



**WESTERN INDIA REGIONAL COUNCIL OF
THE INSTITUTE OF CHARTERED
ACCOUNTANTS OF INDIA**

EPC Contracts - Changing landscape and managing risks



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The Journey of EPC Contracts

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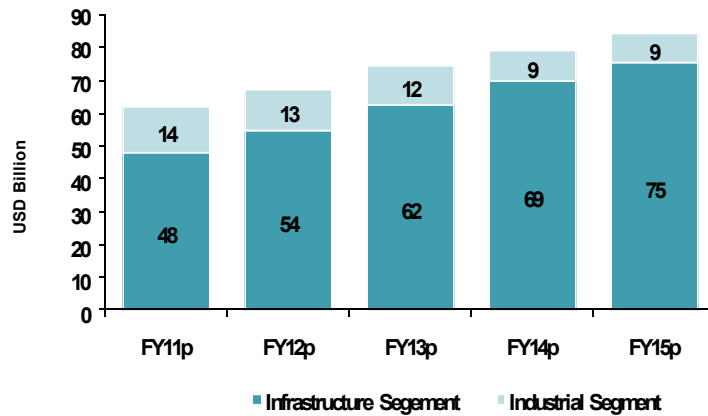


Overview - Infrastructure and EPC Contracts



Infrastructure Developments – A major focus of Government

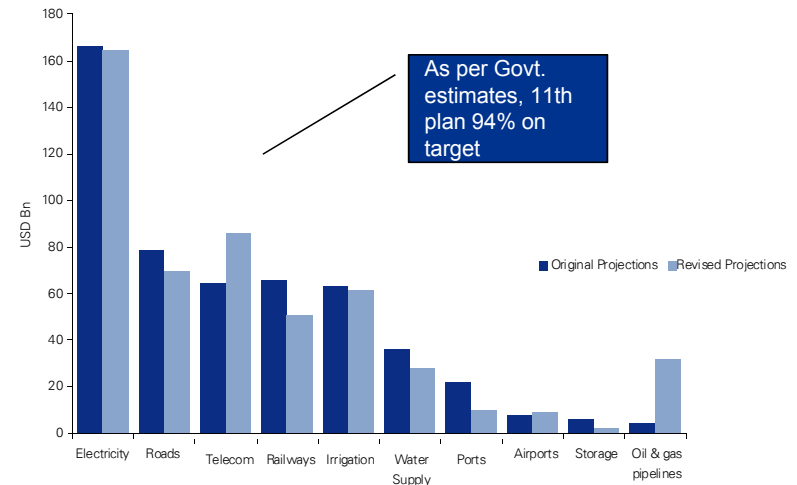
Construction Opportunity from the Public infrastructure and Industrial Segment



12th Plan targets

- Investments projected to increase to USD 1 trillion
 - twice the 11th plan target
- Private investment estimated to be 50% (it is 31% in 11th plan)
 - in absolute terms, will be equal to total 11th plan investment
 - target for 12th plan is 3.2 times the target for 11th plan
- Key investment destinations remain unchanged

11th Five Year Plan



Projected Infrastructure Investments in 12th Plan

	Base Yr (2011-12)	2012-13	2013-14	2014-15	2015-16	2016-17
GDP (USD Billion)	1,595	1,738	1,895	2,065	2,251	2,454
GDP Growth (%)	9.00%	9.00%	9.00%	9.00%	9.00%	9.00%
Infrastructure Investment (% of GDP)	9.00%	9.25%	9.50%	9.75%	10.00%	10.25%
Infrastructure Investment (USD Billion)	144	161	180	201	225	252
Total Investments (USD Billion)	1,019					

EPC Contract - Constituents

Three distinct principal aspects for executing a project

Engineering

Design and engineering for the project.

Includes basic, project and detailed engineering for *project as well as plant, equipment and components thereof*.



Construction

Civil works, receiving / handling equipments, erection, commissioning and testing of the project.

