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THE ROLE OF DOUBLE TAXATION AGREEMENTS IN THE CREATION OF PERMANENT ESTABLISHMENTS IN ENGINEERING PROCUREMENT CONSTRUCTION CONTRACTS AND LARGE CONTRACTS

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Abstract:
Tax treaties, which are often negotiated bilaterally at the political level, are crucial to the entire spectrum of developing and completing the projects that are necessary for infrastructure development, with more favourable treaties for them in terms of net cost benefit analysis, are chosen by contractors to work with carry a lower risk of getting subsequently challenged by the taxman. This paper examines the role of double taxation avoidance agreements (DTAA), in large Contracts and Engineering Procurement construction contracts, the various rulings, given by the judiciary. This is an exploratory study draws on secondary data as per rulings of judiciary, OECD reports, consulting firm reports, Judicial rulings have been considered as per past 10 yrs ,and key cases of PE arising due to DTAA clauses are dealt with. DTAAs play a crucial role in large projects, helps lower costs and benefits the economy due to lower unit service costs. The Role played by DTAAs in the process prior to coming together of the various members of an EPC contract for allocating share of contract , is crucial both to their effectiveness of project delivery and tax planning too. The paper proposes a Framework linking the various elements connecting the DTAA to the PE arising.

Keywords: DTAA, Tax planning, Tax avoidance , EPC contracts, Permanent establishment

1. Introduction

Tax treaties are agreements between two countries with the goal of minimizing or eliminating double taxation. They are often referred to as double tax agreements or treaties. These treaties' main goals are to divide up the taxing rights among the participating nations and protect citizens from double taxation by enabling them to claim specific credits, deductions, or exemptions. Let us take an example of a situation where a person lives in Country A but receives money from sources in Country B. In the absence of a tax treaty, both nations might be able to tax this person's income, leading to double taxation. To ensure that the individual is not taxed, twice, a tax treaty between the two nations will specify which nation has the primary authority to tax particular categories of income. For people and companies who operate in several jurisdictions, tax treaties are essential in avoiding double taxation. These bilateral agreements between nations specify methods as to what incomes are subject to taxes and how taxes should be imposed. Double Tax Avoidance Agreements (DTAA) treaties reduce the amount of taxes owed or identify exclusions to effectively end double taxation in certain situations. Therefore, it's critical that international investors and expatriates working in India are informed of any potential double-taxation agreements (DTAAs) between India and the native nations that affect them, as well as how these agreements are really implemented between India and their home countries.

The Role of DTAAs in the process of structuring of large contracts, with multiple participants, with different skill sets is an important component which cannot be wished away. Typically DTAAs are political instruments of cooperation between nations in their economic cooperation agreements are given a final shape by these instruments which will enable the entities to convince investors, banks and financial institutions, bring certainty to taxable outcomes, restrict the overreach of judiciary and enable capital flows into the country through subsidiaries, holding

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companies, Associate entities etc. These are clearly beneficial to the carrying on of the economic activities and reinforce the investor confidence of granting a preferential treatment in terms of duration of project, type of income -business income, capital gains, dividends, Foreign technical Services, Royalties, Foreign included services etc, by taking the project's income into a special domain for treatment in accordance with DTAA. The objective of a DTAA is to avoid double taxation, arising both in the source country and the country of execution of project, and lowers the cost of doing business helping infrastructure development and growth in the executing state. There is also a negative association as commonly found that the major participants in large contracts, EPC contracts typically look at jurisdictions that provide large and substantial tax breaks, and set up associates and subsidiaries to which the main contracting partner off loads a major portion of contracts to enable them to reduce tax outgo. While this approach is legally sound and accepted often it comes with a negative overtone for the developing countries who are forced to accept the terms as specified by developed countries while entering into DTAA, and consequently are required to share their legitimate taxing rights to developed countries. This has likely caused a sectoral divide along these lines and gets often discussed at forums and activated a movement against these practices in the form of BEPS actions, North-South differences on taxation rights etc. This paper attempts to discuss the key elements and role played by DTAAs in the large contracts, EPC contract domain.

2. Background to the Study

The aspect of arising of Permanent establishments in EPC contracts is critical for the simple reason that these are large contracts of significant economic interest to the executing nation for its effect on infrastructure development , and the EPC contractor for the risk it takes in implementing the project in a developing country. Typically these contracts involve two parts the offshore part and on site part , and the main contract gets decomposed or split into two parts , with participation of one or more vendors and contractors to execute the same .The contractors and sub-contractors are located in various jurisdiction which give rise to tax implications on revenue arising which cannot be easily predicted. Besides the rates applicable for different income streams vary based on the nature and type of income stream, as commonly classified and has implications as well. DTAAs are specially designed instruments, negotiated politically between countries and therefore go out of the ambit of local judiciary and taxman. Using effective routing mechanisms subsidiaries in favourable jurisdictions, the EPC contractors can bring down the effective tax rates considerably, as used in tax planning by MNCs.

3. Research Objectives/Hypothesis

The objectives for this study are: -

I. To understand the role played by DTAA between countries in the process of creation of a permanent establishment in contracts, its linkage to elements of tax planning and tax avoidance.

II. To understand the Judicial rulings in the context of DTAA- which India has with other countries in the context of PE arising in EPC contracts/large contracts.

