2010-TIOL-195-ITAT-MUM

(Also see analysis of the Order)

IN THE INCOME TAX APPELLATE TRIBUNAL
BENCH 'L' MUMBAI

ITA No.1532/Mum/2005
Assessment Year : 2001-02

ASST DIRECTOR OF INCOME TAX
(INTERNATIONAL TAXATION)
CIRCLE-2(2), MUMBAI

Vs

VALENTINE MARITIME (MAURITIUS) LTD
C/o VINOD AGNANI, CHARTERED
ACCOUNTANTS, MONTREAL
B-31, SHATRINAGAR ANDHERI
(WEST), MUMBAI-400053

Pramod Kumar and P Madhavi Devi

Dated : April 5, 2010

Appellant Rep by: Smt Gunjan Mishra
Respondent Rep by: Shri Hiro Rai

Income tax - Sec 197, 44B, 44BB - Indo-Mauritius DTAA - Article 5, 7, 12 - Permanent Establishment - whether 'duration test' is to be applied to calculate the threshold limit for treating it as PE by aggregating the periods of various contracts carried out in India - Is it necessary for the various engineering and construction projects to form a coherent whole - geographically and commercially before it is treated as a PE for taxing business profits

Assessee is a tax resident of Mauritius - also issued a Mauritian tax residency certificate - engaged in the business of marine and general engineering and construction - During the relevant previous year, the assessee executes three contracts in India - for the first contract, the assessee declares its job was to replace the main deck with temporary deck, and its income is business profit which cannot be taxed in India as it has no PE - also claims the total duration of work was 100 days which was below the threhold limit of nine months as applicable for construction PE under the DTAA - For the second contract, the assessee declared that its work was for hook up or accommodation barge - initially it accepted the taxability of hire charges received u.s 44B - for the third contract, it declared that it was for charter hire of Barge for power project along with services of technical personnel - the contract was for seven and half months - claimed that this contract was for rendering technical services as such, and hire of

barge was only incidental thereto" and, therefore, "the consideration was in the nature of fees for technical services arising in the course of normal business activities" - further claimed that since it did not have any permanent establishment in India, the income earned under this contract, which could only have been taxed as business profits under Article 7, was not taxable in India.

The assessee submits that under Article 5(2)(i) of the India Mauritius tax treaty, a permanent establishment will include "a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine month" but, for the purpose of applying this threshold limit of PE duration, each of the contract is to be examined separately. It is pointed out that the word 'contract' is used in singular and not plural, and the reference is, for this reason also, clearly for individual contract. The assessee also refers to the OECD Commentary and literature on 'Permanent Establishment' in support of the legal contentions. None of these contracts is for duration of more than nine months, and for that reason, according to the assessee, the case of the revenue fails on duration test.

The AO takes the view that there is no good reason to assume that each of the contract is to be considered individually as this approach is "not based on sound logic". He referred to the Indo-UK DTAA where it is specified in the protocol that for the purposes of applying the duration threshold test, each of the project is to be considered separately. In the absence of any such provision or protocol clause in the India Mauritius tax treaty, all the contracts are to be considered together for the purposes of applying duration threshold test. On the basis of this reasoning, and having noted that "it is a fact that if all the projects are taken together, it exceeds more than nine months", the Assessing Officer concluded that the assessee had a PE in India, and, accordingly, its income from all the contracts will be taxable in India.

The CIT(A) takes the view that, for the purpose of determining the existence of permanent establishment, all the contracts were to be considered independently as these are not inter connected. It is also held that these amounts cannot be treated as royalty under Section 9(1)(vi), clause (iva) of Explanation 2 thereof, of the Act, as the amounts were paid for time charter of the barges. The CIT(A) also concludes that neither the income in question is taxable as business profits under Article 7 of the India Mauritius tax treaty, nor can it be taxed as 'royalties' under the Act.

On further appeal to the Tribunal, held that,

++ a PE refers to a fixed place of business through which business of the enterprise is wholly or partly carried on, and includes, *inter alia*, "a building site or construction or assembly project, or supervisory activities connected therewith, where such site, project or supervisory activity continue for a period of more than nine months.". In a way, the permanence test for existence of a PE stands substituted, to this limited extent, by a duration test for certain types of business activities, i.e. building construction, construction or assembly project, or supervisory activity connected therewith.

++ There is also a valid, and more holistic view of the matter, that this duration test does not really substitute permanence test but only limits the application of

general principle of permanence test inasmuch as unless the activities of the specified nature cross the threshold time limit of nine months, even if there exists a PE under the general rule of Article 5(1), it will be outside the ambit of definition of PE by the virtue of Article 5(2)(i). To that extent, the construction PE clause could also be viewed as an arbitrary degree of permanency that is required for any fixed place of business PE. Save and except for this additional yardstick for the degree of permanence, the normal PE definition would apply;

++ the business of the assessee is to give barge on hire and that activity cannot be, and is certainly not, carried out at the barge so hired out. When business of the enterprise is not even carried out at this fixed place, there cannot be any basis for holding a barge to be a permanent establishment of the enterprise;

++ even a plain reading of Article 5(2)(i) indicates that, for the purpose of computing the threshold time limit, what is to be taken into account is activities of a foreign enterprise on a particular site or a particular project, or supervisory activity connected therewith, and not on all the activities in a tax jurisdiction as whole. It is important to bear in mind the fact that the expressions used in the relevant definition clause are in singular, and there is no specific mention about aggregating the number of days spent on various sites, projects or activities.

++ the very conceptual foundation of this approach rests on the assumption that various business activities of the enterprise in different locations are not so inextricably interconnected that these are essentially required to be viewed as a coherent whole. The locations are thus separate places of business, and activities at different locations are, therefore, required to be viewed on standalone basis. In a typical building site, assembly or installation project, or supervisory activities in connection therewith, each of site or project is an independent unit, and the approach to these types of PEs recognize this normal business practice.