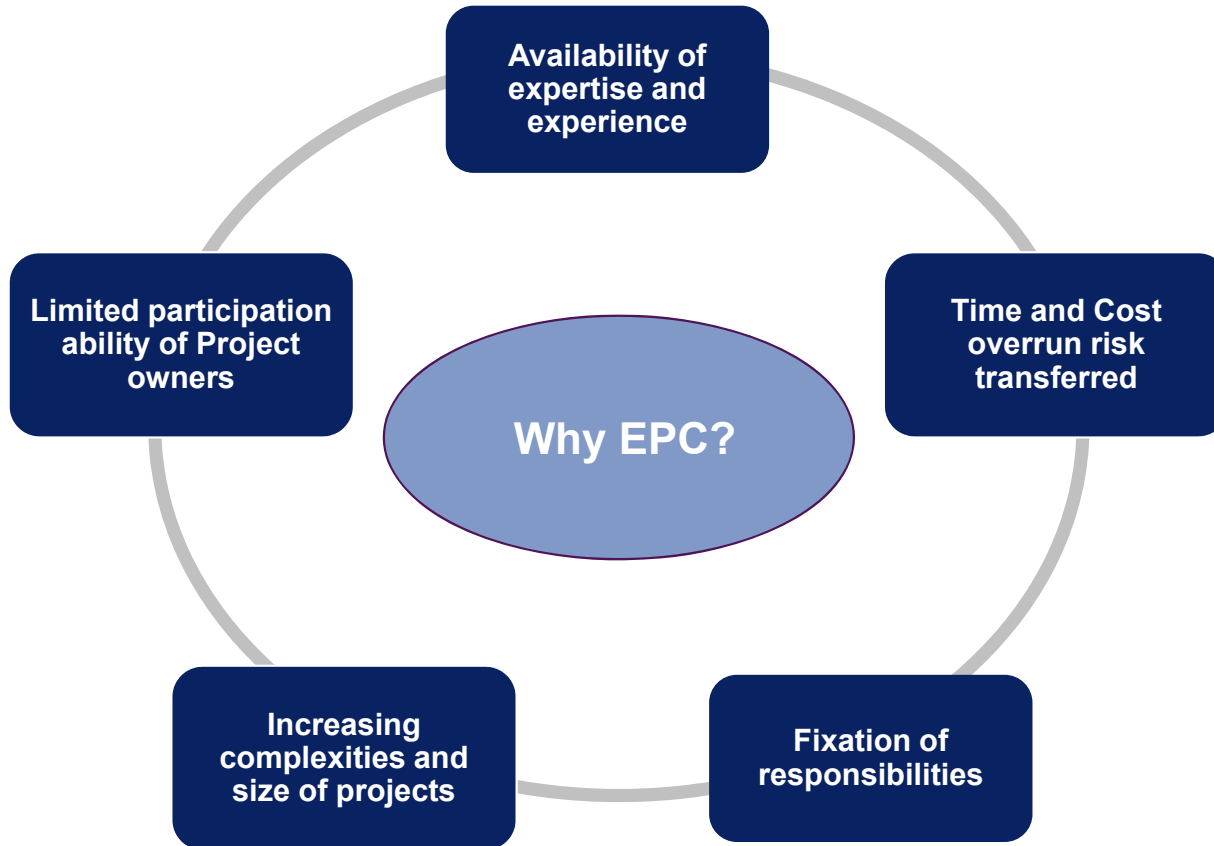
An EPC contract is typically executed between the Project Owner and Contractor(s) for erecting an industrial plant, infrastructure project, etc.

In most cases, an EPC Contract is executed as a "Turnkey Contract", which entails the Owner only having to commence production/ Business after the handing over of the completed project.

