal further ruled that the assessee was not liable to pay any tax under Section 234B of the Act. It was now the turn of the Department to feel aggrieved and hence the present appeal under Section 260A of the Act has been filed

by the Department to challenge the order of the Tribunal dated 8th August, 2008.

8. The focal point of controversy between the parties is whether the income from the offshore contract between the parties would be taxable in India under the provisions of Section 9 of the Act, the relevant portion whereof reads as under:-

> **"Income deemed to accrue or arise in India.**
> **9.** (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 1*].—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."

9. It was submitted by Mr. Venkatraman, the learned counsel for the assessee that the supply of equipment in this case was made on principal to principal basis and, therefore, the income from supply of equipment was not taxable in India. In this regard, reliance was placed on the circular of CBDT Circular No.23 dated 23.07.2009. Reliance was also placed on the decisions of the Supreme Court rendered in ***Income tax Officer and Ors. vs. Sri Ram Bearings Ltd. and Ors., (1997) 224 ITR***

***724 (SC)*** and ***Mahabir Commercial Co. Ltd. vs. Commissioner of Income-Tax West Bengal, (1972) 86 ITR 417 (SC)*** to submit that income from the offshore supply of equipment was not covered under Section 5(2) of the Act.

10. At the outset Mr. Sajeev Sabharwal, the learned counsel for the Revenue contended that a plain reading of the two contracts would show that they were integrated contracts. Relying heavily upon Article 6 of both the contracts, the contention of Mr. Sabharwal was that any default or breach in one contract was not to relieve the respondent-assessee of its obligation under the other contract. Mr. Sabharwal emphasized that a reading of Clause 6 of both the agreements was by itself sufficient to bear out his contention that in terms thereof, the equipment/material supplied by the assessee in the first contract when erected and commissioned by the assessee under the second contract was required to give satisfactory performance in accordance with the terms of the agreements. Any default in supply or in erection would be taken as a default in the other agreement so that one agreement could not work without the other. It is expedient at this juncture to reproduce clause 6 of both the onshore and offshore agreements in juxtaposition with each other, which read as under: -

| **(2nd Contract)** | **(1st Contract)** |
|---|---|
| Offshore agreement C-42101-S858-1/CA-II/787 | Offshore agreement C-42101-S858-1/CA-II/778 |
| The Contract agreement No. C-42101-S858-1/CA-I/788 has also | The Contract Agreement No. C-42101-S858-1/CA-I/787 has also |

| | |
|---|---|
| been made on 26th February 2001, between the Employer and the Contractor for On-shore Erection Contract (hereinafter referred to as the 'Second Contract') for the subject package which includes performance of all activities within India, inter-alia port handling and custom clearance of supplies from abroad, inland transit insurance, handling and transportation to site, unloading at site, storage, preservation, insurance, erection/installation (including Survey, planning field engineering activities, tower analysis and strengthening as required), testing and commissioning and demonstration for acceptance (with the equipment and services being separately provided by POWERGRID AS LISTED IN SPECIFICATION, Vol.II, of the Bidding Documents including its subsequent amendments) at site of the complete Fiber Optics system including associated equipment/civil works etc. for complete execution of the Fibre Optic Cabling System Package under Eastern Region System Coordination & control project, training of employer's personnel within India and maintenance of the Fibre Optic Cabling System as per technical specifications. Notwithstanding the award of work under two separate contracts in the aforesaid manner, the contractor shall be overall responsible to ensure the execution of both the two contracts to achieve successful completion and taking over of the project by Power Grid as per the requirements stipulated in the contract. It is expressly understood | been made on 26th February 2001, between the Employer and the Contractor for Off-shore Contract (hereinafter referred to as the 'First Contract') for the subject package which includes all works to be performed in countries outside India covering, inter-alia, design, engineering, manufacture, testing and CIF supply of all offshore equipment & materials including mandatory spares and training of employer's personnel outside India etc. required for the complete execution of Fibre Optic Cabling System Package under Eastern Region System Coordination and Control Project. Notwithstanding the award of work under two separate contracts in the aforesaid manner, the contractor shall be overall responsible to ensure the execution of all the two contracts to achieve successful completion and taking over the project by the Power Grid as per the requirements stipulated in the contract. It is expressly understood and agreed by the contractor that any default or breach under the 'first contract' shall automatically be deemed as a default or breach of this 'second contract' also and vice-versa and any such default or breach or occurrence giving the employer a right to terminate the 'first contract', either in full or in part and/or recover damages under that contract, shall give the employer an absolute right to terminate this contract at the contractor's risk cost and responsibility, either in full or in part &/or recover damages under this 'second contract', as well. However, such default or breach or occurrence in |

| | |
|---|---|
| and agreed by the contractor that any default or breach under the 'second contract' shall automatically be deemed as a default or breach of this 'first contract' also and vice-versa and any such default or breach or occurrence giving the employer a right to terminate the 'second contract', either in full or in part and/or recover damages under that contract, shall give the employer an absolute right to terminate this contract, at the contractor's risks cost and responsibility, either in full or in part &/or recover damages under this 'first contract', as well. However, such default or breach or occurrence in the second contract shall not automatically relieve the contractor of any of its obligations under this 'first contract'. It is also expressly understood and agreed by the contractor that the equipment/materials supplied by the contractor under the 'first contract', when erected & commissioned by the contractor under this 'second contract' shall give satisfactory performance in accordance with provisions of the contract. | the first contract shall not automatically relieve the contractor of any of its obligations under this 'second contract'. It is also expressly understood and agreed by the contractor that the equipment/materials supplied by the contractor under the 'first contract', when erected & commissioned by the contractor under this 'second contract' shall give satisfactory performance in accordance with provisions of the contract. |

11. It was contended by the learned counsel for the Revenue that a reading of the terms of the offshore supply contract clearly showed that the property in equipment passed to the buyer only in India and that such property did not pass till the equipment was erected and yielded satisfactory performance in India. Thus, 10% of the amount paid for

offshore supply should be deemed to have accrued and chargeable to tax in India.