III. To layout a framework on how the DTAAs can play a crucial role in both tax planning, tax avoidance and growth of economy of nations

4. Conceptual Model

The use of DTAA is a a potent tool for tax planning, tax avoidance, and fund movements across geographies in a effective and proper manner, particularly can be deployed in EPC contracts where different contractors various jurisdictions, participate.Since DTAAs are specific to a particular country, hence general domestic income tax law as applicable cannot be readily applied by the taxman for attempting to tax the income arising. Further there is variation in the rates of taxes as applicable for business income, Fees for included services, Fees for technical services, dividends, Capital gains, withholding taxes applicable etc, and using the DTAA route can be effectively exploited, to reduce the tax liability and effective rates of tax. In this context the paper examines the linkage between various elements in the same, and how the concept of PE is not generating revenue due to the specific clauses incorporated in the DTAAs is discussed by the help of certain judicial rulings, in the Indian context.

5. Research Methodology

The study is exploratory and the authors review the previous research in this area about DTAAs, their function in tax planning and avoidance, in the context of PE arising in contracts and the various causes contributing to these worldwide practices. In the context of digital taxes and BEPS, the exploratory study draws on secondary data from (2005-06 to 2023-24) Itatonline.org, rulings of the ITAT, High Court, Supreme Court, and AAR, studies from KPMG and E&Y, OECD reports, and working papers. The various court decisions, the structures that form in the context of EPC contracts, and the components that go into the reasons for the same, further provide light on the reasons why the court construes a PE as having existed or not. The authors provide a framework that incorporates the part that DTAA plays in the organisation and design of EPC contracts, as well as the connections between the various parties, their goals, and the reasons why they collaborate.

6. Literature Review

One of the most controversial subjects discussed in this article is the agency Permanent Establishment (PE) of Articles 5(5) and 5(6) of the Base Erosion and Profit Shifting (BEPS)-Project Action 7. The introduction of the PE notion, which indicates the limiting nature of source-state taxation rights, has been the subject of intense debate. Strong national interest in maintaining a high threshold coexists with the growing need to rebalance taxing rights as a result of globalisation and the expansion of modern business models. However, the necessity for a significant change still exists and is becoming more urgent as unilateral actions are taken. The attribution of profits, a topic overlooked by the BEPS Project, will certainly come into focus now that the agency PE is in the limelight, and this essay examines the shortcomings of the present attribution regulations and makes suggestions. (Eisenbeiss, J. (2016). For the Double Taxation Treaty's distributive provisions to be applied, especially to corporate earnings, a precise definition of the term "permanent establishment" is essential. The cases of Roche and Dell have generated a lot of discussion in Spain because the court's rulings led to a construction of the term "permanent establishment" that deviates significantly from the widely accepted conventional interpretation of the Commentaries of the Model Tax Convention of the Organisation for Economic Co-operation and Development. The goal of this expansive interpretation of the idea of permanent establishment is to prevent multinational corporations with significant business operations in Spain from evading taxes through the use of a fictitious company structure scheme. (Ferrer, F. A. V. (2016).

The rise of the digital economy has put into question the conventional notion of a permanent establishment as defined in Article 5 OECD MC, as it disapproves of business models that require a physical site in order to operate. Given the shortcomings of the principle, large multinational firms have abused their position to move their earnings, evading taxes in the States where the money is earned in accordance with their economic capacities. The concept of a permanent establishment as specified in OECD MC Art. 5, its typology following modifications made by the BEPS Project, and numerous circumstances that do not fall within this definition are examined. It also looks at whether its legal system is still relevant in the modern world or, conversely, if the idea of permanent establishment should be completely abandoned in light of the problems caused by the current OECD MC article 5, which is unable to handle the difficulties presented by the digital economy. (Hermosín Álvarez, M. (2021).

The study will specifically look at how the Organisation for Economic Co-Operation and Development's (OECD)2015 Action 7 -Final Report on Preventing the Artificial Avoidance of PE

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Status was incorporated into Articles 12–15 of the MLI and also assesses the MLI's Articles' potential effectiveness in light of Australia's and the UK's misgivings and their respective unilateral anti-Base Erosion and Profit Shifting (or "BEPS") actions, and examines both countries' unilateral strategies in an effort to demonstrate the necessity of multilateral solutions for achieving global coherence and reestablishing trust in the international tax system. (Ivanova, M. (2015). Current tax solutions based on an enterprise's physical presence in another country's territory have been established for traditional businesses that do not conduct their operations digitally, notably on the Internet. This is true for the taxation of a permanent establishment (PE). The purpose of the study is to discuss the applicability and effects of the new EU and OECD suggestions for taxing income from the digitalization of the economy in light of the requirements for permanent establishments. In particular, EU Directives and OECD Reports or Statements before and after the BEPS Project are analysed in the paper's analysis of legal sources and working materials. The tax effects of the proposed and existing legislation for the permanent establishment in the digital business have been compared and analysed. The OECD Inclusive Framework made the decision to shift its focus away from the issue of digitalization and towards globalisation, as well as away from taxing the greatest technological conglomerates and towards taxing the largest and most successful businesses. Compared to the conventional idea of PE, which called for a study of the physical presence, the PE concept under the 2021 compromise has been greatly simplified. (Jamroży, M., & Majdowski, F. (2022).