++ in certain treaties entered into by India, there is a specific departure from this rule as evident from the wordings used in definition clauses of corresponding PEs. For example, Article 5 (2)(k) of *India Australia tax treaty*, states that "The term 'permanent establishment' shall exclude especially .... a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than six months."

++ In the case of *India Thailand tax treaty*, the definition for this type of permanent establishment, which finds place in Article 5 (2)(h) of the said treaty, is worded as "a building site or construction or assembly project, or supervisory activities in connection therewith, where such site, project or activity continues for the same or a connected project for a period of periods aggregating to more than 183 days " There are two types of provisions in the construction PE clauses - one set of cases in which treaties provide for aggregation of time spent on various projects, and other set of cases in which treaties do not provide for such an aggregation of time spent on different projects.

++ Even such an aggregation, when applicable, would require exclusion of double counting of days when more than one site or project exists on a day, or when work is carried out at two or more different places on a day, as multiple counting of

common days would lead to an absurdity inasmuch as when work is carried on five sites together for one hundred days each, such a computation will lead to five hundred days in a year which is an impossibility. Therefore, when definition clause specifically provides for aggregation of time spent on various sites, projects or activities, the sum total of the time spent on such sites, projects or activities, except for parallel counting of days, is to be taken into account for applying the threshold time limit. However, when aggregation is not specifically provided for the in the relevant PE definition clause, as in the present case, normally it cannot be open to infer the application of aggregation principle;

++ There is unanimity in OECD and UN Model Convention Commentaries that the duration test "applies to each individual site or project". The OECD Commentary further recognizes that a building site should be regarded as a single unit, even if it is based on several contracts, provided it forms a coherent whole commercially and geographically, and that in a situation in which the very nature of construction or installation project may be such that the contractor's activity is to be relocated continuously or at least from time to time, the activities performed at each particular spot in a single project must be regarded as a single unit.

++ OECD Commentary refers to the situations, in the second category, in which aggregation principle is to be applied even in the absence of specific treaty provisions to that effect. The exercise of aggregation of time spent on various locations is only a logical consequence of those various locations being viewed as one place of business. So far as geographical coherence is concerned, what is to be really seen is whether different places of activities, of an enterprise in the other contracting state, are one place of business or different places of business. If one comes to the conclusion that these are different places of business, matter ends there. However, if these places are seen as one place of business, the next thing to be ascertained - commercial coherence, is whether the work done at these sites constitutes one business venture, consisting of one or more contracts, or different business ventures altogether;

++ the only other situation in which aggregation of time spent of various activities is to be done is when the activities are so inextricably interconnected or interdependent that these are essentially required to be viewed as a coherent whole. The test of 'commercial and geographical coherence' thus does find a mention in the OECD Commentary but interestingly, this test refers to such a degree of coherence that the different units, taken together, form a 'coherent whole - geographically and commercially". That is almost the same thing as different units being viewed as one place of business. That cannot be equated with mere commercial and geographical coherence simplicitor in the normal course of business situations;

++ the justification for aggregation of time spent by the assessee on different project sites, for applying threshold of duration test, is not sustainable. Neither the work having been carried out for the same principal is sufficient to justify the aggregation of time spent on all the projects, nor the fact that this work was carried out in the same area, which is a huge geographical area anyway, is sufficient to invoke that exercise. Even if these projects are commercially coherent in the sense that these projects are for the same organization directly or through a sub contractor, and geographically coherent in the sense that these are on nearby

locations, these two factors would not necessarily mean that these projects are to be necessarily seen as a coherent whole - geographically and commercially.

++ the true test is in interconnection and independence - in addition to geographical proximity and commercial nexus. There is no finding, nor even a suggestion, by any of the authorities below to the effect that the three contracts are inextricably interconnected, interdependent or can only be seen only as a coherent whole in conjunction with each other;

++ As a matter of fact, all the three contracts are for three different purposes - for charter of accommodation barge, for use of barge in domestic area and for replacement of decks. None of these contracts are such that these can be viewed as interconnected or interdependent.

++ the CIT(A) was quite justified in holding that the duration of these projects cannot be aggregated for the purposes of ascertaining whether or not the permanent establishment of the assessee can be said to have existed in India. It is an admitted position that unless the time spent on these different contracts is aggregated, the threshold limit of nine months, as laid down in Article 5(2)(i), cannot be satisfied. In view of these discussions, and bearing in mind entirety of the case, it was held that the CIT(A) was quite justified in holding that the assessee did not have a permanent establishment in India.

++ the assessee did not have a permanent establishment in India, and accordingly its business profits cannot be brought to tax. So far as the hire for barges is concerned, the taxability under section 44BB is upheld and confirmed. As regards levy of interest under sections 234 B and C, it is accepted fact that the issue is now covered in favour of the assessee by a large number of decisions of the Tribunal, including Special Bench decision in the case of *Motorola Inc Vs DCIT* (2005-TIOL-103-ITAT-DEL-SB) which has since been approved by the jurisdictional High Court in the case of *DIT Vs NGC Network LLC* 2009-TIOL-43-HC-MUM-IT.

Revenue's appeal partly allowed.

Cases followed

Poompuhar Shipping Corporation Limited Vs ITO *(2007-TIOL-109-ITAT-MAD)*

ORDER

Per : Pramod Kumar:

1. This is an appeal filed by the Assessing Officer, and is directed against the order dated 26th November 2004 passed by the Commissioner (Appeals) in the matter of assessment under section 143 (3) of the Income Tax Act, 1961 (hereinafter referred to as 'the Act'), for the assessment year 2001-02. The grievances raised in the memorandum of appeal, which are by way of questions requiring our adjudication, are as follows:-

1. Whether, on the facts and in the circumstances of the case and in law, the CIT(A) was right in holding that the assessee company did not have a permanent establishment in

India, during the accounting period relevant to the assessment year 2001-02, in respect of three projects executed by the assessee in India ?

