

Taxation Of Permanent Establishments In Large Contracts, Epc Contracts-Emerging Global Practices In Taxation, Tax Planning, And Way Forward In Digital World–A Perspective

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Abstract: The imperative of EPC contracts in today's race to economic development is a key requirement for any organisation across nations. These contracts are specific to the development of economy, and usually have a two part component set up, one being performed outside the state where the project is being executed and the other at the site of the state where the project is getting executed. POEM, Model conventions-OECD and UN, read with DTAA to determine the formation of a permanent establishment.. EPC contracts are highly competitive and are won against competitive bidding and global tenders, and involve funds flowing into the state where projects are executed, The fund providers practise tax planning, would like to ensure a decent return on capital employed, and avoid the tax effects arising in the process, hence resort to split of contracts, SPV structures which are legally practiced across countries in the globe. The various rulings in different jurisdictions take steps to protect their interests in the process, and evolve rulings which further complicate the position that will be taken by taxman. The authors present the linkages between the tax planning, EPC contract design, different rulings followed across the jurisdictions and look at how the contract are likely to be executed in a digital world in the future. This leads to possible litigation, and more stringent views by Judiciary and novel approaches, structures adopted by the tax payer. The authors also discuss the Post BEPS scenario and how arising of PE may treated in the digital world, in context of Pillar 1 and Pillar 2. All these necessarily demand a substantial amount of planning, involving advisory from reputed tax counsel from external sources. The study is an exploratory study, wherein they attempt to design a framework, bringing out the inter-relationship between the various factors which it is felt will be quite useful in guiding a corporate in structuring of an EPC contract and reducing the risk of facing serious challenges to the structure from the revenue, and thus aid in area of tax risk mitigation for large projects and bring some clarity to the outcome.

Keywords: Tax planning, Tax avoidance, EPC contracts, Permanent establishment, POEM, DTAA, Digital-taxation, Offshore, Onsite, SPV structures, BEPS

1. Introduction

Any foreign entity or corporate in another nation that may be connected to a permanent place of business there is said to have a "Permanent Establishment" if it is a significant, long-lasting, or long-term component of the enterprise. Only the portion of a profit that can legally be linked to activities performed in India is subject to taxation. Tax planning activities generally are an acceptable part of EPC contracts, and SPV entities, which are structured in conjunction with tax advisors and banks help in the efficient allocation and routing of funds with risk mitigation. Past studies have proved that significant tax savings happen, in billions of dollars. Also incentives appear to be in place to give more thrust to Tax planning efforts which is used by MNCs in a legitimate manner, and these cannot easily be challenged by the taxman. Also there appears to be significant efforts to use tax haven, based SPVs or friendly country DTAs for funds to be routed to the SPV.

A key fact aspect of EPC contracts is that they are also to some extent looking at exploiting tax advantage by recourse to tax avoidance, and several past studies have evidenced the same across geographies. Globally and more particularly in Indian context, the importance of EPC contracts for its positive impact on growth and development is a known fact. The taxation of a business connection happens only if a PE gets created in the

process and due to tax avoidance measures, and tax planning efforts undertaken, the amount of income as accruing to a PE may be less than what is attributable to the operations carried out in India, and this alone may be considered for tax purposes. The different types of contract forms which an EPC contract can take are purely dependent on the type of industry, the number of vendors -participants in the contract, the countries of which they are residents, and the DTAA between those countries and India where the contract gets executed at the ground. The concept of using unique SPV structures, to enable tax minimization, and tax avoidance, possible links to tax havens among other things, are also found. The way contracts are drafted and the interests of the financiers of these projects are also motivated by different factors. The study is into two parts, wherein in the first part analysis of Tax planning and avoidance behaviour by EPC companies is done, with second part followed by the key factors and cases decided by judiciary and linking the same with the past studies. The authors attempt to build a framework and checklist, which can be useful for EPC corporates to help in possible detection of factors that may cause arising of permanent establishments and become liable to taxation, and aid in the process of tax risk mitigation.

2. Review Of Literature

In relation to Permanent establishment, the various aspects of corporate governance, tax avoidance, changing tax laws related, uncertainty, and SPV structures, can be said to have an impact on the possible desire to reduce the taxability arising on account of Permanent establishments in the country of execution of the project. With tax avoidance also playing a key role and hence the following reviews would be more relevant, in this context. According to Tax Justice. net reports for 2021, India loses USD31. 7Bn in taxes, mainly due to tax abuse committed by MNC corporations. We first look at the tax planning linkage to corporates and in the second stage look at the formation of permanent establishments.