12. The contention of the learned senior counsel for the assessee, Mr. N. Venkataraman, on the other hand was that the sale transaction had taken place outside India since the property in goods/equipments was transferred outside India. The Bill of Lading in respect of the equipment sold was issued in Korea in favour of PGCIL, i.e., the buyer, and the notified party was also the PGCIL. The Bill of Entry clearly showed that the importer was PGCIL and the goods were directly transferred to the site of PGCIL and not to that of LGCL. In terms of the contract, the ownership of the equipment and materials supplied to the PGCIL was transferred to PGCIL in the country of origin, i.e., in Korea. PGCIL was also the co-insurer under the insurance policy pertaining to the equipment. It was further submitted that the property in goods got transferred to the buyer outside India in terms of clause 31.2 of the contract which clarifies that the assessee and the PGCIL intended to transfer the title in the property/goods as soon as the goods were loaded on to the ship at the port of shipment and the shipping documents were handed over to the nominated bank where the letter of credit was opened. There was no other term in the contract which was inconsistent with clause 31.2.

13. It was submitted that sequentially, with the completion of the sale, income accrued outside India. The accrual of such income was not

attributable to any operation carried out in India. As regards the Permanent Establishment (P.E.) of the assessee in India, it was submitted that there was no material on record to show that the said permanent establishment had any role to play in the offshore supply of equipment. In such a situation, Section 9(1)(i) of the Act had no application as income could not be said to have accrued or arisen in India unless the income was attributable to such permanent establishment. Mere existence of a permanent establishment could not constitute sufficient business connection to take the P.E. as a taxable entity more so, as the clause (a) of Explanation 1 to Section 9(1)(i) of the Act emphasizes that only such part of the income as is attributable to the operations carried out in India could be taxed in India. It was contended that there was a subtle but clear-cut distinction between the existence of 'business connection' and the income accruing or arising out of such business connection, which was required to be borne in mind as no activity relating to the offshore supply of goods was carried out in India, what to speak of income accuring or arising out of such business connection. Dealing with the contention of the learned counsel for the Revenue that one of the conditions imposed by the RBI while permitting the assessee to have a project office as per letter dated 11th April, 2001 was that the office expenses will be met in India only from the remittance received from the head office and that this showed a business connection of the

project office with the head office, it was stated that such a contention was altogether meaningless.

14. A look now at the relevant provisions of the offshore agreement entered into on 26th February, 2001, which have been reproduced by the Tribunal as under: -

> "10.4 …. In Article 1, there is description of contract documents. Article 2 provides for contract price and terms of payment. The assessee was to receive US$ 7,282,069 as CIF price component including testing and training charges. The amount also includes Indian agent's commission (IAC) @ 1.01%. Article 3 provides for effective date for determining time for completion of the Contract. Article 4 provides that this contract is between the assessee and Power Grid and not with Government of India. Article 5 refers to the list of Appendices, which shall form integral part of the agreement. Article 6 on which revenue has laid lot of emphasis specifically states that notwithstanding award of work under two separate contracts, the contractor shall be overall responsible to ensure the execution of both the two contracts to achieve successful completion and taking over of the project by POWERGRID. It further provides that "any default or breach under the 'Second Contract' shall automatically be deemed as a default or breach of this 'First contract' and also vice-versa.
>
> 10.5 Appendix 1 relating to "Terms and Procedures of Payment" is s under:-
>
> "1.0 Terms of Payment
>
> In addition to the Conditions stipulated under clause GCC Clause 12, the following terms and conditions will apply.
>
> 1.1 CIF Price Component (excluding Indian Agent's Commission (IAC) of the Contract Price for all the equipment and materials excluding 'Mandatory spares and Tools & Tackles for Off-line maintenance'.
>
> 1.1.1 Advance Payment

Ten percent (10%) of the CIF price component (excluding IAC) of the Contract Price for all the equipment and materials excluding 'Mandatory spares and Tools & Tackles for Off-line maintenance', amounting to US$ 637,302 (US Dollars Six Hundred Thirty Seven Thousand Three Hundred and Two only) shall be paid within 30 days of signing of Contract Agreement, Submission of claim, Advance Payment Security/Bank Guarantee for equivalent amount valid at least till 90 days after issuance of Operational Acceptance Certificate, and Performance Security of 10% of the Total Contract Price i.e. US$ 728,207 (US Dollars Seven Hundred Twenty Eight Thousand Two Hundred and Seven), with a validity upto 60 days beyond the Defect Liability Period for this Off-shore Contract and the Performance Security for the On-shore Erection Contract as mentioned in the Contract Agreement for the same. The Advance Payment Security and the Performance Securities for both the Contracts, to be furnished as per the Contract in the specified format, shall be kept valid initially at least upto 31.10.2003 and 30.9.2004, respectively, and shall be extended from time to time as may be required under the Contract.