2. Whether, on the facts and in the circumstances of the case and in law, the CIT(A) was right in holding that the application of provisions of Section 44BB will and 44BBB will not arise in this case ?

3. Whether, on the facts and in the circumstances of the case and in law, the CIT(A) was right in holding that the payments to the assessee for project C99/05 and C99/06 cannot be considered as royalty as envisaged in clause (iva) of Explanation 2 to Section 9(1)(vi) of the Income Tax Act, 1961, and also under Article 12 of the Indo- Mauritius DTAA.

4. Whether, on the facts and in the circumstances of the case and in law, the CIT(A) was right in holding that the question of levy of interest under section 234 B and 234 C will not arise in this case.

2. The assessee before us is a company incorporated in, and tax resident of, Mauritius. The assessee was also issued a Mauritian tax residency certificate. It was in this backdrop that the assessee claimed the application of treaty benefits under the *India Mauritius Double Taxation Convention (1984) 146 ITR (Statutes) 214*, which have not been disputed by the revenue authorities. The assessee is engaged in the business of marine and general engineering and construction. During the relevant previous year, the assessee had executed following contracts in India:

Contracting Party	Contract Number	Nature of activities	Contract revenues
Arcadia Shipping Ltd	C 99/07	Replacement of B121 main Deck with temporary deck	US $ 550,000
Arcadia Shipping Ltd	C 99/05	Charter of hook up/ accommodation Barge for BHN revamp project	US $ 1,817,377
Kier International	C 99/06	Charter of barge JU 253 for PPN power project	US $ 1,436,777

3. In the course of the assessment proceedings, it was submitted by the assessee that, as far as contract # C 99/07 with Arcadia Shipping was concerned, it was for replacement of B 121 main deck with temporary deck, and income from this activity was in the nature of business profits which could only be taxed under Article 7 of the India Mauritius tax treaty. The assessee also submitted that the said taxability could only arise in the event of assessee having a permanent establishment (PE) in India, and since the assessee did not have any PE in India, the income from this contract was not taxable in India. It was also pointed out that the total duration of work under this contract in India was only one hundred days which was less than threshold limit of nine months, as applicable for construction PE, under the India Mauritius tax treaty. As regards the contract # C 99/05 with Arcadia Shipping Limited, it was submitted by the assessee that the said contract was for hook up/ accommodation barge in connection with BHN revamp project. The assessee also pointed out that the assessee was issued a withholding tax order, under section 197 of

the Act, permitting tax withholding @ 3.6% on gross basis by considering the hire charges as income covered under section 44B of the Act. Based on the said order under section 197, the assessee accepted taxability @ 7.5% on gross basis, under section 44 B of the Act, on the payments received during the relevant financial year. Finally, as regards the contract # C 99/06 with Kier International, it was submitted that the said contract was for charter hire of Barge JU 253 in connection with PNP power project, along with services of technical personnel. This contract, according to the assessee, was executed for a duration of seven and a half months i.e. from 27th February 2000 to 12th October 2000. The assessee's contention was that "a barge, along with technical personnel was provided by the assessee", that "this contract was for rendering technical services as such, and hire of barge was only incidental thereto" and, therefore, "the consideration was in the nature of fees for technical services arising in the course of normal business activities". Once again, the assessee's claim was that since the assessee did not have any permanent establishment in India, the income earned under this contract, which could only have been taxed as business profits under Article 7, was not taxable in India. When these submissions were put to scrutiny, and the Assessing Officer required the assessee to give clarifications in connection with the same, the assessee revised his claim and contended that even revenues earned under contract # C 99/05 with Arcadia Shipping Ltd were offered to tax on the mistaken assumption that tax withholding certificate issued under section 197 would govern they are not taxable in India. It was also contended that the settled legal position is that if a claim has not been made in the income tax return, or if an income is offered under the wrong basis, the same can be corrected at assessment, and even appellate, stage. The assessee then submitted that under Article 5(2)(i) of the India Mauritius tax treaty, a permanent establishment will include "a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine month" but, for the purpose of applying this threshold limit of PE duration, each of the contract was to be examined separately. It was pointed out that the word 'contract' is used in singular and not plural, and the reference is, for this reason also, clearly for individual contract. The assessee also referred to the OECD Commentary and literature on 'Permanent Establishment' in support of the legal contentions embedded in his arguments. None of these contracts was for duration of more than nine months, and for that reason, according to the assessee, the case of the revenue fails on duration test. The assessee thus claimed that the only mistake that the assessee has made in its income tax return is in offering an income to tax which was not in fact taxable i.e. revenue earned under contract # C 99/05 with Arcadia Shipping Limited.

4. None of these submissions, however, impressed the Assessing Officer. The Assessing Officer observed that there was no specific reason assigned in the income tax return as to why revenues under contract # C 99/05 were offered to tax, and thus "the assessee himself has accepted that it has a PE in India, by offering receipts from contract # C 99/05 for taxation". It was also noted that there was no good reason to assume that each of the contract was to be considered individually as this approach is "not based on sound logic". It was also pointed out that in the *India UK Double Taxation Avoidance Convention (1994) 206 ITR (Statue) 235*, it is specified in the protocol that for the purposes of applying the duration threshold test, each of the project is to be considered separately. In the absence of any such provision or protocol clause in the India Mauritius tax treaty, all the contracts are to be considered together for the purposes of applying duration threshold test. On the basis of this reasoning, and having noted that "it is a fact that if all the projects are taken together, it exceeds more than nine months", the Assessing Officer concluded that the assessee had a PE in India, and, accordingly, its income from all the contracts will be taxable in India. The Assessing Officer further observed that "a barge with crew provided by the assessee may itself also constitutes a fixed place of business through which business of the assessee is carried out" as "it is not necessary that a 'fixed place' means a placed fixed