The study aims to determine if corporate tax preparation practises boost business value in a European setting. Tax savings and the Effective Tax Rate (ETR) in the financial statements' disclosures of tax reduction determine how tax planning affects a company's worth, makes the case that tax planning has a negative impact on a firm's worth due to higher agency charges. It also discovers that corporate ETRs are lower than the statutory tax rate. In fact, expanding the gap between the effective tax rate and the statutory tax rate results in greater tax savings, and tax planning can be defined as the actions taxpayers take to lower their tax obligations in order to benefit from tax savings. (Ftouhi, K., Ayed, A., & Zemzem, A. (2015).

Various tax authorities continue to face unsolved concerns related to corporate tax planning operations on a global scale. Using a longitudinal method, this study examined 4,500 firm-years' worth of financial statistics and tax expenses from publicly traded businesses in Malaysia, that were compiled from 2001 to 2012. The effective tax rate stated in a company's financial statements reflects any tax planning that has taken place, and the discrepancy between the statutory tax rate and the effective tax rate reveals the extent of the companies' sophisticated tax planning. Tax planning is reflected by certain financial ratios as per the findings from the combined OLS regression model. (Rashid, N. M. N. N. M., Noor, et al (2015). How managerial ability (MA) affects the trade-off between tax and nontax costs from the standpoint of a firm's sustainability is examined. Finding the ideal cost balance that exists between tax and financial reporting costs is essential to efficient tax planning for corporate sustainability. Using Tobit regression model and data envelopment analysis (DEA) frontier to calculate MA, it captures changes in market value after removing business variables that are outside of management control, it substantiates increase in value. Tax expenses, nontax costs, and the trade-off between them are the study's key variables. The key findings are MA ability and the tax cost variable have a distinctly positive association, MA and the nontax cost variable have a markedly adverse connection. and, MA and the trade-off between tax and nontax costs have a negative relationship. It suggests that, given that MA is reflected by tax and financial reporting concurrently, a manager should take into account the trade-off between tax and nontax costs to increase the firm's value. (Lee, K., & Yoon, S. (2020).

How tax planning affects the firm values of companies listed on Bursa Malaysia, using Effective Tax Rate (ETR) and Book Tax Differences (BTDs) is examined using regression results, that demonstrate ETR has a significant and positive link with firm value while BTDs has an insignificantly negative relationship with firm value after adjusting for company size, leverage, asset tangibility, firm age, and dividend. Leverage, asset tangibility, firm age, and dividends are only a few of the control variables that have a bad connection with firm value, and it looks that, ETR proxy rather than BTDs should be used to estimate business value. (Razali, M. W.

M., Ghazali, et al (2018). The research examines how tax planning and good corporate governance affect firm value. Using Multiple regression analysis on manufacturing businesses that were listed on the Indonesia Stock Exchange over 5 year data, and a purposive sampling strategy, the findings indicate, that institutional ownership proxy, appears to have a large impact on firm value, and tax planning also has a big impact. (Hidayat, A., & Yuliah, N. (2018). The connection between tax planning and company value, is examined, to comprehend how tax payers take use of tax law gaps in order to increase the worth of their businesses, using 7year cross section and time series data applying panel regression technique. Effective tax rate and tax savings were used as the explanatory variables for tax planning, and used Tobin Q was used to determine business value. Effective tax rate and firm value were shown to be negatively correlated, although tax savings and firm value were found to be positively and negatively correlated, with leverage reporting a negative result, whereas the control factors of company size and capital intensity revealed a mixed result. It makes several recommendations, like: firms should adopt good governance practises so that the information asymmetry between managers and shareholders will be mitigated in order to increase the value of the firm and shareholder monitoring of managers in order to reduce their intentions of diverting organisations resources for their selfish needs Izevbekhai, M. O., & Odion, A. O. (2018).