1.1.2 Progressive Payment

Seventy Five per cent (75%) of the CIF price component (excluding IAC) for all the equipment and materials excluding 'Mandatory spares and Tools & Tackles for Off-line maintenance' shall be paid as follows:

i) Fifty five per cent (55%) of the CIF price component (excluding IAC) for all the equipment and materials excluding 'Mandatory spares and Tools & Tackles for Off-line maintenance' <u>shall be paid on pro-rata basis through</u>

irrevocable confirmed Letter of Credit established in favour of contractor and on shipment of equipment and submission of documents specified in Clause SCC 18.1.

ii) Twenty percent (20%) of the CIF price component (excluding IAC) for all the equipment and materials excluding 'Mandatory spares and Tools & Tackles for Off-line maintenance' shall be paid on pro-rata basis within 30 days of receipt of equipment at site and on submission of claim and physical verification by the Employer.

Note: Pro-rata shall refer to functionally complete part(s) of the facilities, for which unit rates are identified in the contract.

1.1.3 Final payment

The final fifteen percent (15%) of the CIF price component (excluding IAC) for all the equipment and materials excluding 'Mandatory spares and Tools & Tackles for Off-line maintenance' shall be paid within 30 days of Operational Acceptance (on successful completion of system availability tests) and proof of submission of the required no. of reproducible, O&M manuals, approved drawings, data sheets, test reports, pamphlets and manual of spares, maintenance & testing equipment etc. as per the Contract and as (sic? on) submission of claim by the Contractor.

1.2 CIF Price Component (excluding IAC) of 'Mandatory spares and Tools & Tackles for Off-line maintenance'

(a) Seventy Five per cent (75%) of the CIF price component (excluding IAC) of the 'Mandatory spares and Tools & Tackles for Off-line maintenance' shall be paid on pro-rata basis through irrevocable confirmed Letter of Credit established in favour of contractor on

shipment and submission of documents specified Clause SCC 18.1.

(b) Balance Twenty Five per cent (25%) of the CIF price component (excluding IAC) of the 'Mandatory spares and Tools & Tackles for Off-line maintenance' shall be paid on pro-rata basis within 30 days of receipt and shortage of material at site and on submission of claim by the Contractor and physical verification by the Employer.

Note: Pro-rata shall refer to functionally complete part(s)of the facilities, for which unit rates are identified in the Contract.

10.6 In para 1.6, there is provision for payment of interest on delayed payment. The said provision is as under:-

> "In the event that the Employer fails to make any payment on its respective due date, Employer shall pay to the Contractor interest on the amount of such delayed payment at the rate as applicable for 46 days from deposit scheme as established by London inter Bank Offered Rate (LIBOR) shall become payable as from the end of the 15 days period on certified amount due, but not paid, at the end of the such period."

Appendix 1 relates to "Payment Procedures":

"Method of Payment

2.1 Payments shall be made promptly by the Employer within thirty (30) days of submission of an invoice/claim and other requisite documents as per the Contract, by the Contractor. All the payment shall be released to the Contractor directly except the payment due on shipment, mentioned at 1.1.2(i) and 1.2(a) above, <u>which shall be paid through irrevocable confirmed Letter of Credit. Letter of Credit will be established approximately 30 days prior to confirmed date</u>

of shipment and shall remain valid for a period of 90 days.

2.2 The Contractor shall submit a request to the Employer at POWERGRID, Kolkata (ERULDC), for opening the Letter of Credit, at least 60 days in advance, accompanied with details for establishment of Letter of Credit along with supporting documents, if any. A copy of the same along with supporting documents (if any) shall, however, be submitted to the Employer at POWERGRID, New Delhi (International Finance Deptt. and T&CC Deptt.).

2.3 All invoices/claims for payment along with requisite documents as per the Contract, shall be submitted to the Employer at POWERGRID, Kolkata (ER-ULDC). The advance copy of documents in case of payment through Letter of Credit shall be sent to the Employer at POWERGRID, Kolkata (ER-ULDC) and copies of the same shall be sent to the Employer at POWERGRID, New Delhi (International Finance Deptt. & T&CC Deptt.). Invoice/claim for Advance Payment along with requisite documents shall, however, be submitted to the Employer at POWERGRID, New Delhi (Contract Services Deptt.)."

Appendix 3 provides for taking of insurance policy by the assessee including Cargo Insurance and Installation All Risks Insurance etc.

Appendix 4 provides for Time Schedule. Appendix 8 provides for Functional Guarantees by the assessee.

10.7 There are then general conditions of contract, which also include definition of words and expression used in the agreement. Para 31.1 relating to transfer of ownership is relevant and is as under:-

***"31.1 Ownership of the Plant and Equipment (including spare parts) to be imported into the country where the Site is located shall be transferred to the Employer***

***upon loading onto the mode of transport to be used to convey the Plant and Equipment from the country of origin to that country."***

15. In so far as the provisions of the second contract, *viz.*, "onshore erection contract" are concerned, the relevant terms thereof as reproduced by the Tribunal are as under: -

> "10.8 It would be appropriate to refer to the second onshore "erection contract". The job assigned under the contract is relevant and is as under:
>
> > "M/s. LG Cable Ltd., South Korea, a Company incorporated under the laws of South Korea and having its registered office at LG Twin Tower, 20, Yoido-dong, Youngdungpo-gu, Seoul 150-605, South Korea (hereinafter called "the Contractor" and also referred to as "LG").
> >
> > WHEREAS the Employer desires to engage the Contractor for performance of all activities within India, inter-alia, including port handling and custom clearance of supplies from abroad, inland transit insurance, handling and transportation to site, unloading at site, storage, preservation, insurance, erection/installation (including survey, planning, field engineering activities, tower analysis & strengthening as required), testing & commissioning and demonstration for acceptance (with the equipment and services being separately provided by POWERGRID as listed in Specifications, Vol-II of the Bidding Documents including its subsequent amendments) at site of the complete Fibre Optic system including associated equipment/civil works etc. for complete execution of the Fibre Optic Cabling System Package ("the Facilities") under Eastern Region System Coordination and Control Project, training of Employer's personnel within India and maintenance of the Fibre Optic Cabling System as per technical

specifications, and the Contractor has agreed to such engagement upon and subject to the terms and conditions hereinafter appearing."