to that the contract # C-99/05, which was for hook up/ accommodation barge in connection with BHN revamp project, was essentially in connection with providing facilities, or services, for extractions for, or exploration of, mineral oil. The income from the said contract is, therefore, taxable in India under section 44BB on gross basis @ 10%, which thus works out to an effective tax@ 4.8% on gross receipts. The Assessing Officer further noted that even if it was to be held that the assessee did not have any PE in India, since barge hire is admittedly covered by consideration for "use of industrial, commercial or scientific equipment", the assessee will be liable to be taxed @ 15% on gross basis. The taxability of domestic law, on this basis, was to be beneficial to the assessee, and as such there was no need to refer to the treaty provisions. As regards contract # C 99/07, the Assessing Officer observed that since this contract was for replacement of B 121 main deck, with the temporary deck, this was also in connection with providing facilities covered by section 44BB, and, accordingly income was to be taken @ 10% on gross basis, which will return in taxability @ 4.8% on the gross amount. It was also noted that, as discussed above, the assessee has a PE in India, the assessee does not get any relief from the said taxability under Indian Income Tax Act. Finally, with regard to the charter of barge JU 253, the Assessing Officer held that the assessee has earned money from barge hire in the domestic traffic, and it will be reasonable to estimate profits from the same @ 10% of gross revenues. He thus proceeded to tax 10% of the receipts on account of this barge hire as income of the assessee liable to be taxed in India. Without prejudice to this stand, the Assessing Officer also observed that in case was to be held that the assessee did not have any PE in India, since barge hire is admittedly covered by consideration for "use of industrial, commercial or scientific equipment", the assessee will be liable to be taxed @ 15% on gross basis. With these observations, the Assessing Officer proceeded to tax income, embedded in entire receipts of the assessee, @ 10% of the gross receipts. Aggrieved by the stand so taken by the Assessing Officer, assessee carried the matter in appeal before the CIT(A).

5. The CIT(A) was of the view that, for the purpose of determining the existence of permanent establishment, all the contracts were to be considered independently as these were not inter connected. The CIT(A) also held that these amounts cannot be treated as royalty under Section 9(1)(vi), clause (iva) of Explanation 2 thereof, of the Act, as the amounts were paid for time charter of the barges. It was observed that there is important distinction between the voyage/ time charter vis-a-vis bare boat charter, and that while bare boat charter is covered by the definition of 'royalty' under the domestic law, time/voyage charter is not covered by the said definition. A reference was also made to views expressed by the Ministry of Finance to the effect that income from bare boat charter is in the nature of royalties. The CIT(A) thus concluded that neither the income in question is taxable as business profits under Article 7 of the India Mauritius tax treaty, nor can it be taxed as 'royalties' under the Act. It was thus held that the income earned by the assessee from various contracts is not taxable in India. Aggrieved by the stand so taken by the CIT(A), the Assessing Officer is in appeal before us.

6. We have heard the rival contentions, perused the material on record and duly considered the factual matrix of the case as also the applicable legal position.

7. The first issue that we must address ourselves to is whether or not, on the facts and in the circumstances of the case, the assessee can be said to have a PE in India. Article 5 (2)(i) of the Indo Mauritius tax treaty, which is broadly the same as Article 5(3)(a) of UN Model Convention - except mainly for replacement of 'six months' duration test by 'nine months' duration test, and for including it in paragraph 5(2). The relevant extracts from Article 5 of India Mauritius tax treaty are as follows:-

Article 5 - Permanent Establishment

1. For the purpose of this Convention, the term 'permanent establishment' means a fixed place of business through which the business of enterprise is wholly or partly carried on.

2. The term 'permanent establishment' shall include:

(i) a building site or construction or assembly project or supervisory activities in connection therewith, where such site, project or supervisory activity continues for a period of more than nine months.

8. In view of the above treaty provisions, it is unambiguous that a PE refers to a fixed place of business through which business of the enterprise is wholly or partly carried on, and includes, *inter alia*, "a building site or construction or assembly project, or supervisory activities connected therewith, where such site, project or supervisory activity continue for a period of more than nine months.". In a way, thus, the permanence test for existence of a PE stands substituted, to this limited extent, by a duration test for certain types of business activities, i.e. building construction, construction or assembly project, or supervisory activity connected therewith. There is also a valid, and more holistic view of the matter, that this duration test does not really substitute permanence test but only limits the application of general principle of permanence test inasmuch as unless the activities of the specified nature cross the threshold time limit of nine months, even if there exists a PE under the general rule of Article 5(1), it will be outside the ambit of definition of PE by the virtue of Article 5(2)(i). To that extent, the construction PE clause could also be viewed as an arbitrary degree of permanency that is required for any fixed place of business PE. Save and except for this additional yardstick for the degree of permanence, the normal PE definition would apply. One of the arguments taken by the learned Departmental Representative was that since two contracts with Arcadia Shipping (i.e. C 99/05 and C 99/07) are for the period of 137 days and 99 days respectively and since only contract (i.e. C 99/07) had some installation work while the other contract (i.e. C 99/05) was only for providing accommodation barges, the assessee can be said to have a fixed place of business for substantial duration and it should, therefore, be held that the assessee had a PE under Article 5(1) as a 'fixed place of business'. It is difficult to understand, much less approve, rationale of this argument. Firstly, in order to be treated as a PE, a fixed place of business must be a fixed place of business through which the business of the assessee is wholly or partly carried on. It is not the business of the assessee to provide accommodation on the barge and providing accommodation is the only activity carried on at the barge, if that can be treated as a fixed place of business. The business of the assessee is giving barge on hire and that activity cannot be, and is certainly not, carried out at the barge so hired out. When business of the enterprise is not even carried out at this fixed place, there cannot be any basis for holding a barge to be a permanent establishment of the enterprise. In the case of *McDermott Industries (Aust) Pty Ltd Vs Commissioner of Federal Taxation Full bench judgment by Federal Court of Australia — reported as 2005 ATC 4398 - referred to in 'Principles and Practice of Double Taxation Agreements' by Prof Robert Deutsch at page 150 (published by BNA International, UK)*, even a barge was held to be a permanent establishment but then it was a case where in terms of Australia Singapore Double Tax Convention, under Article 4(3), an enterprise of a Contracting State is deemed to have a permanent establishment and to carry on trade or business through that permanent establishment in the other Contracting State if , *inter alia*, "substantial equipment is being used in that other State by, for or under contract with the enterprise." As learned counsel rightly points out, it is only in the event of the tax treaty having such a specific provision that a barge could be treated, by itself, a permanent establishment, but then no such