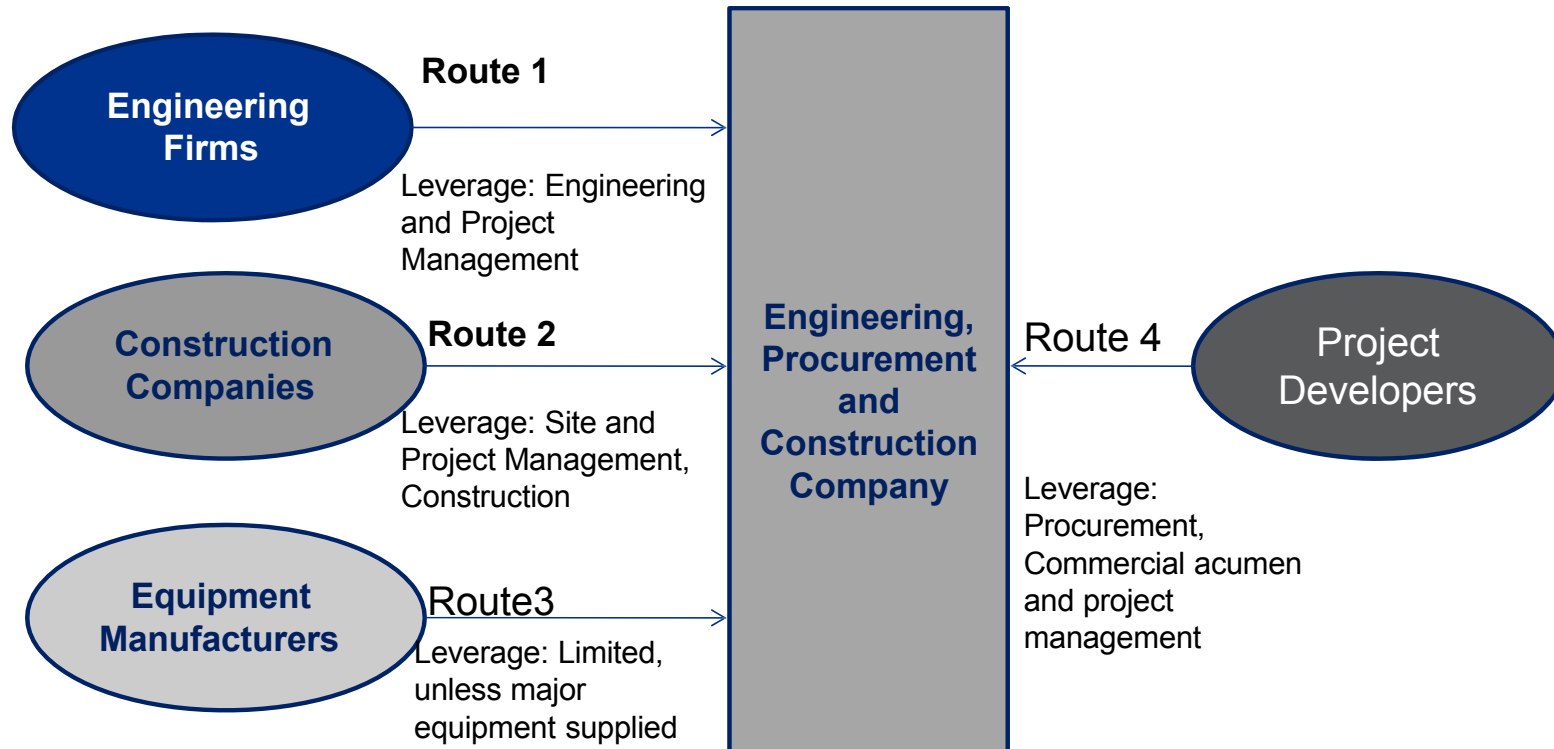
Procurement

Identifying, negotiating and arranging supplies of equipment and ensuring *compatibility* of different pieces of equipment with each other

Need for EPC contracts



Evolution of EPC Industry globally



There is a clear need for emergence of large EPC companies in India to support the infrastructure growth, however there are not enough large Indian companies moving in that direction

EPC contract – Key Attributes

EPC contract results in several distinctly identifiable income streams to the contractor