10.9 The contract price and terms of payment are provided in Article 2 and is as follows:

"Article 2. Contract Price and Terms of Payment

2.1 Contract Price (Reference GCC Clause 11/SCC Clause 9)

The Employer hereby agreed to pay to the Contractor the Contract Price in consideration of the performance by the Contractor of its obligations hereunder. The Contract Price shall be aggregate of INR 59,982,160 (Indian Rupees Fifty Nine million Nine hundred Eighty Two thousand One hundred and Sixty only) and US$ 88,400 (US Dollars Eighty Eight thousand and Four hundred only), or such other sums as may be determined in accordance with the terms and conditions of the Contract. The break-up of the Contract price is as under:-

| | | |
|---|---|---|
| (i) Inland Transportation & Insurance charges | : INR | 3,734,944 |
| (ii) Erection, Testing & Commissioning Charges | : INR | 56,247,216 |
| (iii) Maintenance charges | : US$ | 76,046 |
| (iv) Training Charges | : US$ | 12,354 |
| Total (i to iv) | : INR | 59,982,160 |
| | + US$ | 88,400" |

Article 3 refers to effective date for determining time for completion Articles 4 to 6 of second contract are similar to the first contract. Thereafter in Appendix 1, para 1.1 relates to Terms of Payment of Services Portion and is as under:

"Inland Transportation & Insurance Charges and expatriate supervision & other local service charges i.e., Erection, Testing & Commissioning Charges shall be paid as follows:

(i) Eighty five percent (85%) of Inland Transportation and Insurance Charges shall be paid on pro-rata basis after

receipt of material at site, production of documentary evidence by the Contractor and on certification by the Employer.

Eighty five percent (85%) of expatriate supervision & other local service charges i.e., Erection, Testing and Commissioning charges shall be paid on pro-rata basis after installation at site and on certification by the Employer.

Note: Pro-rata shall refer to functionally complete part(s) of the facilities, for which unit rates are identified in the Contract.

[A condition precedent to release of above mentioned pro-rata payments shall be submission of Performance Security of 10% of the Total Contract Price i.e., INR 5,998,216 (Indian Rupees Five Million Nine Hundred Ninety Eight Thousand Two Hundred Sixteen only) plus US$ 8,840 (US Dollars Eight Thousand Eight Hundred and Forty only) for the 'On-shore Erection Contract'. Submission of Performance Security for 'On-shore Erection Contract' as per the details given at Clause 1.1.1 of Appendix 1 attached to 'Off-shore Contract' No.C-42101-S858-1/CA-I/787.]

(ii) Balance fifteen percent (15%) of the charges shall be paid within 30 days of Operational Acceptance along with the corresponding final payment for supply portion mentioned at clause 1.1.3 of Appendix-1 (Terms and Procedure of Payment) attached to the Contract Agreement ref. No.C-42101-/S858-1/CA-1/787 (for Off-Shore Contract) for Fibre Optic Cabling System Package under ERSC&C Project."

Para 1.4 is also relevant as it relates to Interest for Delayed Payment. It is similar to provision of interest of Agreement-1 quoted above.

In Appendix 3, there is provision for insurances to be taken by the contractor. It is provided as under:

> "In accordance with the provisions of GCC Clause 34 read in conjunction with SCC, the Contractor shall at its expense take out and maintain in effect, or cause to be taken out and maintained in effect, during the performance of Contract, the insurances set forth below in the sums and with the deductibles and other conditions specified. The identity of the insurers and the form of the policies shall be subject to the approval of the Employer, such approval not to be unreasonably withheld.
>
> (a) Cargo Insurance
>
> Covering loss or damage occurring, whilst in transit from the supplier's or manufacturer's works or stores until at the Site, to the Facilities (including spares parts and tools & tackles for off-line maintenance therefor) and to the Construction Equipment to be provided by the Contractor or its Subcontractors.

| **Amount** | **Deductible Limits** | **Parties Insured** | **From** | **To** |
|---|---|---|---|---|
| 110% of the CIF value | Mandatory Limit of Insurance Company, subject to maximum of 5% of Insurance amount. | Contractor and Employer | Warehouse | Warehouse +60 days |

> (b) Installation All Risks Insurance
>
> Covering physical loss or damage to the Facilities at the Site, occurring prior to Completion of the Facilities, with an extended maintenance coverage for the Contractor's liability in respect of any loss or damage occurring during the Defect Liability Period while the Contractor is on the Site for the

> purpose of performing its obligations during the Defect Liability Period."

16. Adverting to the sheet anchor of the case of the respondent-assessee that the supply of equipment was completed outside India and the property in the case got transferred to PGCIL outside India, and thus the profit, if any, on such supply of equipment accrued to the assessee outside India and therefore the same could not be taxed under Section 9(1)(i) of the Act, the following facts are noteworthy.