The relationship between tax preparation actions and business value is examined using board diversity as a moderating variable, using data for non-banking and financial companies on the Indonesia Stock Exchange. The findings indicate, there is evidence that tax planning increases corporate value, and discovered evidence that board diversity may boost the favourable influence of tax planning on business value, with the exception of minority, which may reduce it. Also sensitivity test with the complete model and sample suggests that tax planning had a strong positive effect on increasing firm value. However, other board diversity variables, such as age, did not consistently moderate the relationship between tax planning and firm value. (Lestari, N., & Wardhani, R. (2015). There is little to no study on corporate tax planning for businesses in developing nations, and observes, tax avoidance and business tax planning go hand in hand. Large sums of money are raised through taxation, which the government must collect to support overall economic stability and growth. This study aims to investigate how corporate tax planning is impacted by businesses that engage in international operations, using a cross-sectional-time series valuation employing panel data analyses—also known as Tobit estimations. The results show a connection between businesses operating internationally and corporate tax structuring in emerging markets. (Ariffin, Z. Z. (2013). The relationship between the Big 4 accounting firms and the degree to which multinational corporations establish, maintain, and manage their networks of tax haven subsidiaries is examined in this research. Using count models using firm-level data, the paper develops a variety of hypotheses and extend internalisation theory. The results show that the use of the leading professional audit firms by MNEs and the size of their tax haven network are strongly correlated and connected by a causal chain. Thus it contends that public policy pertaining to the function of auditors can significantly affect MNEs' tax evasion practises. Jones, C., Temouri, Y., & Cobham, A. (2018). Banks are crucial in facilitating tax planning by businesses and individuals. An effort has been made to examine how banks are connected to tax evasion by borrowers and other individuals utilising lending contracts as a barometer and assessing customer tax avoidance. Users are constantly assisted by commercial and investment banks, insurance firms, wealth managers, and other financial service providers when dealing with tax-related concerns. Banks in particular and financial institutions in general are in a good position to be urged to engage in proactive tax planning. This tax management is facilitated by their network of corporations spread across numerous jurisdictions. (Nag, A. (2017). A risk intelligence strategy should strike a balance between value creation and risk generation while achieving income and profit goals within the parameters of the risk appetite. In the chain of business, risk anticipation and the evaluation of regulations for managing tax lifecycle risks with regard to planning, forecasting, compliance, and dispute constitute genetic information. Unexpected tax risks have the potential domino impact on other risks if they arise. This article investigates the idea of tax risk management with particular reference to the specific risk areas. It does this by combining literature and visual representation structure methodologies. Cozmei, C., & Șerban, E. C. (2014).

Banks play a significant part in aiding client companies' tax planning. The paper establishes the extent to which banks are related with tax avoidance by corporate borrowers by capturing bank-client connections using lending contracts and assessing borrower tax avoidance with the three-year cash effective tax rate and the unrecognised tax advantage balance. The average tax avoidance of a bank's other borrowers is an economically

significant indicator of a client firm's own tax avoidance, according to multivariate analysis. Additional tests show indications that banks serving as mediators in tax preparation may have contributed to this finding. It also obtains evidence that when clients start a new relationship with a bank whose current borrowers are sizable tax avoiders, tax avoidance increases significantly for them. The findings indicate that banks facilitate corporate tax reduction in addition to acting as financial intermediates and tax planning intermediaries. Gallemore, J., Gipper, B., & Maydew, E. (2019). After the financial crisis of 2008–2010, it became politically unworkable in the EU and elsewhere not to tax Big Tech, which was making billions of dollars in profits from market jurisdictions but not paying any taxes because of the PE limit in the treaties. This is why Pillar One was created. The Diverted Profits Tax (DPT), which was first implemented in the UK in 2015, was followed in 2016 by the Multinational Anti-Tax Avoidance (MAAL) rule in Australia and the Equalisation Levy (which is comparable to a DST) in India. In 2019, France was the first nation to enact a DST, which was followed by more than 25 other nations. The DSTs must be suspended until January 2024 in accordance with Pillar One, which was established in October 2021. In the event that Pillar One fails, governments have three choices for taxing Big Tech: DSTs, withholding taxes, and income taxes. (Avi-Yonah, R. S. (2023)). The system of foreign taxes is changing, and the regulations governing digital platforms with a worldwide audience after five years, will probably appear very different, and they already do so in a very noticeable way. When all is said and done, the ensuing tax standards will deviate from enduring international tax norms, necessitating conceptual advancements on the current framework. The gravitational pull of the three largest global platforms—Facebook (Meta), Amazon, and Google—will have compelled many of these changes, so the most intriguing aspect of these developments is not how the tax laws have shaped digital platforms' business models but how digital platforms have shaped international tax law. Hayashi, A., & Kim, Y. R. C. (2023). Analysis of how special purpose vehicles are used, what drives them, and how that affects earnings (SPVs), indicate strong corporate governance tends to reduce the usage of SPVs, according to Tobit regressions of the factors that influence their use, except for those SPVs founded mainly for economic, tax, or other reasons. (Feng, M., Gramlich, J. D., & Gupta, S. (2009). A business can employ a business entity in tax planning as long as it is not a colourable tool. The corporate veil was lifted in 2009 by the Vodafone verdict, which used low standards. Any tax preparation involving a corporate entity may be challenging if the tax claim ultimately succeeds. As a result, the report advises employing a business structure for tax planning in a cautious manner. (George, M. P., & Agarwal, P. (2010)).

3. Research Gap

The past studies have indicated the issues arising in tax planning and the taxation of EPC contracts and permanent establishment arising therein, with different types of PEs arising in the process. However the aspect of design framework, linking the factors involved in EPC contracts responsible for arising of a Permanent Establishment, with possible solution and coming out with a checklist based on both OECD tax risk parameters and the key judgments parameters as propounded by various jurisdictions has not been found to have been discussed in this study. This study on EPC contracts proposes to examine this and also how taxation will evolve in the digital age, and its effect on EPC contracts.