FOUR BROAD CLUSTER OF INCOME STREAMS

Offshore supply of equipment / materials

Offshore supplies

Offshore designing of layout, networking etc

Offshore services

Procurement of local materials

Onshore supplies

Onshore skilled* and unskilled services**

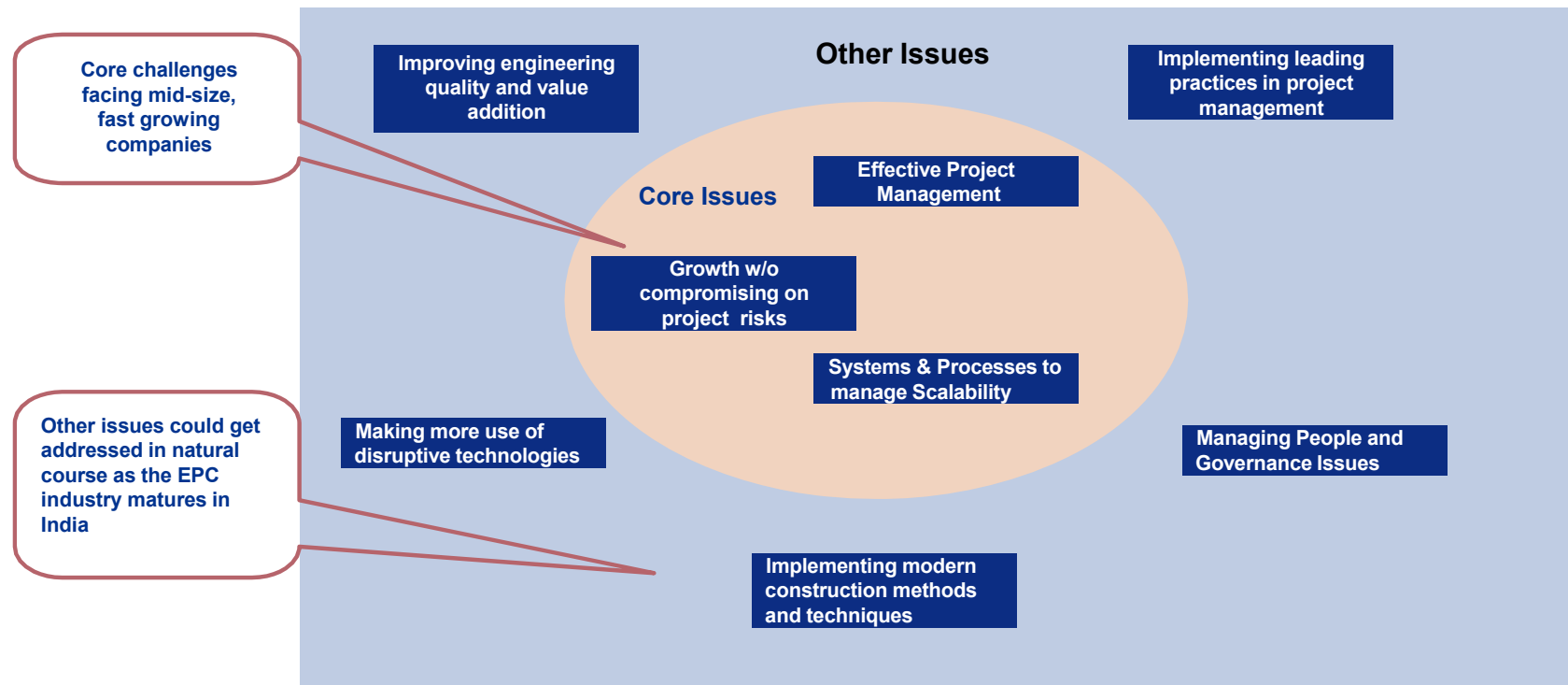
Onshore services

Tax treatment of income streams would depend upon which of the two broad categories the stream belongs to – 'offshore' or 'onshore'

