



## Consideration from offshore construction contract for installation of 'Single Point Mooring' is not taxable as royalty as well as FTS in India

### Background

Recently, the Delhi High Court in the case of Technip Singapore Pte. Ltd.<sup>1</sup> (the taxpayer) held that consideration received for the offshore construction contract for installation of Single Point Mooring (SPM)<sup>2</sup> including anchor chains, floating and subsea hoses to enable unloading of crude oil from the Very Large Crude Carriers (VLCCs) to meet the crude oil requirement of taxpayer's refineries located in the eastern part of India is not taxable as royalty as well as Fees for Technical Services (FTS) in India.

### Facts of the case

- The taxpayer is a leading solutions provider of offshore construction, engineering, project management, and support services to the oil and gas industry worldwide.
- The Indian Oil Corporation Ltd (IOCL) invited tenders for 'Residual Offshore Construction work' at the Paradip port. IOCL was setting up offshore crude oil receiving facility having SPM terminal about 20 km off the coast of Paradip port on the east coast of India. The said facility would enable unloading of crude oil from VLCCs to meet the crude oil requirement of its refineries located in the eastern part of India. The work involved installation of IOCL supplied SPM including anchor chains, floating and subsea hoses.

- The taxpayer signed a contract with IOCL for the above offshore construction work involving installation of IOCL supplied SPM including anchor chains, floating and subsea hoses.
- As per the contract, the contractor was to provide all marine spread, specialised manpower, and equipments, installation tools and tackles, consumables, labour, logistic supplies, planning, engineering, documentation, etc. to fulfil the project specifications upto the commissioning stage. The contractor was responsible for taking over all the owner supplied project materials from the place designated by the owner, required for installation of complete SPM system including their sub systems.
- Further, it is required to depute an installation engineer during the entire installation period of SPM system for assisting and advising the installation contractor in the installation of the SPM system.
- IOCL sent to the taxpayer a 'Letter of Acceptance' in which it *inter alia* set out the 'contract value and price schedule'. It was stated therein that the contract value would be USD18,598,140. The letter also indicated the amount in US dollar agreed to be paid for each item of work. Broadly the break up was (i) Mobilisation and demobilisation of marine spread (ii) Pre and post erection work (iii) Actual installation work (iv) Documentation, Misc.
- The taxpayer stated that it did not have any project office or any other premises in India for executing the work under the above contract. The taxpayer's obligations under the contract were fulfilled by deputing men and materials at the offshore site where the activity was performed.

<sup>1</sup> Technip Singapore Pte. Ltd. v. DIT (W.P (c) No. 7416/2012) (Delhi High Court) – Taxsutra.com

<sup>2</sup> A floating equipment/device that serves as a loading/offloading station and a mooring point for oil tankers for loading/ offloading crude and other petroleum products to/from the onshore refinery/process platform. SPMs are connected to an onshore refinery/process platform through a submarine pipeline. SPM systems are also called as CALM systems i.e. 'Catenary Anchor Leg Mooring system'

- The taxpayer filed an application before the Authority for Advance Ruling (AAR) for determination of certain questions regarding its tax liability in respect of the services rendered by it under the above contract.
- The AAR held that the payment made for use of equipment, i.e. the barges, and stated as mobilisation and demobilisation expenses which comprised a substantial part of the payment, fell within the definition of royalty under Article 12(3)(b) of the India-Singapore tax treaty (tax treaty).
- Further, installation was considered by AAR to be ancillary and subsidiary to the use of equipment or enjoyment of the right for such use. Consequently, the payment for the installation was held to be falling under the definition of FTS in terms of Article 12(4)(a) of the tax treaty.

### Taxpayer's contentions

- Under the contract, IOCL had no right to use or control over the movement or operation of any equipment, vessels, etc. belonging to the taxpayer. The equipment was being used only by the taxpayer for rendering services for the offshore construction work. The work involved installation of IOCL supplied SPM including anchor chains, floating and subsea hoses. Thus, IOCL had no control or dominion over the movement of the vessel or the equipment brought to the site and used by the petitioner for the purposes of rendering services under the contract.
- The contract made it clear that in the case of any damage or loss to the property, equipment, etc., supplied to IOCL while being installed or during the movement, the responsibility would be on the taxpayer alone.
- The very purpose of the mobilisation of the equipment was to install the IOCL supplied SPM. The primary purpose was the offshore construction work which was the work of installation of the IOCL supplied SPM which included anchor chains, floating and subsea hoses. Therefore, the AAR erred in concluding that the installation activity was ancillary and subsidiary to the use of the equipment.
- The conclusion arrived at by the AAR was without giving the taxpayer any opportunity of addressing the issue. The AAR proceeded to decide against the taxpayer on a point on which there was no dispute between the parties.
- The income earned by the taxpayer from the contract in question did not fall within the definition of the 'royalty' under Article 12 of the tax treaty.