4. Objectives Of The Study:

1. To study the relevance and importance of tax planning in the context of EPC contracts, and find if EPC contracting corporates are practicing tax planning
2. To examine the role of key factors, which influence the structure of the EPC contracts, and the reasons why split of contracts may be considered, necessary by corporates.
3. To study the decided cases in the context of EPC contracts holding the importance of tax planning of EPC contracts, by split into offshore and onsite part, and rationale behind these decisions.

5. Methodology:

The various court decisions and the circumstances that went into them shed more light on the reasons for the court's interpretation of whether a PE has arisen or not. The exploratory study takes into account the legal pronouncements of ITAT, HC, SC, and views of professional consultants like Deloitte, KPMG, E&Y, etc. and offers advice and recommendations on the most recent developments in business practise.

5.1 Data Source

The study is exploratory and draws on secondary data from a variety of government reports, historical studies, publications from the Tax Justice network, the OECD, Deloitte, PWC KPMG, Itatonline. org, the Chartered Accountant Journal, the Bombay Chartered Accountant Journal, the High Court, the Supreme Court, and the AAR, among other sources. Also, the authors examined significant court cases, specifically how they were decided at different levels at the ITAT, AAR, HC, and SC levels mainly from 2007-08, to 2023.

6. Results & Discussion:

Cases Analysis:

Based on the samples of EPC corporates collected, it appears to indicate that there is possibly some amount of tax planning and tax avoidance (ETR) being practiced by the EPC corporates, and coupled with the past studies that indicate a relationship between tax avoidance and ROA, in a move to increase shareholder value the corporates may be looking at different ways of structuring the EPC contracts, and at times, it comes under judicial review of the courts. Further past precedents decided by courts add further to the confusion and the dimensions of the same.

i) Study the relevance and importance of tax planning in the context of EPC contracts, and find if EPC contracting corporates are practicing tax planning

While tax planning is an accepted method adopted in trade and commerce to reduce the liability arising, often it appears corporates get into the domain of tax avoidance which is fraught with risks and uncertainties, as the same is likely to be challenged by the tax-man and the Govt. While the cost for tax payer is in the form of uncertainty, interest on tax payments, and penalties, the cost for the Govt, takes the form of slow down of FDI flow, funds getting re-routed from destinations which have more favourable tax treaties with India, possible loss of investor interests, and loss of recognition in international arbitration (e.g Vodafone case, Cairn Energy case) with its associated costs. It is also observed that in the Indian context the department has been reluctant to issue any guidelines on tax planning or possible warnings in tax avoidance context, coupled with judicial rules which create more uncertainty to investors, in the context of taxation of income, capital gains too. With shareholders wealth and investor aggressiveness for higher returns, it is to be a natural corollary for tax planning. Further in the context of EPC contracts the margins are low in the range of 6% to 12% and hence the pressure to plan adequate for taxes, is compelling given the tight project execution deadlines, sponsor demands and project priorities.

In line with the past literature, studies, and aspects certain factors appear to be quite relevant and useful for structuring contracts. These factors are effective tax rate, chances of detection of tax avoidance, perceived fairness of tax administration action, rulings delivered by the judiciary, concerns of stakeholders, funders for project as to safety to assured minimum return on their investments, tax aggression initiatives of the Govt etc. Further split contracts help mitigate tax risks and add commercial value, by shifting of major portion of work to the offshore entity can lower tax risk, and is the practice followed globally. The structure of participating entities plays an important role in mitigating tax risk, and subsidiary as a structure for local execution of contracts is an accepted commercial practice. Also Courts look through the contract, in its entirety, while issuing the final ruling on taxability, and look at the prime commercial purpose behind the contract. Split contracts and documentation and the acts of parties while executing contracts to determine the role of parties, are examined by courts -for possible tax implications. (Dong Fang Electric Corp, 2012) Firms with lower cash effective tax rates bear significantly greater tax uncertainty. (Dyreg, Hanlon 2019) Past studies mention large firms, multinationals, and Institutional owners are likely to be practicing tax avoidance, and External Tax advisors are more confident of a structure when they recommend it to entity. (Fallen 1995). These factors can significantly influence the outcome of arising of a PE or otherwise in tax cases and is therefore becoming a crucial aspect of planning for EPC contracts in such a way that liability due to PE arising is kept to a minimum level, and thus the imperative of tax planning, which at times borders on tax avoidance too.

ii) Examine the role of key factors, which influence the structure of the EPC contracts, and the reasons why split of contractors may be considered, necessary by corporates