**Skilled services viz technical services – design, detailed engineering, training etc*

***Unskilled services viz other local services– Installation, commissioning and other related activities*

Key internal challenge of EPC Industry

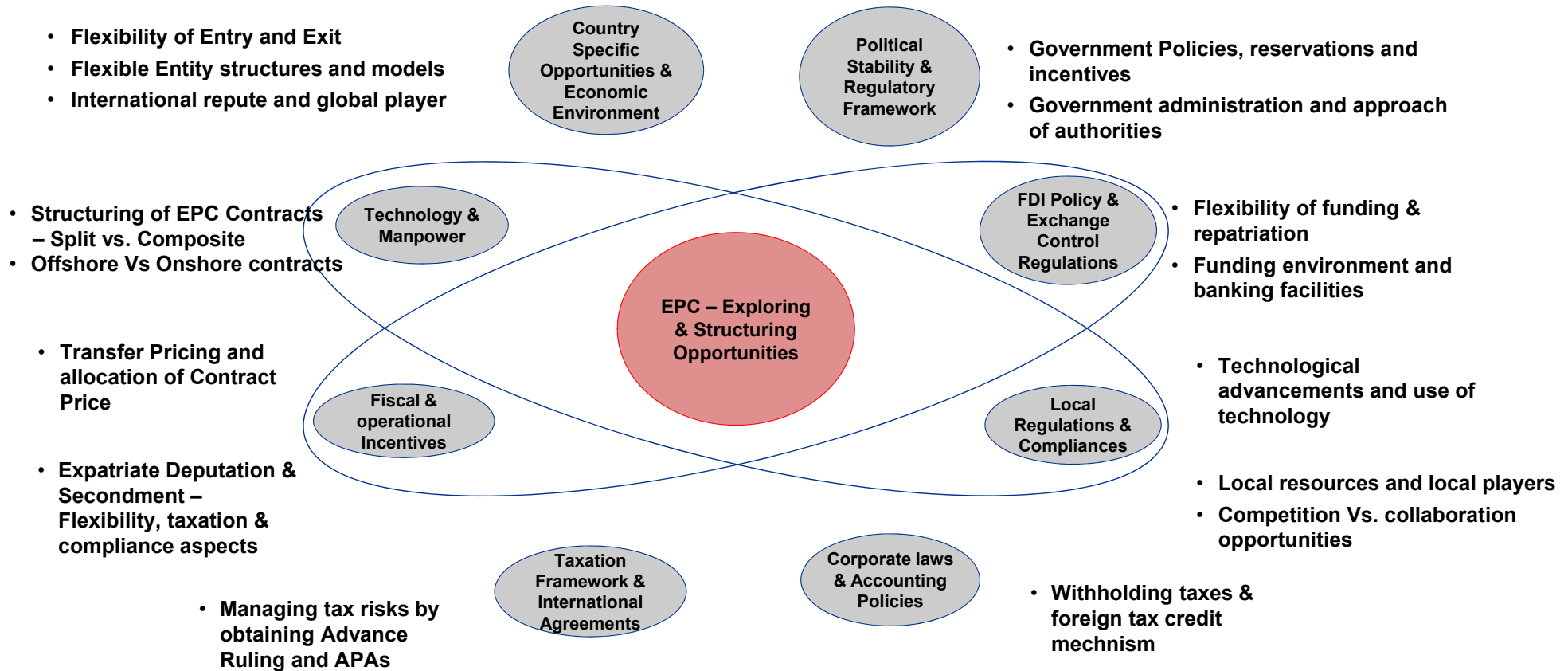


Key internal challenge facing the Indian EPC Industry is the ability to manage scale & diversity, with rapid growth & diversification into new business areas

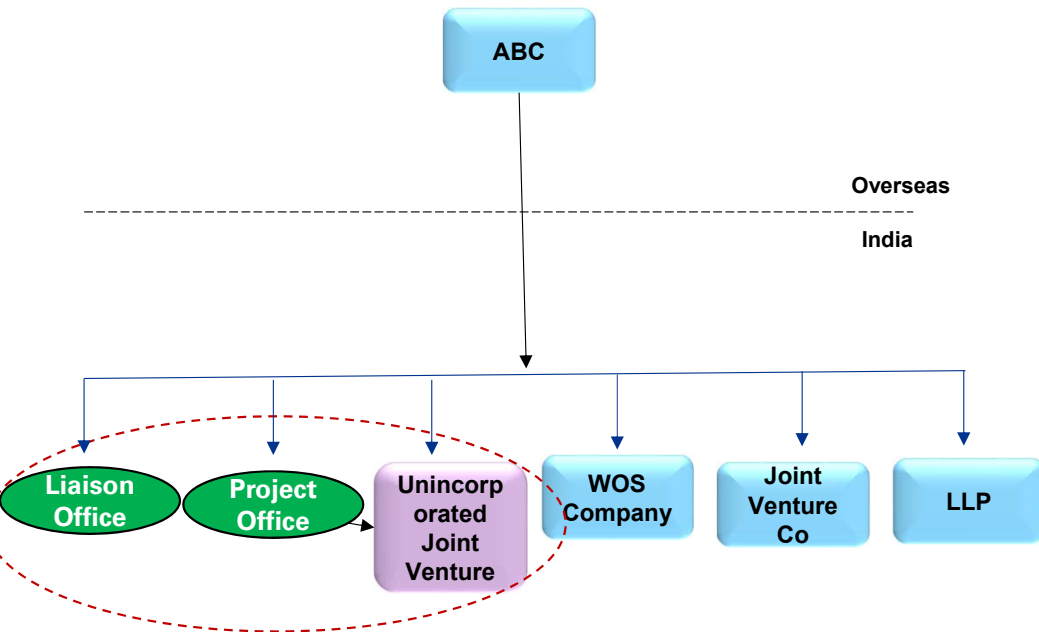
EPC Contract Structuring – Multi Dimensions