provisions exist in the India Mauritius tax treaty. Learned counsel has also invited our attention to the fact that in the said case, the Australian Federal Court did not even see need to address the issue of treating barge as a permanent establishment under the basic rule, i.e. Article 5(1) in the present context. This also shows, as we have noted above, that by no stretch of logic, when an assessee is in the business of hiring out the barges, a barge so hired out cannot be viewed as a place of carrying on its business, which, as we understand, is limited to, qua that barge, the barge having been so hired out. Secondly, treating a project site as PE under the main rule, i.e. Article 5(1), cannot be without taking into account the provisions of Article 5(2)(i) because in the case of an construction, installation or project site, as we have noted above, what is given in Article 5(2)(i) is a test of permanence, howsoever arbitrary as it may be, for the purpose of Article 5(1). Article 5(1) and Article 5(2)(i) of the India Mauritius tax treaty, in such cases, are required to read together rather than read on standalone basis. The argument of the learned Departmental Representative is thus devoid of any legally sustainable merits.

9. Coming back to the provisions of Article 5(2)(i), even a plain reading of Article 5(2)(i) would show that, for the purpose of computing the threshold time limit, what is to be taken into account is activities of a foreign enterprise on a particular site or a particular project, or supervisory activity connected therewith, and not on all the activities in a tax jurisdiction as whole. It is important to bear in mind the fact that the expressions used in the relevant definition clause are in singular, and there is no specific mention about aggregating the number of days spent on various sites, projects or activities. In other words, each of the building site, construction project, assembly project or supervisory activities in connection therewith is to be viewed on standalone basis. Broadly, the underlying rationale of this approach is that various business activities performed by one and same enterprise, none of which constitutes a PE, cannot lead to a PE, if combined. In our humble understanding, the very conceptual foundation of this approach rests on the assumption that various business activities of the enterprise in different locations are not so inextricably interconnected that these are essentially required to be viewed as a coherent whole. The locations are thus separate places of business, and activities at different locations are, therefore, required to be viewed on standalone basis. In a typical building site, assembly or installation project, or supervisory activities in connection therewith, each of site or project is an independent unit, and the approach to these types of PEs recognize this normal business practice.

10. It is also interesting to note that in certain treaties entered into by India, there is a specific departure from this rule as evident from the wordings used in definition clauses of corresponding PEs. Take for example, Article 5 (2)(k) of *India Australia tax treaty 194 ITR Stat 241*, which states that "The term 'permanent establishment' shall exclude especially .... a building site or construction, installation or assembly project, or supervisory activities in connection with such a site or project, where that site or project exists or those activities are carried on (whether separately or together with other sites, projects or activities) for more than six months." (emphasis supplied by us by underlining). In the case of *India Thailand tax treaty 161 ITR Stat 82*, the definition for this type of permanent establishment, which finds place in Article 5 (2)(h) of the said treaty, is worded as "a building site or construction or assembly project, or supervisory activities in connection therewith, where such site, project or activity continues for the same or a connected project for a period of periods aggregating to more than 183 days " (emphasis supplied by us by underlining). Similar are the provisions in India's tax treaties with *Austria 251 ITR Stat 97*, *Belgium 247 ITR Stat 39*, *Bulgaria 220 ITR Stat 30*, *Canada 229 ITR Stat 44*, *China 214 ITR Stat 160*, *Denmark 180 ITR Stat 1*, *Italy 220 ITR Stat 3*, *New Zealand 166 ITR Stat 90*, *Norway 169 ITR Stat 15*, *Spain 214 ITR Stat 197*, *Turkey 224 ITR Stat 145* and *USA 187 ITR Stat 102*. In these remarkably large number of cases, the relevant PE clauses are so worded that there is a specific mention for application of aggregation principle on all, or even connected,

sites, projects or activities for computation of threshold duration test. There are thus two types of provisions in the construction PE clauses - one set of cases in which treaties provide for aggregation of time spent on various projects, and other set of cases in which treaties donot provide for such an aggregation of time spent on different projects. Even such an aggregation, when applicable, would require exclusion of double counting of days when more than one site or project exists on a day, or when work is carried out at two or more different places on a day, as multiple counting of common days would lead to an absurdity inasmuch as when work is carried on five sites together for one hundred days each, such a computation will lead to five hundred days in a year which is an impossibility. Therefore, when definition clause specifically provides for aggregation of time spent on various sites, projects or activities, the sum total of the time spent on such sites, projects or activities, except for parallel counting of days, is to be taken into account for applying the threshold time limit. However, when aggregation is not specifically provided for the in the relevant PE definition clause, as in the present case, normally it cannot be open to us to infer the application of aggregation principle. Revenue has laid lot of emphasis on the fact that while in *Indo UK Double Taxation Avoidance Agreement (1994) 206 ITR (Statue) 235*, there is a specific mention in the protocol to record the agreement "to apply the 'more than six month test' separately to each site or project which has no connection with any other site or project and to each of the connected sites and projects", there is no such provision in the India Mauritius tax treaty and it is not open to us to infer the said provision. We are not impressed by this argument. The provisions set out in protocol to the tax treaties need not necessarily be substantive provisions, and these can also be, and often are, merely clarificatory provisions *'ex abundanti cautela*'. What is stated in the said protocol to Indo UK tax treaty is nothing other than what is anyway within the scope of the construction PE clause, as analyzed in the OECD Model Convention Commentary (adopted by the UN Model Convention Commentary as well) - an analysis, with which we are in considered agreement. The protocol provision is merely clarificatory in nature and is apparently set out as a measure of abundant caution. The absence of similar protocol clarification in other tax treaties entered into by India would not, therefore, warrant a different interpretation of the treaty provision.