Another study examines whether certain criteria requirements are equally important for the designation of a permanent establishment and whether these requirements, particularly the territorial link, are still appropriate in light of recent economic changes, case law from various countries that has examined double tax treaties, and technological advancements. (Schaffner, J. (2013). The phrase "PE" basically refers to the circumstances in which a foreign company's presence in a nation is subject to taxation in host nation, is therefore heavily debated in both taxes' theory and practise. The paper demonstrates why the traditional definition of the concept is no longer relevant for the business model of a digital company, to analyse some alternative solutions, and to arrive, in the conclusion, the urgent need for an international consensus in defining the concept. (Šestáková, M. (2018). The goal of the study is to ascertain whether Indian courts recognise dependent agent and permanent establishment (PE) as the same taxable business, and what earnings therefrom are attributable to the PE of a non-resident enterprise in the event that the dependent agent is paid at an arms-length standard. The study analyses the decisions made by the Bombay High Court, and the Supreme Court in the cases of Morgan Stanley & Co. Inc., and Set Satellite cases. (Sharma, R. (2009).

The digital economy has expanded dramatically over the last 15 years, and it now makes up more than half of the global market capitalization. If commercial activity is digital, there is no longer a requirement for a physical location to produce revenues from the specific jurisdiction. To address substantial economic presence without a fixed location of operation, the international taxation rules that allocate taxes rights for business earnings to non-resident jurisdictions have not changed. As a result, the permanent establishment principle has been misused for tax planning purposes, which has caused profit to move from high-tax jurisdictions to low-tax jurisdictions and also resulted in an unfair distribution of rights between related jurisdictions, especially harming market jurisdictions. The challenges that are now being raised by the application of the permanent establishment principle to digital firms are analysed , and also considers potential consequences and remedies under new nexus laws while taking into consideration previous research and development trends. (Zingulis, A. (2020).Using information from OECD nations for the years 1982 to 1992, the paper investigates the effects of bilateral tax treaties on foreign direct investment. Contrary to popular belief, it discovers that recent treaty formation does not encourage fresh investment. As predicted by arguments that treaties are meant to stop tax evasion rather than encourage foreign investment, and it finds that treaty formation may actually decrease investment for some specifics. (Blonigen, B. A., & Davies, R. B. (2005). In light of Canada's bilateral tax agreements, domestic income tax, and the offshore

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natural resource development in Eastern Canada, this paper explores the implementation of the permanent establishment idea from a legal and economic standpoint. The author points out commercial benefits from using the idea and suggests that Canada should renegotiate its network of tax treaties to take Revenue Canada's assessment practises into account. (O'Keefe, W. J. W. (2000). The additional burden of at least two taxes on a comparable type of revenue, resource, financial transaction, etc. is known as double taxation. It refers to the taxation of a comparable income, resource, or exchange by at least two nations; for example, money paid by a citizen of one nation to a citizen of another. Tax agreements between nations usually reduce the double liability. Deals between two sovereign states are known as DTAAs. These are a communication protocol between two tax systems, each located in a different nation, with the goal of reducing the effects of double taxes. One of the obstacles to improving the financial ties between nations is still double taxation. Every nation seeks to tax the revenue generated inside its borders in accordance with at least one intersecting element. By means of DTAAs, all nations obligate other nations within their financial domain to promote global trade and investment with negligible hindrances. Nevertheless, the worldwide tax system needs to be updated often to address the problems and drawbacks of today. Furthermore, India must strengthen data sharing and management assistance provisions in its DTAAs in order to take advantage of the present global trend toward more notable openness and receptiveness. The ultimate ratification of DTAAs has only improved the fairness and equity of tax collection, and as ties between the nations deepen, this will only result in more advantageous tax arrangements. The Vodafone example is thoroughly discussed in the paper and is related to the subject at hand. (Achintya, K., & Vyas, K. (2022). It is necessary to weigh national and international interests while taxing producing components. The three primary goals of the country are revenue, allocative efficiency, and equitable taxation outcomes. The distribution of productive resources around the world are fundamentally impacted by tax systems since factor returns and underlying tax bases transcend national borders. There must be changes made to domestic taxation to reduce potential conflicts. The residence and source principles make up one set of rules related to direct taxation. The origin and destination principles make up another set of rules for indirect or consumption taxes, such as GST or VAT. Cross-border transactions are growing in number and complexity in the increasingly globalized world we live in. All countries seek to tax income generated within their boundaries according to one or more connecting factors, such as the income source's location (source principle), the residence of the taxable entity (residence principle), or the presence of a permanent establishment (PE) for profitable business operations within the country.