17. That the offshore supply of equipment related to the supply of specified goods discharged from Korea for which the PGCIL had opened an irrevocable letter of credit in the name of the respondent-assessee with a bank in South Korea. The consignor of the equipment supplied from Korea to Haldia Port was the respondent while the importer was the PGCIL. The equipment was delivered to the shipping company named in the Bill of Lading and the Bill of Lading and other documents were handed over to the nominated bank. Accordingly, with the delivery of the Bill of Lading to the bank, the property in the goods stood transferred to PGCIL. The cargo insurance policy was obtained by the respondent-assessee and it named the PGCIL as co-insurer. Clause 31.2 of the Contract unequivocally clarified that the respondent-assessee and the PGCIL intended to transfer the title/property in the goods as soon as the goods were loaded on to the ship at the port of shipment and the shipping documents were handed over to the nominated bank where the Letter of Credit was opened. The sale was complete and unequivocal.

There is no condition in the contract which empowers the respondent to keep control of the goods and/or to repossess the same. With the completion of this sale the income accrued outside India. There was neither any material to show that accrual of such income was attributable to any operations carried out in India nor any material to show that the permanent establishment of the respondent-assessee had any role to play in the offshore supply of the equipments.

18. Furthermore, as noticed above, the scope of work under the onshore contract was under a separate agreement and for separate consideration. There is, therefore, in our opinion no justification to mix the consideration for the offshore and onshore contracts. None of the stipulations of the onshore contract could conceivably postpone the transfer of property of the equipments supplied under the offshore contract, which, in accordance with the agreement, had been unconditionally appropriated at the time of delivery, at the port of shipment. When the equipment was transferred outside India, necessarily the taxable income also accrued outside India, and hence no portion of such income was taxable in India.

19. The contention of the learned counsel for the Revenue during the course of arguments that offshore supplies are not taxable only in the case of sale of goods simpliciter, and that the contract is a turnkey contract split/divided into offshore and onshore supplies at the instance of the respondent-assessee, in our considered opinion, is not sustainable

in view of the authoritative pronouncement of the Supreme Court in the case of ***Ishikawajma*** (supra) wherein it has been held that offshore supplies are not taxable even in the case of a turnkey contracts as long as the title passes outside the country and payments are made in foreign exchange. The Supreme Court in this regard observed as follows: -

> "The fact that it has been fashioned as a turnkey contract by itself may not be of much significance. The project is a turnkey project. The contract may also be a turnkey contract, but the same by itself would not mean that even for the purpose of taxability the entire contract must be considered to be an integrated one so as to make the appellant to pay tax in India. The taxable events in execution of a contract may arise at several stages in several years. The liability of the parties may also arise at several stages. Obligations under the contract are distinct ones. Supply obligation is distinct and separate from service obligation. Price for each of the component of the contract is separate. Similarly offshore supply and offshore services have separately been dealt with. Prices in each of the segment are also different."

20. It is also noteworthy that in the case of ***Ishikawajma*** (supra) the contract was entered into between the appellant which was a company incorporated in Japan, and which had formed a consortium along with **Ballast Nedam International BV, Itochu Corporation, Mitsui & Co. Ltd., Toyo Engineering Corporation and Toyo Engineering (India)**

**Ltd.** on the one hand and the Petronet LNG Limited on the other indisputably involving "(i) offshore supply, (ii) offshore services, (iii) onshore supply, (iv) onshore services and (v) construction and erection." The price was payable for offshore supply and offshore services in US Dollars (as in the instant case) whereas that of onshore supply as also onshore services and construction and erection was payable partly in Indian rupees. The liability to pay income tax in India by the appellant being doubtful, an application was filed before the Authority for Advance Rulings (Income Tax) in terms of Section 241 (Q)(1) of the Income Tax Act, 1961. The following questions pertaining to the offshore supply of equipments and materials were proposed by the appellant for determination, apart from the three other questions pertaining to offshore services: -

> "1. On the facts and circumstances of the case, whether the amounts, received/receivable by the applicant from Petronet LNG for offshore supply of equipments, materials, etc. **are liable to tax in India under the provisions of the Act and India-Japan tax treaty?**
>
> 2. If the answer to (1) is in the affirmative in view of Explanation (a) to section (1)(i) of the Act and/or Article (1) read together with the protocol of the Indian-Japan tax treaty, **to what extend are the amounts reasonably attributable to the operations carried out in India and accordingly taxable in India**?

21. Before the Authority, no issue was raised as regards the liability of the appellant to pay Income Tax on onshore supply and onshore services and on its activities relating to construction and erection. The Authority

after referring to a large number of decisions governing the field inter alia opined that in the case of a transaction of sale of goods simpliciter 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 accure or arise in India, if it accrues or arises through or from any business connection in India. Whether there is a business connection in India or/and whether all operations of business are not carried out in India are questions of fact which have to be determined on the facts of each case. The authority thus opined that the appellant was liable to pay tax in respect of offshore supply of equipments and materials under the provisions of the Act and the India-Japan Treaty.

22. At this stage, it may be relevant to note the provision in the said case since the same dealt with the passing of the title to the goods supplied in the following terms: -

> "Clause 22.1 deals with passing of title to the goods supplied in the following terms:
>
> 22.1 Title to Equipment and Materials and Contractor's Equipment Contractor agrees that title to all Equipment and Materials shall pass to Owner from the Supplier or Subcontractor 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 Owner's rights under any other provision of this Contract."