### Tax department's contentions

- Although the AAR may not have given a finding as regard the taxpayer having Permanent Establishment (PE) in respect of the contract with IOCL, the taxpayer could not take advantage of that fact and claim that the AAR did not hold that the taxpayer has a PE in India in relation to the contract with IOCL.
- The consideration for mobilisation and demobilisation constituted 68 per cent of the total consideration, and the actual installation constituted 25 per cent. Therefore, a large percentage of the consideration related to supply/use of the equipment.
- It was not necessary that the equipment should be in the direct dominion and control of the IOCL for the payment to constitute the royalty. As long as the equipment can be exploited by or by the order of IOCL, the requirement of dominion/control would stand satisfied, and payment for the same would qualify as royalty.
- The tax department had placed reliance on the decision in the case of Ishikawajima-Harima Heavy Industries Ltd<sup>3</sup> and supported the decision of the AAR that the payment of mobilisation and de-mobilisation fell under the definition of royalty under Article 12 of the tax treaty and the payment for installation was FTS under the tax treaty.

### High Court's ruling

#### **Re-characterisation of contract**

- The tax department's attempt at re-characterising the contract as one for hire of equipment must fail. From the various clauses of the contract, it is evident that IOCL did not have dominion or control over the equipment. The clauses of the contract make it clear that at all times during the execution of the contract the control over the equipment brought by the taxpayer was to remain with the taxpayer.
- While the SPM system was supplied by IOCL, the task of installation, testing and pre-commissioning were the work of taxpayer. The system was to be capable of satisfactorily functioning as a complete terminal for the discharge of crude oil from vessels to the onshore tankfarm.
- It was the taxpayer which had to supply all marine spread specialized manpower and equipments, installation tools and tackles, consumables, labour, logistic supplies, planning, engineering, documentation, etc.

<sup>3</sup> Ishikawajima Harima Heavy Industries Ltd v. DIT [2007] 158 Taxman 259 (SC)

- The taxpayer was made responsible for taking over all the IOCL supplied project materials from the place designated by IOCL, which was required for installation of complete CALM SPM system including their sub systems. In the circumstances, the High Court observed that it was unable to appreciate how the AAR could conclude that the de facto control of the equipment was with IOCL.

### **Permanent Establishment**

- The AAR was not called upon to decide whether, in the context of the contract with IOCL, the taxpayer had any PE in India. That was not even the contention of the tax department before the AAR. The finding of the AAR that the taxpayer had a PE in India was rendered in the context of a contract that the taxpayer had with the L&T (different contract). Therefore, it is not open for the tax department to now contend that the taxpayer cannot take advantage of the absence of a finding by the AAR as regards the existence of a PE qua the contract with IOCL.
- The tax department was unable to counter the factual position that in terms of Article 5(1) of the tax treaty, the taxpayer has no fixed place of business in India. Under Article 5(3) of the tax treaty, the taxpayer can be said to have a PE in India only if the installation or construction activity is carried on in India for a period exceeding 183 days in any fiscal year. The taxpayer was present in India only for 41 days during FY2008-09 for the rendering of service to IOCL. The taxpayer also did not have a project office in India for executing the contract with IOCL.
- Since the tax department was not able to show that the taxpayer had a PE in India, the income earned by the taxpayer from the contract with IOCL cannot be brought to tax in India in terms of Article 7 of the tax treaty.

### **Mobilisation/demobilisation charges**

- There was no occasion for the AAR to examine the question as to whether the payment received for mobilisation/demobilisation could be treated as royalty under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act) read with Article 12 of the tax treaty.
- As far as the tax treaty in the present case is concerned, the income earned by the taxpayer would be treated as royalty only where it is received as consideration for the use of the equipment, i.e., industrial, commercial or scientific. It can also be for the use of or the

right to use any copyright or for information concerning industrial, commercial or scientific experience. It is clear from the contract itself that the control of the equipment throughout remained with the taxpayer and did not get transferred to IOCL.