Countries sign tax treaties with treaty partners in order to reduce the multiple taxation of the same productive activity in several jurisdictions, and addresses tax treaty concerns. (Shome, P., & Shome, P. (2021). The study explains the concept of "Treaty Shopping" and how Indian government's addresses the same, in the context of misuse of treaty, by studying India DTTA with Mauritius, the actions initiated in form of issuing GAAR regulations, and examines relevant court rulings like Vodaphone case, Azadi Bachao Andolan case, and also highlights recent changes to the global tax system, in Indian context such as such as being signatory to MLI instruments and its implications on the Indo-Mauritius Tax Treaty. (Thukral, M. (2022

In today's globalized world, tax information exchange agreements are becoming increasingly important. They are essential to the fight against tax evasion, which is a major issue for developing nations like India that must address the issue of tax evasion and tax avoidance. The Tax Information Exchange Agreements (TIEAs) are a tool that the developed nations have put into place to counteract unfair tax practices and to foster international cooperation in tax matters through information exchange. By negotiating an increasing number of tax information sharing agreements, the problem of tax evasion by taxpayers—that is, moving their money to tax havens—can be mitigated to a larger extent in the nations affected. This study primarily attempts to assess the current advances in tax information exchange between India and other countries, keeping all the previously mentioned factors in mind. It concludes that tax information sharing agreements are important for addressing the issue of tax evasion and detrimental tax practices in India, and that a sensible strategy for negotiating these agreements with other tax havens and nations is needed. Nayaka, B. (2021). The goal of the study is to determine how to stop treaty shopping in India from abusing DTAAs. The researcher uses the doctrinal method after examining how India's DTAA compares to those of other nations, how the judiciary handles cases of DTAA misuse through treaty shopping, and how other nations have attempted to prevent DTAA misuse through treaty shopping. Researchers discovered that misuse of the DTAA by treaty shopping can be prevented in India by including a particular anti-treaty shopping article in the DTAA and by-passing domestic legislation. (Yadav, S., & Bhopal, K. (2018). Since the introduction of bilateral tax treaties, the BEPS initiative represents the most significant global development in the field of taxation. By use of legislative wording, the GAAR and the BEPS mandated Principal Purpose (PP) provision stipulate that tax authorities must consider taxpayer aims when determining whether or not there has been illegal tax evasion. Legislation is not necessary for the appropriate countermeasure of accounting for taxpayer objectives in tax avoidance. Tax laws would be interpreted broadly and purposefully so as to take into consideration the goals of the taxpayer. Legislative wording really tends to make things more complicated in this area. Ostensibly more objective elements are present in both the PP clause and the GAAR test, with the aim of offering precise standards for the implementation of anti-avoidance regulations. Nevertheless, in the end, the effects of the GAAR test and the PP clause are diminished by these so-called objective considerations. (Nuggehalli, N., & Nuggehalli, N. (2020). After adjusting for the consideration of treaty shopping, the implications of double tax treaties (DTTs) on foreign direct investment (FDI) are examined in this study. DTTs must be understood as a network rather than a bilateral issue since foreign direct investment (FDI) can travel through one or more conduit nations before arriving in the host country. It determines the shortest tax distance, the most affordable between any two nations by taking treaty shopping into consideration. This enables corporate income to be routed through intermediary jurisdictions. The study uses this data to distinguish between , tax treaties that provide investors with a financial advantage—and irrelevant DTTs. From there, it draws two significant conclusions. First, irrelevant DTTs have no effect on bilateral FDI; only neutral and pertinent tax treaties have this effect. It estimates that a relevant DTT contributed about 22% of the rise in FDI. Second, FDI will rise as a result of large tax savings brought about by treaty benefits. (Petkova, K., Stasio,et al (2020) .The primary factors that lead to double taxation are discussed in this paper, along with its various manifestations (economic and international legal double taxation), the necessity to end double taxation, and strategies for doing so. Practical examples have been used in the avoidance method presentation to compare the tax benefits for income beneficiaries between the exemption method and the credit method. However, the comparison of tax reductions between the methods of exemption and crediting has not been done. (Barbuta-Misu, N., & Tudor, F. (2010). Another research clarifies the potential for multinational corporations to engage in international tax planning through an innovative technique. Treating, the international corporate tax system as a network, the shortest paths are calculated by which the multinational corporations repatriate their profits, to minimize their tax obligations. The shortest paths are built using corporate income taxes, withholding taxes on profits, and the double taxation relief schemes. The network comprises 108 countries. Treaties against double taxation usually result in lower bilateral withholding taxes. Treaty shopping—the ability to route investments through a third nation in order to benefit from treaty provisions—is determined to have an average potential reduction in the total effective tax rate of more than 6%. Multinational corporations often only have to pay taxes totalling 6% after the corporate income tax in the nation of residence. Additionally, the network approach determines which nations are most likely to act as conduits. In three of the four network centrality metrics, the United Kingdom is ranked first. Less than five percent of the global flows are taxed on dividends in the conduit nations. Lastly, a mock tax haven raid is conducted. It is discovered that the effect on network centrality and tax reduction is negligible. The outcome shows how treaty shopping significantly reduces the impact of the remaining double tax rates. (Van't Riet, M., & Lejour, A. (2014)

7. Discussion

a) To understand the role played by DTAA between countries in the process of creation of a permanent establishment in contracts, its linkage to elements of tax planning and tax avoidance