23. The interpretation of different components of contract was dealt within Annexure-A appended thereto. So far as 'offshore services work items' are concerned, the same had been defined to mean the items of work set forth as item numbers D-2.2.1, 2.2.2 and 2.2.3 of the Contract Price Schedule; details whereof have been mentioned in the said Annexure, which, inter alia, provided:

> "Notes
>
> General
>
> 1. xxx xxx xxx
>
> 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 the Contract.
>
> 3. Offshore Services (Exhibit D-2.2) is the price of design and engineering including detail engineering in relation to supplies, services and construction and erection and cost of any other services to be rendered from outside India.
>
> 4. Offshore Supply (Exhibit D-2.3) is the price of Equipment and Material supplied from within India for direct delivery at Site and permanent incorporation in the Works.
>
> 5. Onshore services (Exhibit D-2.4) is the price of design engineering, detail engineering, customs clearance, inland transportation, procurement services, supervision services, project management, testing and commissioning and any such service in relation to the Works rendered in India."

24. The break down of contract price was as under:

| Exhibit No./Sl. No. | Description of Scope | In Indian Rupees | In US Dollars | Name and address of Contracting entity |
|---|---|---|---|---|
| D-2.1 | Offshore Supply (Total of 2.1.1., 2.1.2 and 2.1.3) | Nil | 81,711,877 | IHI, BNI and TEIL |
| D-2.2 | Offshore Services (Total of 2.2.2 to 2.2.3) | Nil | 19,756,225 | IHI, BNI and TEIL |
| D-2.3 | Onshore Supply (Total of 2.3.1 to 2.3.3) | 1,869,978,658 | Nil | IHI, BNI and TEIL |
| D-2.4 | Onshore Services (Total of 2.4.1 to 2.4.3) | 1,774,353,282 | 12,780,467 | IHI, BNI and TEIL |
| D-2.5 | Construction and Erection (Total of 2.5.1 to 2.5.3) | 3,958,464,384 | 36,795,623 | IHI, BNI and TEIL |
| D-2.0 | Total (D-2.1 to D-2.5) (See Note 9) | 7,602,796,324 | 151,044,192 | |

25. Since it was not in dispute that the title in the equipments supplied was to stand transferred upon delivery thereof outside India on high-seas basis as provided for in Article 22(1), the Authority for Advance Rulings proceeded on the basis that supplies had taken place offshore. It, however, rendered its opinion on the premise that offshore supplies or offshore services were intimately connected with the turnkey project and

proceeding on that basis the Authority, as already stated, opined that the assessee company was liable to pay tax in India though the property in the goods which were subject matter of the offshore supply passed outside India, in view of the fact that it had a business connection in India. It further opined that if a contract envisaged a composite compensation for the various obligations to be performed and if certain operations are to be performed by or through a business connection then, profits would be deemed to have accrued in India. The petitioner had a permanent establishment in India within the meaning of the said term in paragraph 3 in Article 5 of the Double Taxation Avoidance Agreement entered into between the Governments of India and Japan.

26. Reversing the aforesaid finding of the Authority for Advance Rulings, the Supreme Court in respect of the offshore supply and equipments held as under: -

> "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) There exists a distinction between a business connection and a permanent establishment. As the permanent establishment cannot be said to be involved in the transaction, the aforementioned provision will have no application. The permanent establishment cannot be equated to a business connection, since the former is for the purpose of assessment of income of a non-resident under a Double Taxation Avoidance Agreement, and the latter is for the application of Section 9 of the Income Tax Act.

(6) Clause (a) of Explanation 1 to S. 9(1)(i) states that only such part of the income as is attributable to the operations carried out in India, are taxable in India.

(7) The existence of a permanent establishment would not constitute sufficient 'business connection' and the permanent establishment would be the taxable entity. The fiscal jurisdiction of a country would not extend to the taxing entire income attributable to the permanent establishment.

(8) There exists a difference between the existence of a business connection and the income accruing or arising out of such business connection.

(9) Paragraph 6 of the Protocol to the DTAA is not applicable, because, for the profits to be 'attributable directly or indirectly' the permanent establishment must be involved in the activity giving rise to the profits."

27. Applying the aforesaid law enunciated by the Supreme Court in the case of ***Ishikawajma*** **(supra)**, there can be no manner of doubt that the offshore supplies in the instant case are not chargeable to tax in India. The instant case, in fact, in our view stands on a better footing as two separate contracts have been entered into between the parties, albeit

on the same day, one for the offshore supply and the other for the onshore services, but even assuming that both these contracts need to be read together as a composite contract, the issue in controversy is nevertheless squarely covered by the decision of the Supreme Court in ***Ishikawajma*** (supra). It is beyond dispute that PGCIL had issued irrevocable letter of credit in favour of the respondent-assessee and in paragraph 31.2 agreed that the property in the goods will pass to the buyer (PGCIL) as and when the respondent-assessee loads the equipment onto the mode of transport for transportation from the country of origin. The stipulation in the second agreement (Erection Contract) relating to certain performances by the respondent-assessee including port handling, custom clearance, transportation, insurance, handling on site, unloading at transportation site, testing and commissioning to the satisfaction of the buyer are in a separate agreement for a separate consideration which is clearly enunciated in the second agreement as follows: -

> "Whereas the employer desires to engage the contractor for performance of all activities within India……………… subject to the terms and conditions hereinafter appearing."