Past studies indicate the presence of very many factors which influence the split up of contracts. While several motives like adding firm value, increased tax savings, reducing effective costs of project may be valuable in themselves, the primary reason for EPC contracts to split the contracts have more to do with the form of EPC contracts where different players come together and work under one umbrella contract to deliver the project. It therefore becomes natural to clearly define the scope of each project and put them in a separate agreement and the overall linkage between these contracts is given reference to in the master agreement. Another key factor is the insistence by financial institutions and investors to setup an SPV for executing contracts and house the assets and liabilities and monitor their cash flows and manage the profit and loss separately. With separation of off shore and on-site parts of EPC contracts, it helps corporates primarily to i) divide the scope of work ii) Able to execute the major part of contracts outside India iii) SPV route and contract split route giving them possible tax savings iv) lower margins typical of EPC contracts being in the region of 6% to 12% v) High nature of complexity in integrating various sub-systems vi) Participation of various players for execution of the project vii) Assembly, Installation, testing, commissioning and performance at the on-site place. This helps considerably in execution of project and globally is an accepted practice. In the process the funders, and banks and auditors also assist in SPV structuring for the entity, as their support is crucial to effective project delivery. They look at optimising of tax savings, using intermediary SPVs and in the process the split contracts emerge. These though are standard routes for tax planning, however judiciary has different approaches and may try to interpret the splits in manner which are not entirely from business or commercial perspective. The current principles adopted by the judiciary, is that the transactions should have a commercial purpose, look at the contract- not look through, it must not attract the provisions of GAAR, meaning that the objective of tax benefit should not be the prime purpose of contract, though incidentally it may turn out to be one of the purposes. Further courts have already held in many cases that offshore supply of equipment and services is not taxable in India, unless a clear nexus appears to exist between the PE arising in India and services performed, in which case only attributable part of profits on work executed as arising in India is taxable. These necessarily incentivise the large entities in EPC contracts to perform major part of work, like delivery of equipment, design and services, fabrication to be executed outside of India. While tax planning practices are a given and accepted and well known across the world and are in the knowledge of jurisdictional tax administration, the lack of cooperative framework has hindered the effective tracing of the planning and avoidance activities. Over time and increased loss of revenue to certain nations, they have become more cautious in extending exemptions, benefits and concessions to industry and have put safeguards, pre-conditions and clearly laid out regulations for reducing shifting of profits from high tax to low tax regimes. Key among these initiatives is the BEPS action category which aim to regulate the extensive tax planning initiatives taken by large corporates and MNCs. Among the most significant ones that affect this aspect are the action points related to BEPS, harmful tax practices (A-5), Permanent establishment status (A-7), Avoidance of artificial splitting of contracts, disclosure of aggressive tax planning (A-12), Multi-lateral instruments (A-15), Prevention of treaty abuse (action -9), These are closely linked to tax planning and are especially employed in structure, design and execution of EPC contracts. Post the BEPS, opportunities have reduced considerably due to close monitoring and reporting in the form of reports under the OECD announced BEPS to which India is also a signatory. Transfer pricing regulations though are existing in Action -8, 9, 10, 13, are not yet fully accepted by India. This also causes issues in pricing for EPC contracts particularly as it involves transfer pricing implications for plant and equipment as well as services, and may cause arising of additional impact due to income additions, more so in context of intangibles, like patent, trademarks, brand royalty and rights to use etc. OECD has also developed tax risk indicators which can be useful as guidance tool in this regard and certain geographies like UK have published reports, guidance and advisories on tax avoidance, shelters, while Singapore has initiated measures for corporate tax governance and solicits voluntary active participation and co-operation from the tax payer, based on certain specified regulations.

iii) Study the decided cases in the context of EPC contracts holding the importance of tax planning of EPC contracts, by split into offshore and onsite part, and rationale behind these decisions.

In the development of EPC contracts, the importance of tax planning, avoidance, and contract splits are closely tied. Tax planning is acceptable, but the judiciary has taken a dim view of tax avoidance. However, corporations frequently struggle with how to increase shareholder value through tax avoidance practises as opposed to pure tax planning, which results in lower levels of wealth creation and project profitability, by getting

under the taxman's glare. Looking at historical judgements at various levels reveals the main elements of tax planning and possible tax avoidance aspects in relation to EPC contracts. In the following cases the tax planning and avoidance aspect and has been upheld by courts.