11. There is unanimity in OECD and UN Model Convention Commentaries that the duration test "applies to each individual site or project". In paragraph 18 of the *OECD Model Convention Commentary OECD Model Tax Convention on Income and Capital, 1992 (as updated in 2005)* to Article 5, it is specifically stated so. *UN Model Convention Commentary UN Model Tax Convention between Developed and Developing Countries, 2001*, in paragraph 11 of its commentary on Article 5, However, this replacement of or modification of - whichever way one views it, permanence test for existence of PE, by test of minimum length of time -as in the situation before us, has left scope of abuse of these provisions such as by artificially splitting the contracts, each covering a period of less than threshold limit and each attributed to different company owned by the same group. Recognizing this fact, the OECD Commentary, dealing with the twelve month test for construction assembly and project site prescribed in the OECD Model Convention, observes that, "apart from the fact that such abuses may, depending on the circumstances, fall under the application of legislative or judicial anti avoidance rules, countries concerned with this issue may adopt solutions in the framework of bilateral negotiations". The OECD Commentary further recognizes that a building site should be regarded as a single unit, even if it is based on several contracts, provided it forms a coherent whole commercially and geographically, and that in a situation in which the very nature of construction or installation project may be such that the contractors activity is to be relocated continuously or at least from time to time (e.g. construction of roads and canals, dredging of waterways or laying of pipelines), the activities performed at each particular spot in a single project must be regarded as a single unit. In other words, OECD Commentary refers to the situations, in the second

category, in which aggregation principle is to be applied even in the absence of specific treaty provisions to that effect, or, to put it more appropriately, the situations in which different locations of activities of an enterprise, in the other contracting state, are required to be viewed as one place of business. The exercise of aggregation of time spent on various locations is only a logical consequence of those various locations being viewed as one place of business. A view can indeed be taken that a road or canal construction, or dredging of waterways or pipeline, is a single place of business for the enterprise, even if work is relocated periodically, because that a road, canal, waterways or canal have geographical unity in the sense these are one linear point on a map, as well as commercial unity- given the nature of the business of the enterprise, it is a single site and a single place of business. It is this approach that is true justification for the aggregation to be applied, if at all one considers these progressive relocations to be distinct sites, for time spent on difference sites. Therefore, so far as geographical coherence is concerned, what is to be really seen is whether different places of activities, of an enterprise in the other contracting state, are one place of business or different places of business. If one comes to the conclusion that these are different places of business, matter ends here. However, if these places are seen as one place of business, the next thing to be ascertained, i.e. commercial coherence, is whether the work done at these sites constitutes one business venture, consisting of one or more contracts, or different business ventures altogether.

12. There are two important issues, therefore, that we need to deal with at this stage - first, as to who has the onus to show that the contracts are artificially split, or otherwise the affairs are so arranged, so as to circumvent the duration test; and - second, what are the circumstances in which the aggregation principle is to be applied, even in the absence of specific provisions to that effect in a tax treaty, so as to give a reasonable meaning to definition of a PE in respect of building, construction, or assembly project or supervisory activity in connection therewith. In our considered views, these are only two sets of circumstances in which time on each set of relevant business activity by an enterprise, in the other Contracting State, is to be aggregated.

13. As for the cases of alleged treaty abuse, alleged artificial splitting of contracts, or other alleged modes of maneuverings to enter into sham arrangements to defeat the provisions of treaty, the onus must lie on the revenue authorities to establish the factual elements embedded in such allegations. It is only elementary that no one is expected to prove a negative. Hon'ble Supreme Court, in the case of *K P Varghese Vs Income Tax Officer (1981) 131 ITR 597 =* ***(2002-TIOL-128-SC-IT)***, has observed that "...to throw the burden of showing that there is no understatement of consideration, on the assessee, would be to cast an impossible burden upon him to establish a negative, namely, that he did not receive any consideration beyond that declared by him". By the same analogy, an assessee cannot be expected to demonstrate that contracts are not artificially split, that the affairs are not so contrived so as to circumvent the duration test or that there is no maneuvering so as to abuse the treaty provisions. It is, therefore, for the revenue authorities to establish, beyond a reasonable degree of doubt, that there is an abuse of treaty provisions by so artificially contriving the affairs as to wrongfully entitle the assessee to treaty benefits. No doubt, in order to enable the revenue authorities to discharge this onus, the assessee must comply with reasonable requisitions of the revenue authorities and truthfully share the information available with him, but the exercise to establish treaty abuse is to be conducted by the revenue authorities. Unless that exercise is conducted, it cannot be open to disregard the claim of the assessee by simply making vague and generalized claims about artificial splitting of contracts and about the sham arrangements to defeat the treaty provisions. In the case before us, no such exercise is carried out. In the orders of the authorities below, a reference is made to the contracts having been awarded by one entity -directly or indirectly, and the fact that the work is carried out at the same place but these facts, by themselves,

does not put the case in the category in which treaty provisions are abused by artificial arrangements, and, for that reason alone, the time spent on all the activities is required to be aggregated. The aggregation of time spent on various activities, on account of artificial splitting of contract by the assessee or other modes of treaty abuse, can not thus apply unless the reasons embedded in this approach are established by the revenue. That is not the situation before us.