- The Delhi High Court in the case of Asia Satellite Telecommunications Co.<sup>4</sup> Ltd has held that the concept of dominion or control is the sine qua non use.
- For the payment to be characterised as one for the use of the equipment, factually, the equipment must be used by IOCL. In the present case, there is no finding that the equipment had actually been used by IOCL. There is a difference between the use of the equipment by the taxpayer 'for' IOCL and the use of the equipment 'by' IOCL. Since the equipment was used for rendering services to IOCL, it could not be converted to a contract of hiring of equipment by IOCL.
- Therefore, the High Court observed that it was unable to concur with the finding of the AAR that in the instant case the consideration received by the taxpayer from IOCL for mobilisation/demobilisation should be considered as royalty.

### **Installation charges**

- In the light of the finding that the payment of mobilisation/demobilisation cannot be termed as royalty, the question of treating the work of installation as ancillary to such work and the payment for installation as FTS does not arise.
- In terms of the contract with IOCL, the taxpayer provides services of construction and installation of SPM. This does not involve any transfer of any technology, skill, experience or know-how, to enable IOCL to undertake such activities on its own.
- The tax department's contention that the work of mobilisation/de-mobilisation and the work of installation are separable components of the work as a whole is not borne out by the documents constituting the written contract. Therefore, the decision in the case of Ishikawajima-Harima Heavy Industries Ltd. is not of assistance to the tax department.

<sup>4</sup> Asia Satellite Telecommunications Co. Ltd. v. DIT [2011] 332 ITR 340 (Del)

- The taxpayer is right in contending that the services rendered by it to IOCL under the contract fell under the exclusionary portion of Explanation 2 to Section 9(1)(vii) of the Act i.e. consideration for any construction, assembly, mining or like project undertaken by the recipient. The tax department has been unable to deny by the same.
- Therefore, on two counts the findings of the AAR on FTS cannot be sustained. The installation services are not incidental to the mobilisation/demobilisation service. The contract was in fact for installation, erection of equipment. Mobilisation/demobilisation constituted an integral part of the contract.
- Further, the AAR has proceeded on a factual misconception that the dominion and control of the equipment were with IOCL. It was erroneously concluded that the payment for such mobilisation/demobilisation constituted a royalty. In that view of the matter, the consideration for installation cannot be characterised as FTS and brought within the ambit of Article 12 of the tax treaty. The resultant position is that no part of the income earned by the taxpayer from the contract with IOCL can be taxed in India.

### Our comments

Taxability of consideration for providing offshore construction services by utilising the equipment for mobilisation and demobilisation was an issue before the Delhi High Court. In various decisions, it has been held that mere use of equipment to provide services is not taxable as royalty. The recipient of services must have the right to use or control over the movement or operation of the equipment.

The Delhi High Court in the case of Asia Satellite Telecommunications Co. Ltd. has held that the payments made for using capacity in a transponder for uplinking/down linking data do not constitute 'royalty' under the provisions of the Act. The High Court had held that the customers did not make payments for the use of any process or equipment since control over the process or equipment was with the taxpayer and not with the customers.

The AAR, however, in the taxpayer's case had held that the payment for mobilisation and demobilisation is related to use of equipment for undertaking installation work and taxable as royalty under Article 12(3)(b) of the India-Singapore tax treaty. The Delhi High Court reversed the AAR's decision and held that IOCL (service recipient) did not have dominion or control over the equipment. The High Court observed that the clauses of the contract make it clear that at all times during the execution of the contract the control over the

equipment brought by the taxpayer was to remain with the taxpayer. It is held that there is a difference between the use of the equipment by the taxpayer 'for' IOCL and the use of the equipment 'by' IOCL. Since the equipment was used for rendering services to IOCL, it could not be converted to a contract of hiring of equipment by IOCL. Therefore, consideration received by the taxpayer from IOCL for mobilisation/demobilisation is held to be not constituting a royalty.

Consequently, the installation of SPM supplied by IOCL, which was considered as ancillary and subsidiary to the use of equipment, was also held to be not taxable as FTS.



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