In the context of DTAA between two countries clearly the objective is to reduce the risk of getting taxed in both countries, and get the most beneficial treatment possible, in the context of corporates liable to income taxes. While the role of domestic income tax laws in different countries is key to the taxability, what is more important from an operational perspective of investor's flow of funds and suitability of banking channels and structures is also key, and in addition the ability of the said country to get better deal negotiated with other nations. In this regard, it is found that factors as geographical, market access, access to banks and Financial institutions, political and economic stability, play a key role coupled with the DTAA the country has been able to get for its investors and corporate entities resident therein. The strategy appears to be aligned more towards economic power shifts, domestic markets of the larger partner etc . A case in point could be the number of DTAAs signed or re-negotiated by India , and China, which has risen substantially over the recent years indicating the key role played by the DTAAs in relation to entities in global economic growth, with a huge domestic demand and investor interests. Complications too arise in the way income streams generated in the process of economic activity, in forms of business income, Fees for Technical services, Fees for Included services, Royalty, capital gain, and dividends, are taxed. In addition withholding taxes(WHT) form a crucial component of negotiation among the entities and typically it is observed that capital flows favour nations with a lower WHT rate as that contributes to capital appreciation and increased funds at disposal of investors and banks. In the process, therefore corporate entities create Special purpose vehicles in various jurisdictions, after carefully evaluating the overall cash flows, tax benefits, accruing to the countries, net of taxes. Since these components are well defined in the tax treaties, it is important to take full cognizance of the same while drafting the final agreement structures with respective entities in specified countries. India ratified the Multilateral Convention (MLI) in 2019 with the intention of putting tax treaty-related safeguards in place to stop profit-shifting and base erosion. This eliminated the need for bilateral treaty discussions and made it possible to change a number of tax treaties based on the adoption of certain MLI positions. One such amendment was the Principal Purpose Test (PPT), which was introduced to stop treaty misuse. The bilateral negotiations for modifications to the tax treaty between Mauritius and India took place when the MLI requirements were not applicable. A benefit under DTAA will be denied in respect of any item of income , if it was found that the treaty was used primarily to arrange or structure a transaction , only with the objective of principle purpose being reduction of taxes, and that otherwise the transaction would not be based on commercially guided objectives. This is expected to be reducing or control the abuse of India – Mauritius treaty which has been addressed by the recent amendment in terms of 2024 protocol. These measures will effectively go to reduce the possible structures designed to do only treaty shopping and reduce tax liability without any commercial or genuine business purpose. The limitation of benefits clause (LOB) also applies a pause to the possible treaty shopping activities of corporates. The implementation of GAAR regulations (applicable from1st April 2017) is also a step in this direction, to avoid such abusive practices. However the threshold for invoking these provisions under the domestic tax laws are quite stringent, as it needs to be approved by a Panel based on recommendation of the Principal Commissioner of income tax. However it if falls within the safe-harbour limits, then the transaction will be outside the ambit of GAAR. Creation of rights and obligations, misuse or abuse of provisions of the IT act, lacks commercial substance and entered in a manner not ordinarily carried out for a genuine purpose, are the tests applied for invoking of GAAR.

b) **To understand the Indian Court Judicial rulings in the context of DTAA- which India has with other countries in the context of PE arising in EPC contracts/ large contracts**

The Judicial rulings in the context of DTAA between India and other countries, will throw further light and importance how the judiciary is interpreting the cases in light of the DTAA signed by India with various countries. A brief table for the same is given hereunder,

Some Tax cases involving DTAA

SLNo	Cases	Treaty applicabl	Article	Judicial Rulings by Court/ Tribunal
1	Audi AG Vs ADIT -ITA 7335/Mum/2012- tax sutra.com	India -Germany	5	With regard to the principal-to-principal car sales to its affiliated firm in India, German Co. lacks a PE or business link in that country.
2	Overseas transport company V DIT(ITA 3129/Mum/200	India-Mauritius	5	Since a Mauritius firm lacks an office, permanent infrastructure, supervisory personnel, and physical or intangible assets in India, it does not qualify as a fixed or agency PE in that country.
3	UOI Vs UAE Exchange centre(Civil appeal 9775/2011)	India -UAE	5	A UAE-based company's liaison office does not qualify as a PE in India.
4	Huawei technologies Co ltd V ADIT (ITA/1500/Del/2014	India -China	5(2)	A PE in India is an Indian subsidiary of a foreign business. In India, revenue derived from the supply, installation, and commissioning of telecom equipment is subject to taxation.
5	Technip France SAS (AAR No 1413/2012)	India -Fance	7(1)	While offshore services are taxable in India since they are closely linked to the establishment of a plant there, offshore equipment supplied under composite contracts is not.
6	IHI Corporation V ADIT (2015) 63 taxmann 100 Mum	India- France	7	Under the Indo-Japan Treaty, income from offshore services relating to EPCs is not taxable as company income or as fees for technical services.
7	Nippon Steel Engg Co Ltd V CIT (AAR 1203/2012)	India -Japan	7	Payment for equipment supplied from overseas is exempt from taxation in India under both the IT Act and the Indo-Japan Treaty.
8	DSD Noel GMBH V DCIT(ITA 3186/Del2016).taxsutra.co	India -Germany	7	Since the product was created and built outside of India, the income from offshore supplies is not taxed in India under FOB basis transfer.
9	Progress Rail Automotive Inc V DCIT (IT)	India -US	5(1), 5(2)	Delhi HC observed that ITD failed to prove that PRIPL secured order for assessee in India, habitually perfomed such activity, wholly and exclusively concerned with such activity, hence no dependnet agent pe formed, hence not taxable
10	Commissioner of Income tax international taxation 2 V	India -Finland	7	Delhi HC observed that Art 7 allows taxation of profits attributavle to PE in India, even if tax payer incurs loss on global operations, and Art 7 does not restrict source state's right to taxation of income. PE activities to be
11	CIT V Enron Oil and Gas Expat Services Inc 213 Taxman	India -US	7	Since there was no PE in India and no income was attributable to PE in India -not taxable
12	Ericsson Telephone Corporation V CIT 224 ITR (203) (A	India -Sweden	7	Swedsh company catering to Indian customers established PE in India.As payment made for technical services, governed Art 7 of tax treaty
13	ADIT International taxation V Dalma Energy 150 TTJ 70	India -UAE	7	Deduction for expenses incurred to be allowed for business including general expenses, as per S -44C
14	Hyatt International Southwest Asia Ltd V ADIT- ITA 216	India -UAE	7	Even if the global entity incurs financial losses, the PE should be treatedd as distinct and separate for taxation purpose and any profit generated by PE in India will be taxable.
15	Ericsson Telephone corp V ACIT 224 ITR 203 (AAR)	India- Swedish	7	Swedish company had entered into contracts with certain Indian customers ,and had established PE in India. Payments amounted to fees for technical services and hence got covered by Art 7, for taxability of fees.