14. In our considered view, the only other situation in which aggregation of time spent of various activities is to be done is when the activities are so inextricably interconnected or interdependent that these are essentially required to be viewed as a coherent whole.

14. The test of 'commercial and geographical coherence' thus does find a mention in the OECD Commentary but interestingly, this test refers to such a degree of coherence that the different units, taken together, form a 'coherent whole - geographically and commercially". That is almost the same thing as different units being viewed as one place of business. That cannot be equated with mere commercial and geographical coherence simplicitor in the normal course of business situations. The ambiguity of commercial and geographical coherence test apart, this test is not of universal application nor can it be construed as a conclusive test. There could be activities, such as construction of roads, which may or may not be geographically coherent but yet, according to the OECD Model Convention Commentary and in accordance with the fundamental rationale of construction PE concept, the time spent on progressive relocations is required to be aggregated. Similarly, there can be situations in which location of projects may be geographically the same, and yet as these are completely independent projects, the aggregation of time spent on the two projects may not be justified for that reason, as in the case of *Sumitomo Corporation Vs DCIT 114 ITD 61* = ***(2007-TIOL-488-ITAT-DEL)***, where even though the situs of activities were at different parts of the same factory "viz. assembly floor, paint shop and weld shop", yet the Tribunal came to the conclusion that "it cannot be said that all contracts put together formed a coherent whole - commercially or geographically". On a conceptual note also, merely because different construction, project or supervisory activities are being carried out at nearby physical locations, these activities, for this reason alone, are not required to be seen in conjunction with each other. A construction site or project site inherently lacks permanence, in strict sense of that word, since construction, assembly, project or supervisory activity are supposed to continue for a limited time only i.e. till the objective is achieved, and it is perhaps for this reason that the fictional PE for these types of activities is created so as to meet the situations when no PE taxation is triggered under the basic rule. According to this school of thought, this fictional PE comes into existence because even though the nature of business carried out at these locations could be legitimately viewed as lacking permanence, once 'duration of activities test' is satisfied, nothing further needs to be established so far requirement of 'permanence' is concerned. This deeming fiction is to be applied for each construction or project site or supervisory activity in connection therewith. This deeming fiction, like all deeming fictions, is to be applied strictly. As an enterprise working in the other Contracting State, the situs of performing the activities, which triggers this fictional PE, is not necessarily a factor which is even controlled by the enterprise. It cannot thus have much bearing on the business model of the enterprise, and, therefore, on the question whether or not the enterprise is carrying on the business through the PE. As for the 'commercial coherence', there is hardly any consensus on its connotations either. Prof Arvid Skaar, a well known Norwegian international tax scholar, in his book *"Permanent Establishment - Erosion of a Tax Treaty Principle Third Indian Reprint, 2009, published by Kluwer Law International - at page 355*" suggests that "it can normally be assumed that projects conducted under the same contract, i.e. the same document, will be considered a coherent whole" and expresses dissatisfaction about lack of clarity on the issue by adding that "apart from the assumption that one contract is one project, the identification rules of

commentaries are sparse and obscure". There are quite diversified opinions on the connotations of 'coherent whole' or 'commercial coherence'. On one end of the spectrum, there is a decision of the *Belgian Cour' d Appel Anvers, 23 ET 387 (1983) referred to in Klaus Vogel on Double Taxation Conventions (Third Edition) - page 308* which seems to suggest that 'the same ordering party' will constitute commercial coherence, on the other end of the spectrum, there is also a decision by a coordinate bench of this Tribunal in the case of *Sumitomo Corporation Vs DCIT supra* wherein this theory is impliedly rejected and it is held that even when contracts are relating to different areas of manufacture of cars but these contracts are independent and not capable on bringing in a coherent whole, 'mere commonality of principal cannot be sufficient'. The views expressed by the Tribunal are also on the same lines as expressed by Arvid A Skaar in his book *"Permanent Establishment - Erosion of a Tax Treaty Principle" Third Indian Reprint, 2009, published by Kluwer Law International -at Page 365*, wherein he has questioned the school of thought advocated by Klaus Vogel as also the Belgian ruling mentioned above, and observed as follows:

The significance of identical clients has been particularly emphasized by German tax treaty commentators. To be a coherent whole, according to Vogel, the tasks have to be performed at the same place and for the same client. In the present author's opinion, this position seems to presuppose that the creators of the commentaries agreed upon a specific criterion though they used an ambiguous one in the text of the commentaries. However, under treaty interpretation based on Vienna Convention, the intentions of the contracting parties are considered to be expressed in the treaty text. If the relatively precise criterion 'identical client' was intended, this would have been probably indicated by using a less ambiguous term than 'commercially coherent whole'.....

15. In the case of *Sumitomo Corporation Vs DCIT supra*, as we have noted earlier, a co-ordinate bench of this Tribunal has also impliedly rejected the emphasis on commonality of principal. While doing so, the Tribunal has, *inter alia*, observed as follows:

79. Article 5 (4) of Indo Japan tax treaty (182 ITR Stat 380) as was applicable in that case replaces the permanence element for existence of PE by the test of minimum length of time. In a case where there are several sites where supervision is going on in a country, the rule is that the test of minimum period should be determined for each individual site or installation project. Klaus Vogel in his commentary on Double Taxation Conventions, at page 308, has following to say on this aspect:

"The question whether there is a PE in a specific contracting state or not should be considered separately for each activity performed in that State i.e. for each individual place of business existing there as well. In this connection, the place where individual activity is performed may very well be relocated, for instance, where a road is being constructed in stages. If, in contrast, all building sites maintained in one State are treated as one single PE, this would in effect tantamount to force of attraction principle. Moreover, this would violate the principle that various business activities performed by one and same enterprise, none of which constitutes a PE, cannot lead to a PE, if combined."