Table 2: Case Laws on PEs

SL. No	Case law	Citation-Authority	Decision favour of	Decision and Rationale
1	DIT Vs LG Cable Ltd	2011 -TII-02-Del -HC-Intl	A-TP	Offshore supply not held to be taxable in India, simply because of the facts that the contracts are interlinked with the on shore contract's performance.
2	Michelin Tamilnadu Tyres Pvt Ltd (AAR 1218 of 2011)	AAR 1218 of 2011	A-TP	Offshore supply of equipment is not taxable in India under the Income tax act , as well as under the Indo –Japan tax treaty
3	Linde AG, Linde Engineering division and another (2014)	DCIT [TS-226-HC-2014(DEL)]	A-TP	The equipment and materials were manufactured and procured outside India, and the title to these was also transferred outside India. Accordingly, the income attributable to the supply thereof could not be brought to tax under the Act. If the services relating to the design and engineering were inextricably linked to, and formed an integral part of, the manufacture and fabrication of the offshore supply, then such services rendered by the taxpayer would not be taxable as fees for technical services (FTS) other-wise taxable as FTS.
4.	Hyundai Heavy Industries Co Ltd	291 ITR 482 - SC	A-TP	SC held that the installation PE came into existence after the contract with the project owner was concluded, transaction materialized, fabricated platform delivered offshore to the agents of the project owner. Therefore, profits earned for the supply of the fabricated platform not attributable to the installation PE in India
5.	Ansaldo Energia SPA-V- ITO	(2009) 310 ITR 237(Mad)	D-TA	The Four contracts were interwoven it was a composite contract. Since Assessee did not disclose certain information and ITAT confirmed 75% of contracts in contract -I as taxable- matter remitted back to ITAT,by SC to decide on correct profits to be taxable.It was held that the break up of contracts was a façade – PE arises- income taxable

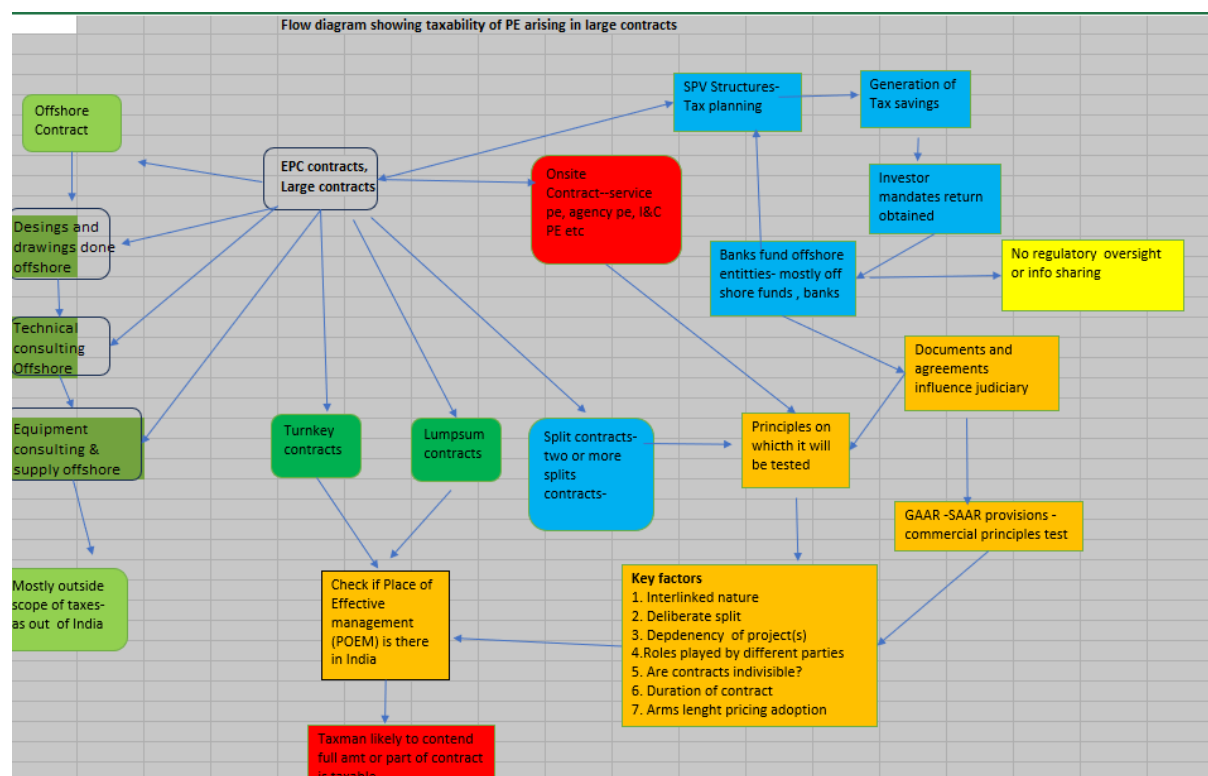
SL. No	Case law	Citation-Authority	Decision favour of	Decision and Rationale
7.	Durr Systems AG, Chennai-V-DCIT(Intl tax)	[TS-5398-ITAT-2023(CHENNAI)-O	D-TA	The German company's income from equipment supply, supervision, and installation is taxable in India since it is integrally related to and a component of the same turnkey project. Further the three components of the turnkey contract—offshore supply, supervision fees, and installation and commissioning of the project—were not naturally divided into two separate parts but had instead been artificially divided. Hence, it was determined that the contract was composite and that the supplies were taxable in India.
8.	<i>JGC Corporation v. Federal Inland Revenue Service</i> (2014) 15 TLRN	Nigerian case	D-TA	It was decided by the High Court, that execution of offshore contracts is not subject to taxes, in Nigeria.
9.	<i>Saipem Contracting Nigeria v. FIRS</i> TLRN (Vol. 15), July 2014.	Nigerian Federal court case	D- TA	Saipem Portugal and Saipem S. A. made appeal at the Federal High Court stating that it was a multiple contract case, and also no profits were derived from Nigeria but the High court held since it was single contract and was performed in Nigeria it will be taxable in Nigeria as per their Corporate Income Tax Act regulations.