28. As regards the payment for the performance of the activities within India, the contract price aggregating to INR 59982,160 plus US Dollars 88,400/- was specifically and separately fixed by Article (2) of the contract titled "Contract price in terms of payment". This

consideration was separate from the consideration for the supply of equipment and there appears to be no justification to intermingle the two. The consideration for the offshore supply of equipment, it is repeated at the risk of repetition, accrued when the goods were sold. The performance of duties as envisaged in the second contract, *viz.*, the Erection Contract, by no stretch of imagination can be conceived to postpone the transfer of property under paragraph 31.2 of the agreement, which property passed on to the buyer simultaneously with the "loading on to the mode of transport to be used to convey the plant and equipment from the country of origin to the country of import." Although the entire consideration was not paid on shipment of equipment, but non-payment of a part of the price could not prevent the transfer of equipment. The passing of the property to the purchaser, as rightly held by the Tribunal had, nothing to do with the payment of the entire price of the equipment to the seller. Even otherwise, a substantial amount in this case was paid to the seller outside India and the Tribunal observed that for the unpaid price the purchaser could have resorted to the provisions of Section 46 of the Sale of Goods Act, which read as under: -

> **"46. Unpaid seller's rights.** – (1) Subject to the provisions of this Act and of any law for the time being in force, notwithstanding that the property in the goods may have passed to the buyer, the unpaid seller of goods, as such has by implication of law-
>
> (a) A lien on the goods for the price while he is in possession of them;

(b) In case of the insolvency of the buyer a right of stopping the goods in transit after he has parted with the possession of them;
(c) A right of resale as limited by this Act.

(2) Where the property in goods has not passed to the buyer, the unpaid seller has, in addition to his other remedies, a right of withholding delivery similar to and co-extensive with his rights of lien and stoppage in transit where the property has passed to the buyer."

29. Thus, the mere fact that 15% of the payment was to be retained by the PGCIL to be paid 30 days after operational acceptance on erection and completion of the system cannot be construed to mean that the title in the goods did not pass to the buyer in the country of origin.

30. Then again, in our considered opinion, undue importance cannot be attached to the fact that the agreement imposed on the assessee-company the obligation to handover the equipment functionally completed. This obligation has been rightly construed by the Tribunal to be in the nature of a trade warranty and the Tribunal in this regard has rightly observed as follows: -

"14.1 But in the case in hand, there is no power either with the seller (the assessee) or with buyer (PGCIL) to repudiate the contract. Warranty is to give equipment after erection in the running condition. The normal trade warrantees could not be mixed up and taken as a right of repudiation or right of disposal of equipment with the buyer or with the seller. The property in equipment having been passed on handing over the equipment to the ship with the delivery of **documents to the bank under irrevocable letter of credit,** the terms referred to above could not affect the passing of the property. Thus when goods were transferred outside India, the taxable income accrued outside

> India. It being not attributable to any operation carried out in India, no portion of the same was taxable in India."

31. We may note also that the buyer's right to examine and repudiate the goods in law does not by itself indicate that the property in the goods had not passed, as is evident from the provisions of Section 59 of the Sale of Goods Act, which read as under: -

> **"59. Remedy for breach of warranty -** (1) Where there is a breach of warranty by the seller, or where the buyer elects or is compelled to treat any breach of a condition on the part of the seller as a breach of warranty, the buyer is not by reason only of such breach of warranty entitled to reject the goods; but he may-
>
> (a) Set up against the seller the breach of warranty in diminution or extinction of the price; or
>
> (b) Sue the seller for damages for breach of warranty.
>
> (2) The fact that a buyer has set up a breach of warranty in diminution or extinction of the price does not prevent him from suing for the same breach of warranty if he has suffered further damage."

32. The aforesaid position was accepted in the case of ***Kwei Tek Chao vs. British Traders and Shippers Ltd. 2 Q.B. 459 (Q.B)***which was duly approved by the Supreme Court in the case of ***Mahabir Commercial Co. Ltd.*** (supra) wherein it was held as under: -

> "……….Where in pursuance of the contract the seller delivers the goods to the buyer or to a carrier or other bailee whether named by the buyer or not for the purposes of transmission to the buyer and does not reserve the right of disposal he is deemed

to have unconditionally appropriated the goods to the contract. The buyer's assent to the passing of the property in the said circumstances is implied and that when the seller dispatches the goods and delivers them to the common carrier for purposes of transit to the buyer, the common carrier not only receives the goods as agent of the buyer but also assents to the appropriation made by the seller. Where however the intention is clearly indicated and the carrier assents it is immaterial by what document the consignment is effected. In cases where the seller bears the freight for the transmission of the goods free of cost to the buyer, the property in the goods passes to the buyer as soon as they are sent to the carrier, though there may be a provision that they are to be paid for by the buyer on behalf of the seller after the arrival of the goods. But where however the seller exercises a right of disposal or where he agrees to deliver the goods at their destination, the carrier is the seller's agent and the delivery is not a final appropriation. The intention of the parties is therefore one of the important elements in determining the situs where the property passes to the buyer in pursuance of the contract. The decided cases are of little help and are only illustrative of the principles which are applicable for determining when the goods are unconditionally appropriated to the contract. In the case of transactions of sale of goods between the buyer and seller living in two different countries, the contract may envisage, the seller sending the goods through a carrier and the payment being made either at that place or at the place where the buyer resides. In such a transaction the banks have come to play an important part and the bankers' commercial credit system facilitates merchants domiciled in different countries and assures payment to the seller on the one hand and delivery of the goods contracted for to the buyer on the other. This is done by means of what are known as letters of credit which under the terms of the contract the seller may insist on the buyer to provide for in a bank doing business in the place of the seller's domicile. …….”

33. In the case of ***Income Tax Officer vs. Shri Ram Bearings Ltd. (1997)224 ITR 724*** the Hon'ble Supreme Court held as under: -

> "The only controversy is with respect to the taxability of 165,000 US Dollars which is stipulated as the consideration for sale of trade secrets. The agreement specifically states that the said sale is effected in Japan. We are unable to see on what basis it can be said that any part of the said amount has been earned in India."