As can be seen from the above judgements by the courts/ Tribunals , the courts have pertinently pointed out the relevant clauses in the DTAA between India and the assessee' s home country, with which DTAA has been concluded and interpretation is made with respect to the DTAA provisions only and not the Income tax Act provisions. These also indicate the extent to which corporates rely on DTAA, and plan their activities well in advance of concluding the agreements or offloading some part of their contracts to group entities, JV entities, associates, and subsidiaries (wholly owned/ partly owned) and third party-

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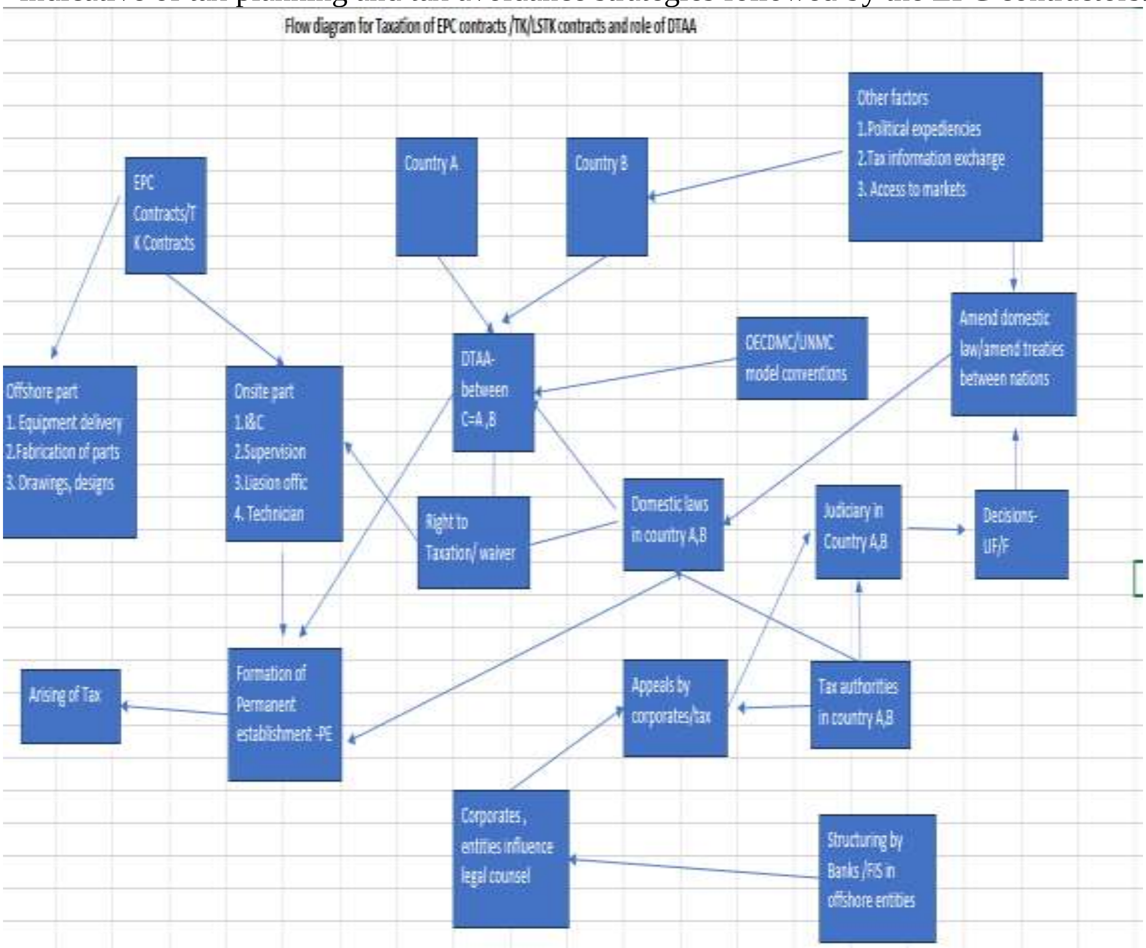
Independent contractors. Since in the majority of cases as above, it was held in rulings that there is no PE (permanent establishment) arising, consequently no part of income can be said to be taxable. Another key factor appears to be the linkages in the contract and whether the contracts are so constructed or inextricably woven together so that references to the offshore work is made in the onshore part (as is the case with Huawei technologies above), it indicates the intent on part of the entity to closely supervise the activities in India and hence the PE is said to have arisen even for the part of offshore services performed. Care should therefore be taken to see that these linkages are not acting to the detriment of the main contractor executing the EPC/ Turnkey contract, as otherwise there is a chance of PE arising. It is therefore best to involve an external counsel and structure agreements suitably in order to avoid such situation, and being challenged by tax authorities in assessments and taxability of income, leading to prolonged tax litigation.