This above rule is, however, subject to exceptions viz. where each building site or installation site forms a coherent whole in the other country and is operated at one place and by the same ordering party. The thrust of learned counsel for the revenue has been on this exception to the rule. We have already highlighted the fact that each purchase order was independent and did not complement each other. The MUL YE 2 project would not stand concluded with the execution of these purchase orders. The assessee was not the only person rendering these supervisory services. The sites were located at different places viz.

assembly floor, paint shop and weld shop. It cannot be said that all contracts put together formed a coherent whole - commercially or geographically. Even purchase orders relate to different areas of manufacture of car.....As already stated, perusal of purchase orders clearly indicate that the various contracts were independent and were not capable of bringing in a coherent whole commercially. Mere commonality of principal cannot be sufficient in this regard.

16. The two situations, referred to in the OECD Model Convention Commentary and which have been incorporated in UN Model Convention Commentary as well, are thus essentially illustrative in nature, and the common thread, and the highest common factor, in both these situations is that in both the cases the activities are so inextricably interconnected that these cannot be viewed in isolation but only in conjunction with each other. The test of 'geographical coherence' and 'commercial coherence', in isolation with the larger picture of all the units forming part of a 'coherent whole', is not only a somewhat vague test with little consensus on its scope, and which can at best be loosely defined, but it is also somewhat unworkable in practical situations. In US Model Convention's Technical Explanation echnical Explanation to *US Model Income Tax Convention -1996*, reference to "commercial and geographical coherence" is substituted by reference to the contracts or projects being "interdependent - both commercially and geographically", and the said commentary, inter alia, states that "a series of contracts or projects by a contractor that are interdependent both commercially and geographically are to be treated as a single project for purposes of applying the twelve month (duration) threshold test". The 'interdependence' test is something that can perhaps be applied with lesser ambiguity vis-a-vis 'cohesion' test simplicitor, and lesser ambiguity is certainly preferable. In any event, the highest common factor in both the examples set out in the OECD and UN Commentary is this 'interdependence' or 'interconnection'. In view of the discussions above, we are of the considered view that the true test must lie in examining whether or not the activities performed by the enterprise in various projects or sites are interconnected and have to be necessarily regarded as a coherent whole. Unless the activities are of such a nature as to be viewed only in conjunction and as a coherent whole, in our humble understanding, there is no justification in aggregation of time spent on various business activities, sites or projects of the enterprise. In this view of the matter, strictly speaking, it is not really relevant whether the activities so carried out by the enterprise are for the same principal or different principals. The relevant considerations, in our considered view, are the nature of activities, their interconnection and interrelationship and whether these activities are required to be essentially regarded as a coherent whole in conjunction with each other.

17. It is thus clear that the justification for aggregation of time spent by the assessee on different project sites, for applying threshold of duration test, is not sustainable. Neither the work having been carried out for the same principal is sufficient to justify the aggregation of time spent on all the projects, nor the fact that this work was carried out in the same area, which is a huge geographical area anyway, is sufficient to invoke that exercise. Even if these projects are commercially coherent in the sense that these projects are for the same organization directly or through a sub contractor, and geographically coherent in the sense that these are on nearby locations, these two factors would not necessarily mean that these projects are to be necessarily seen as a coherent whole - geographically and commercially. The true test, as we have noted above, is in interconnection and independence - in addition to geographical proximity and commercial nexus. There is no finding, nor even a suggestion, by any of the authorities below to the effect that the three contracts are inextricably interconnected, interdependent or can only be seen only as a coherent whole in conjunction with each other. As a matter of all the three contracts are for three different purposes- for charter of accommodation barge, for use of barge in domestic area and for replacement of decks. None of these contracts are such that these can be viewed as

interconnected or interdependent. The CIT(A) was thus quite justified in holding that the duration of these projects cannot be aggregated for the purposes of ascertaining whether or not the permanent establishment of the assessee can be said to have existed in India. It is an admitted position that unless the time spent on these different contracts is aggregated, the threshold limit of nine months, as laid down in Article 5(2)(i), cannot be satisfied. In view of these discussions, and bearing in mind entirety of the case, we hold that the CIT(A) was quite justified in holding that the assessee did not have a permanent establishment in India.

18. Learned counsel, however, fairly accepts that so far as the question of the consideration for barge hire being treated as 'royalty' is concerned, the same is now covered against the assessee in view of *Poompuhar Shipping Corporation Limited Vs ITO (109 ITD 226) =* ***(2007-TIOL-109-ITAT-MAD)***. To that extent, therefore, the order of the Assessing Officer is to be restored. He, however, relies upon the order of the CIT(A).

19. We, therefore, hold that while the assessee did not have a permanent establishment in India, and accordingly its business profits cannot be brought to tax, so far as the hire for barges is concerned, the taxability under section 44BB is upheld and confirmed. As regards levy of interest under section 234 B and C, learned representatives agree that the issue is now covered in favour of the assessee by a large number of decisions of the Tribunal, including Special Bench decision in the case of *Motorola Inc Vs DCIT (95 ITD SB 269)* = (**2005-TIOL-103-ITAT-DEL-SB**) which has since been approved by the Hon'ble jurisdictional High Court in the case of *DIT Vs NGC Network LLC* **2009-TIOL-43-HC-MUM-IT**.

20. In view of the above discussions, and for the reasons set out above, the order of the Assessing Officer is partly restored and, to that extent, grievance of the Assessing Officer is upheld.

21. In the result, the appeal is partly allowed in the terms indicated above. Pronounced in the open court today on 5th day of April 2010.