34. Heavy reliance was placed by the learned counsel for the Revenue on the decision of the Madras High Court in ***Ansaldo Energia SPA represented by its Authorised Signatory Mr. Lorenzo Pesenti v. The Income Tax Appellate Tribunal Chennai Bench (2009) 310 ITR 237 (Mad.).*** But in our view the said case is clearly distinguishable on facts. In the case of ***Ansaldo Energia SPA*** (supra) it was held by the Madras High Court that the Indian subsidiary of Ansaldo, i.e. ASPL, was a legal facade which was created for taxation purposes and was not actually engaged in executing onshore contracts. It is for this reason that the Madras High Court also noticed that the subsidiary company i.e. ASPL already existed in India prior to the award of the contract. In the instant case, there is no such allegation made by the Department and as a matter of fact also the respondent-assessee in the present case had established a Permanent Establishment in India after the award of the contract for the specific purpose of executing the onshore contract. Again in ***Ansaldo Energia SPA*** (supra), it is noteworthy that initially a single contract was awarded to ***Ansaldo Energia SPA*** and later on at the instance of

***Ansaldo,*** the contract was split into four separate contracts. In the instant case, right from the inception and as part of the documents, two separate contracts, i.e. a contract for offshore supplies and another contract for onshore services were executed between the PGCIL and the respondent-assessee. Yet again, in ***Ansaldo*** there was a specific allegation that the contract was 'loaded on' to the contract price for offshore contract whereas no such allegation has been made in the case of the respondent-assessee. It therefore stands on an altogether different footing. Finally in ***Ansaldo's*** case even after the goods were supplied from abroad, the manufacturing activities continued in India 'as a continuous and ongoing process' and there was a reference in the supply contract itself that the responsibility was with the assessee-company till the local parts and the portion of the machinery which was to be designed, fabricated, manufactured and sent from abroad were fused together. In the instant case, however, no activities under the supply contract were carried out in India and there was no such overlapping of responsibilities envisaged under the Supply Contract and the Erection Contract performed by the respondent through its head-office and permanent establishment. ***Ansaldo's*** case is thus clearly inapplicable to the fact situation in the present case and is therefore of no avail to the Revenue.

35. In the final analysis we have no hesitation in holding that viewed from any angle, the fact situation in the instant case is almost identical to

that in the case of ***Ishikawajma*** (supra) and the law as enunciated by the Supreme Court in the said case will squarely apply to the facts of the present case. If at all there is a difference, the facts in the present case stand on a better footing than in ***Ishikawajma*** (supra). In ***Ishikawajma*** (supra) there was a turnkey contract with four separate component activities, *viz.,* offshore supply, offshore services, onshore supply and onshore services awarded by Petronet LNG to a consortium of companies led by the Japanese company Ishikawajma-Harima. In the instant case there are two separate contracts i.e. offshore supply and the onshore services contract awarded by the PGCIL to the respondent-assessee. As in the said case the consideration for offshore contract and onshore contract are separate and distinct from each other, inasmuch as the consideration in the case of offshore supply contract was received outside India through the mechanism of a Letter of Credit in foreign exchange while the consideration for onshore contract was received, for the most in Indian rupees with a nominal amount in foreign currency, the latter being for training charges. The title to the equipment supplied from outside India was transferred in favour of PGCIL outside India. In the case of ***Ishikawajma*** (supra), it was transferred on the high seas but in the instant case, it was transferred in the country of origin itself as soon as the goods were loaded upon the mode of transfer to be used to convey the plant and machinery, i.e., the shipping vessel, even prior to the goods reaching the high seas. Once the title was transferred in the

aforesaid manner, there was no provision either in the agreement or in law providing a recourse to the respondents to take back the title.

36. With regard to the setting up of a permanent establishment also, the permanent establishment of the respondent in the instant case, as in the case of ***Ishikawajma*** (supra), had no role to play in the execution of the offshore supply contract and as a matter of fact was set up for the sole purpose of enabling the performance of the onshore services contract.

37. The contract, however, in the instant case as in the case of ***Ishikawajma*** (supra) would be said to have been successfully performed only after the satisfactory commissioning and erection of the plant and equipments. Since the permanent establishment was not at all involved in the transaction of the offshore supply of equipment, the existence of the permanent establishment (which as held in ***Ishikawajma*** (supra) is for the purpose of assessment of income of a non-resident under the Double Taxation Avoidance Agreement), would be irrelevant in the instant case. Clause (a) of Explanation (1) to Section 9 (i) would not be attracted at all which provides that in the case of a business where all 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. In the instant case there were no operation qua the agreement for supply of equipment, which was carried out in India, and

therefore, no income could be deemed to have accrued or arisen in India whether directly or indirectly or through any business connection in India.

38. In view of the aforesaid we answer the question no.1 in the affirmative in favour of the respondent-assessee and against the Revenue. In these circumstances, question no.2 does not arise for our consideration in the instant case. It may, however, be noted for academic interest alone that the question no.2 has been answered by this Court in ***ITA No. 491/2008 and other connected matters*** titled as ***Director of Income tax vs. M/s. Mitsubishi Corporation*** decided on 30th August, 2010.

39. Accordingly, the appeal stands disposed of.

**REVA KHETRAPAL**
**(JUDGE)**

**A.K. SIKRI**
**(JUDGE)**

**December 24, 2010**
***km/sk***