c)To layout a linkage framework on how the DTAAs can play a crucial role in tax planning, tax avoidance and growth of economy of nations

In the context of how DTAAs can play a crucial role in tax planning, tax avoidance and growth of economic growth of nations and enhance cooperation , the authors construct a framework involving the various factors, detailed below- followed by the brief explanation , which enables an EPC contractor or large contract players executing contracts to structure and effectively reduce their tax rates both effective tax rates (ETR) and cash effective tax rates(CETR). The existence of lower ETR, CETR vis-à-vis the statutory tax rates are also indicative of tax planning and tax avoidance strategies followed by the EPC contractors.



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The EPC contracts, LSTK(Lump-sum Turkey), Turkey Contracts commonly comprise of two parts the offshore part and the onsite part . The offshore part involves activities like equipment delivery, fabrication of plant at off shore in the home country or the contractor, while the onsite activities, mainly relate to installation and commissioning, testing, supervision of project work at site and final handover to client. The DTAA between the two countries serve to reflect their common intention to cede their respective taxation rights, partially deviating from the domestic tax law provisions, and gets agreed at a political level. In case of any conflict between the domestic laws and the DTAA, the provisions of latter will overrule the domestic tax law provisions. These govern the type of income stream arising to the contractor in the process,whether as business income, Fee for technical services, Fees for Included Services, Royalty, Capital gain, dividends, withholding taxes applicable if any etc. By properly structuring the agreements, and identifying nations with which India has got better benefits under the treaty, and off loading part of contracts to entities set up in those nations, following a suitable structure the EPC contractors can, get the benefits of DTAA. In these cases the rates as specified in DTAA will be prevailing over tax rates as mentioned above. This gives confidence to the investors and becomes more binding on the tax authorities, reduces possible extra territorial interpretations of tax authorities, judicial overreach in both countries, and helps bring down the uncertainty in taxation of projects. Further the territorial nexus to the income arising has to be proved before any taxes can be levied and this part is facilitated by the network of large banks financial institutions resident in offshore jurisdictions, providing a flexibility to arrange funds to be routed in a conduit based approach. The aggrieved nation can only ask for re-negotiation of treaties. In recent times India has majorly re-negotiated treaties .with Mauritius, Singapore, Netherlands etc. Having the power to re-negotiate treaties helps the political executive to take a suitable pause and step in as and when needed.

Fig-2

Tax rates applicable as per India's DTAAs with select countries from where funds flow into India

		(Tax rates applicable %- on income sources)							
SL no	Recipient country	Dividend	Interest	Royalty	Technical services	Rank for FDI in 2024	Amt - USD-mill**	Relative % to total	Possible rationale
1	Germany	10	10	10	10	8	505	1%	Technology partners
2	Mauritius	15	7.5	15	10	1	7870	21%	Used as conduit for funds into India
3	UAE	10	5/12.5	10	NA	6	2924	8%	Mainly Indian expats, GCC entities
4	China	10	10	10	10	NA			Technology partners
5	France	10	10	10	10	NA			Technology partners
6	Sweden	10	10	10	10	NA			Technology partners
7	Finland	10	10	10	10	7			Technology partners
8	Luxembourg	10	10	10	10	NA			Funds routing locations
9	South Korea	15	10	10	10	NA			Technology partners
10	Netherlands	10	10	10	10	4	4924	13%	Mainly used as conduit to channel funds into US / from US
11	UK	15/10	10/15	10/15	10/15	NA	1216	3%	Technology partners
12	USA	15/25	10/15	10/15	10/15	3	4998	13%	Technology partners
13	Saudi Arabia	5	10	10	NA	NA			Investors
14	Singapore	10/15	10/15	10	10	1	11774	31%	Highly favourable business climate, quick decisions
15	Japan	10	10	10	10	5	3177	8%	Technology partners
	Total						37388	100%	

Notes ** As Per Statista.com website
https://www.statista.com/statistics/1020989/india-fdi-equity-inflows-investing-countries/

Source https://taxguru.in/income-tax/countrywise-withholding-tax-rates-chart-dtaa.html

In the above diagram fig-2, shows the rates of WHT, we observe that Singapore has contributed to greater FDI and thus seems to be more chosen as preferred conduit of funds nation, followed by Mauritius, Netherlands, USA. As can be seen the rates of WHT on different income streams are mostly kept at 10%, to avoid discrimination between trading partners, and since business income is usually taxed at a higher rate, bringing the income under a different head helps in reducing tax liability. Further duration of project that can be carried out without attracting a PE varies from country to country and this also affects the choice of countries where the sub-contracts are offloaded by the main contractor, to retain flexibility in time for project execution in addition to tax savings. There is also a clause for limitation of benefit (LOB) which prevents misuse of treaty and restricts