A= Assessee D = Department TA =Held Tax Avoidance TP = Held Tax Planning

7. Proposed Framework And Checklist

The authors have gone through the past studies and judiciary trends and precedents in the matter relating to EPC contracts and have come up with a framework which might help the industry and corporates to look at possible scenarios which may likely trigger liability to tax and those that are not likely to trigger tax liability. These are comprised of a variety of factors and the roles they play, the interlinkages between funders, bankers, factors that are considered by judiciary in deciding the outcomes. The two parts of Offshore and one-site are specific components of EPC contracts. SPVs are key to obtaining tax savings and to ring-fence the project from other risks and liabilities, and offshore banking system prevailing globally helps in effective conduit for funds into SPVs. The judiciary while examining the key aspects of the transactions has to go by the tax laws, specifically laid out, past precedents and is conditioned by documents and apparent objectives and cannot go into ulterior motives unless the basic motives, of transaction are basically that related to tax avoidance or evasion. It is to be further noted that there is no regulatory oversight on offshore entities, acting as conduit for funds unless crime nexus proved. These provide an opportunity for tax avoidance, and as evidenced by past studies they are effectively employed by corporates.

A brief flow diagram is as given below :-



The C-by-C reporting as mandated under BEPS for corporations with over Euro750mill will have indicators which may trigger tax investigations and avoid the shifting of profits from high tax regions to low tax regions, and can reduce the tax avoidance impacts partially. Using certain risk indicators as parameters the tax authority can focus on areas which need more attention to get higher revenue collection. Pillar one and Pillar two also propose to limit the scope for tax avoidance or reduction as countries become more sensitive to the revenue losses and look at ways for plugging the loopholes. The tax risk indicators as below can also be used as instrument for developing a suitable checklist and make it for possible preventive tax mitigation strategy.

Table for Tax Risk Indicator – A checklist

SL no	Tax Risk indicator	Risk rating	Response of client /EPC entity
A	General – As per OECD guidelines		
1.	The foot print of a group in a jurisdiction	Amber	Yes – indicates scope for TP
2.	High value of related party transactions in particular jurisdiction	Red	Yes – Indicates risk for contract
3.	Jurisdictions with substantial profit and little activity- higher passive income	Red	Yes – indicates high risk
4.	Significant profits but low level of taxes in certain jurisdictions	Red	Yes – indicates - possible GAAR action
5.	Group or entity active in areas which possess BEPS risk	Amber	Yes -indicates possible action against entity by taxman

6.	Changes in group structure according to location of assets	Amber	Yes – possible action by taxman
7.	Too many no of SPVs in group not commensurate with volume of turnover or commercial purposes	Red	Yes – most likely action or scrutiny may be called
8.	Higher number of subsidiaries generating passive income for holding company	Amber	Yes -if no major substance for operating cos
9.	Marketing entities located in jurisdictions outside key markets	Amber	Yes – indicates high risk
10.	Income tax rate is consistently higher than ETR (effective tax rate) or cash effective tax rate	Amber	Yes -indicates possible risk
B	Specific to EPC contracts		
1.	Whether the scope of contract is such as it requires separate contracts to be handled ?	Yellow	Yes – indicates low risk
2.	Is it of such nature that one EPC firm does not have skill and competencies to deliver the project?	Green	Yes – indicates low risk
3.	Is the duration of project within the limits as given by the country DTA with India for PE formation?	Green-Amber	Yes -indicates low risk
4.	Whether onsite and offshore contracts scope are clearly intertwined into a single contract?	Red – Amber	Yes -indicates high risk
5.	Decomposition of material equipments, services are such that services at site are directly linked to prime activity outside India and are not capable of being bifurcated.	Amber	Yes – indicates – moderate risk
6.	Whether the entities are controlled by persons resident in India or have been acting under directions and instructions of parent outside of India	Amber	Yes -indicates high risk
7.	Whether the contract documentation and linkage to projects execution in India are carefully designed to avoid a dependent agency PE or a Service PE?	Yellow	Yes – indicates low risk
8.	Whether installation, commissioning ,testing services are performed in India by foreign personel deputed to India or a subsidiary of a foreign company in India?	Red	Yes -indicates moderate risk
9.	Whether companies are splitting a contract – clearly with no economic substance as per agreement to obtain tax gains?	Red	Yes – indicates high risk
10.	Whether company is one in which there is Govt holding?	Yellow	Yes -indicates low -moderate risk
11.	Whether company takes advise of tax counsel to structure the EPC contract?	Green/Yellow	Yes – indicates moderate risk