the treaty shopping structures. The other countries are basically providers of technology, and hence it becomes imperative for India to negotiate a better deal, by providing for lower taxation rates, to reduce cost of technology transfer. EPC contractors, if can structure the contracts to take advantage for fees for technical services, royalty etc, it can reduce the tax impact of income. Besides PE arising may also get reduced , as mainly business income arising will be subject to PE and not other streams. Thus effective tax rate can be well reduced by proper planning by the EPC corporates.
The various steps in structuring of an EPC contract can be listed as below:-

a) Identify scope of project, based on tender, RFP, and ascertain component packages.
b) List out the EPC sub-contractors who can be technically most competent for the specific package.
c) Check the DTAA between India the contractors' country, compare duration of contract period for the package to be executed, project dependencies, tax rates for withholding tax, any other special requirements.
d) Allocate packages among the sub-contractors and link the same to the overall contract delivery, specifications.
e) Identify investor preferences on funds flow route , and regions, keep in view the benefits arising in c) above .
f) Choose the optimal mix of investor funds – type, equity , debentures, CCPS, special debt instruments , keeping in mind possible restrictions in allowability of interest on debt.
g) Avoid related party transactions or allocations at the first level at allocations, use arms-length pricing to avoid charge of prices not being at independent arms length. In the second level sub-contract to entities , if in group – at market based prices.
h) Take external legal counsel assistance to structure the type of entity, jurisdiction of incorporation, and obtain board approval,
i) Start laying out the final plan for EPC project execution, and issue work-orders to downstream sub-contractors.
j) Set up a monitoring /steering committee for review periodically on project progress.
k) Ensure effective project management team with skills necessary to deliver project in specified timelines, as per executed contract with customer.

8. Conclusion

The Role of DTAA in the framework of EPC contracts, large contracts and the reliance placed on the same by the foreign investors, global financial institutions, is indeed a crucial fulcrum conducive to the growth and development of infrastructure projects in India. The judiciary, as can be seen from many rulings, have to a greater extent refrained from declaring the treaty benefit as not eligible, unless where the only purpose of contract is tax reduction and no useful commercially rational sense for designing contracts is found. The different articles playing the role for income streams in the form of Royalty, dividend, Fee for technical services, Fee for Included Services, Capital gains, withholding taxes applicable all play a key role in the setting up a entity structure in the respective contractor's country, and as such have to be carefully considered before any decision to offload a part of EPC contract, Large Contract is made. Further the aspect of transfer pricing plays a key role in the entire process, and therefore entities prefer to off load a major part to independent contractor – priced at an arms-length to avoid scrutiny. These independent contractors then sub-contract a part of their share of contract to associates of the main contractor, so that the direct nexus does not become a trigger point for transfer pricing related disputes. Depending on the situation, structure can be either a partly owned subsidiary, intermediate holding company, ultimate holding company, Associate entity. The structures generally are Private Ltd companies, LLPS, Partnerships (in certain jurisdictions only), Joint venture structures, etc due to the lower compliance costs and ease of handling transactions as compared to Public entities listed on stock exchanges , being subject to higher corporate governance standards and regulations .Some studies have found that the problem of finding the best route for tax treaty setup and negotiation adopted by MNCs, is similar to finding solution to the well-known transportation problems in Operations research though modified to some extent, after factoring limitations imposed in the treaty. The process of negotiating treaties between nations is a continuing one, and post the experiences gathered by them over time, the nations at a later date, re-negotiate the treaties with suitable safeguards to reduce the benefit accruing to the entities using the treaty shopping route. Similarly digital thresholds for services component, deemed level of services as percentage of total contract value, depending on type of industry, personnel deployed, comparable sizes for similar industry in other countries, globally, could also trigger regulations by authorities reducing the ability of corporates to go digital and avoid a PE , the future.

9. Implications and Future Scope of Study

The study has considerable implications of value for Corporates , Entities , Vendors operating in the EPC contracting industry, affecting their margins, and taxability at respective jurisdictions they execute projects on site. Effective split of contracts if planned properly help in both protecting margins, by keeping cash effective tax rates lower and enable to obtain decent returns for investors. From the point of view of Taxman, unnecessary litigation can be avoided, since DTAA is generally superseding the domestic laws, unless there are application of general anti avoidance rules or special anti-avoidance rules, limitation of benefits clause that get triggered. Besides it protects the foreign institutional investors, FDI, who invest in these projects in the hope of earning decent returns, encouraging fund flows into the nation. The future research can be directed at how in EPC contracts execution, countries collaborate and coordinate across jurisdictions, in such cases where contractors from different nations ,many jurisdictions involved (more than two), and would encourage more pro-business oriented initiatives without considering only the tax revenue accruing to a particular nation, and help aid in setting up infrastructure in developing nations. Also suitable guidelines by the Govt/ Taxman can reduce issues related to transfer pricing for services, and related provide a safe harbor for projects before getting into the lens of taxman. Funds, being channelized, through offshore SPVs reduces the interest costs significantly for borrowers on projects and helps reduce project costs and its associated elements. Countries like Singapore, Mauritius, Netherlands, France, Belgium, Denmark, Luxembourg, Hongkong etc are quite well known for in- bound funding routes for SPVs in India, looking to raise funds from abroad for projects.Presently there are no guidelines laid down and one has to go by the DTAA only. It is quite possible that a framework may emerge in the future to manage these situations effectively, and guidelines may get formulated.

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