12.	Whether company uses Big 4 services for tax planning?	Amber	Yes -indicates high risk
13.	Whether sub-contracting is done to third party, and finally routed to related party or subsidiary?	Amber	Yes -indicates high risk
14.	Whether a complex structure is being put in place , involving SPVs, with SPVs location in tax havens or more favourable tax jurisdictions to India?	Amber	Yes -indicates high risk

Note – The above matrix has been designed by the authors based on past judicial precedents, OECD tax risk indicators, and other factors. Here Red (4), Amber(3), Yellow (2), Green(1), are given ratings and these can range from 56 (4x14 for EPC contracts) to 14 (1x14) , and similarlyfor OECD based general tax risk indicators we can have from 40(10x4), to 10 (10x1), as risks involved. The sum total of these or a matrix of these can be guiding indicator risk . It can be used for decisions based on the Risk rating matrix – for large EPC contracts and higher the total score, higher the risk and higher the chance of tax man notices that can be received higher the risk of adverse decision from the judiciary. The above checklist can also be converted into an excel document which can be taken as a template too, giving first level identified of the risks involved in an EPC contracts. Based on the extent of risk perceived necessary structuring or split or shift of work for services, material and equipment can happen, to reduce or mitigate the risk involved. The authos believe such a checklist will be quite useful to management.

The digital taxation of EPC contracts will take the form of deemed PE arising,based on turnover, profits, asset levels in the jurisdictions being used to generate tax revenues. It can also lead to independent imposition of levies like the Google tax, online tax on sales revenue, etc and has attained a particular status in terms of consolidated framework for taxing of digital platforms. This could perhaps help in bringing certain off shore work being performed for EPC contracts outside of India , to tax , if direct nexus is proved to the activities being held in India. Futher the concept of POEM – place of effective management will also be useful to determine where the head and brain of the entity is located and where the board meetings of directors are held, and whose instructions are being acted upon by the Indian entity or its directors. These can increase the risk of getting involved in a PE case.

8. Limitations:

The study is exploratory and covers only select EPC companies, and does not consider the behavioural attitudes and litigation nature for cases, for the taxpayer and the department attitude in such cases, and tax morale in economies like India, and is not an empirical study.

9. Conclusion:

The taxation of EPC contracts, which have a variety of structures with separate offshore and onsite parts performed and delivered in India for the final customer, is, according to the authors, one of the most frustrating and complicated aspects of large contracts. The authors conclude that the project sponsor or investor should be informed of the tax outcomes in order to avoid significant uncertainty and loss of trust. Past studies as well as our paper here observes, some amount of tax avoidance practices are likely to be found in practice, so long as it does cross a specified safe harbour limits, the taxman should not be contesting the same and the Govt would do well to announce some safe harbour rules on Turnover, profit margin, asset levels etc. This will bring more certainty to taxation of these project and have an impact on FDI flows and trust of investors, which are essential for economic development. A sine qua non for the efficient growth of the economy at reasonable costs is the certainty of legal outcomes in the field of taxation in EPC contracts. The use of SPVs, trusts, subsidiary structures to get tax savings in the process are likely to continue and care needs to be seen that they do not cross the line into tax avoidance. The taxpayer will use various structures to reduce his tax liabilities, which can be legitimately held to be valid. The judiciary will need to continuously develop new paradigms with sound business judgement as an investor or entrepreneur structures and manages his company. The proper balance on these parameters will increase trust in

the tax policies and measures; otherwise, litigation will be the primary means of resolving the issue, which is best avoided. In the context of digital taxation going forward in future the Pillar 1 and 2 as announced by OECD will find more support, and seek to limit the scope of revenues escaping tax net by resort to taxes on online turnover , not conditioned by PE arising, sales, assets and profits in a jurisdiction, as well as minimum tax level thresholds to be met with failing which the countries have the option to put a top up tax.

Large corporates should come out with their respective standards on tax risk management and imbed it in their annual report ,and strictly abide the same. These policies to be arrived at after intense deliberations at the board level for organisations and be committed to same and this would reduce the level of risk of tax litigation, and bring about a certainty of outcomes on taxability or otherwise of a transaction. Tax risk profiling for jurisdictions and sharing of information exchange between two jurisdiction tax authorities have become necessary and has progressed to significant levels. Active engagement of dialogue between the tax department and the corporates , in a more effective manner with reliance on trust and creation of a less aggressive approach by tax man might help in better outcomes in the context of tax revenues for the Govt, and will not drive the value adding activities offshore, which but for the taxes would have necessarily been performed onshore. All these will finally help the growth of infrastructure contracts and help in growth GDP of the Indian sub-continent.

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