EPC Contract Structuring – Multi Dimensions



EPC Contracts - Entity structure for foreign contractors



Key Considerations:

- Regulatory Reasons/Requirements
- Conditions laid down by Project Owner
- Project execution independently or jointly with a partner
- Conditions of Joint Venture partner
- Long term Vs. short term perspective
- Duration of project
- Single contract Vs. Multiple contracts
- Limiting exposure of risk for the overseas parent
- Foreign funding Vs. local funding
- Tax efficiency and tax leakages
- Repatriation of profits
- Ease of establishing the presence and compliance burden

EPC Contract Structuring - Commercial Issues



EPC Contracts – Contractual issues

PROJECT LIFE SPAN

Owner: IA/PPA/Offtake Agreement/Concession Agreement (**Owner's Agreement**)

Lender: Financing Agreement(s)

Contractor: EPC Contract

Other Contracts



- **COD *vis-à-vis* Owner's Agreements –**
 - Completion of construction *versus* COD.
 - Unit COD *versus* Project COD.
- EPC Contractor's obligations with respect to completion of construction and COD: mapping with the Owner's Agreement and the Financing Agreement.
- **Extension of time with LDs *and* right to terminate or extension of time with LDs *and no right to terminate*:** Mapping provisions of the Owner's Agreement.
- **Pass through of construction risk(s) –** If construction/COD is not completed by the time stipulated:
 - Whether the EPC Contractor is entitled to any relief the Project Owner receives or is entitled to under the Owner's Agreement such as extension of time?
 - The Force Majeure Event of the EPC Contractor's sub contractor or sub-sub contractor mapped to ***equivalent or less*** of the protection EPC Contractor is entitled to under the EPC Contract?
 - Whether the quantum of damage(s) payable by the EPC Contractor for default or delay is ***linked to or limited by*** that of the Project Owner under the Owner's Agreement?

EPC Contracts – Contractual issues

PROJECT LIFE SPAN

Owner: IA/PPA/Offtake Agreement/Concession Agreement (**Owner's Agreement**)

Lender: Financing Agreement(s)

Contractor: EPC Contract

Other Contracts



- **Damages –**

- Whether the delay attributable to the Project Owner or another of the contractor(s) employed by the Project Owner?
- **Treatment of “Concurrent Delays”** – Whether the delay is attributable to Project Owner and EPC Contractor, jointly?

- **Termination** – If Owner's Agreement gets terminated:

- What are the remedies available to the EPC Contractor (Termination Payment, termination of EPC Contract) under the EPC Contract - split or otherwise?

EPC Contracts – Contractual issues

Other key issue(s)

Defect Liability Period

- Fixation of defects liability period *vis-à-vis* the payment withheld by Owner on account of DLP.
- **Trigger of DLP –**
 - Whether the defects liability period triggers post COD of a Unit or COD of the Project.

Variation – Residual Scope

- Delineation of actual scope of work *vis-à-vis* additional scope of work that may be implied under the Owner's Agreement.
- **Right(s) available to EPC contractor *vis-à-vis* additional scope of work** - Additional scope of work to be undertaken in the EPC Contract or separate contract? Right of EPC Contractor to participate in a separate contract.
- Implied or consequential liability *vis-à-vis* EPC contractor's right with respect to additional scope of work.

Suspension

- **EPC Contractor's liability during suspension:**
 - Design risk;
 - Construction risk;
 - Cost risk;
 - Effect and consequence on DLP.

EPC Contracts – Contractual issues

Other key issue(s)

Force Majeure

- **Force Majeure Event** – Inclusive or exclusive definition identifying event(s) that may adversely affect the performance of EPC Contractor's obligation(s).
- Event versus effect of the Force Majeure.
- Treatment of EPC Contractor's obligation(s) during Force Majeure.

Termination

- Project Owner's Right to terminate EPC Contract *vis-à-vis* termination event(s) under the Owner Agreement.
- Treatment of accrued obligation(s) of the EPC Contractor in the event of termination of EPC Contract such as return of mobilization and demobilization advance.

EPC Contracts – Direct Tax Issues



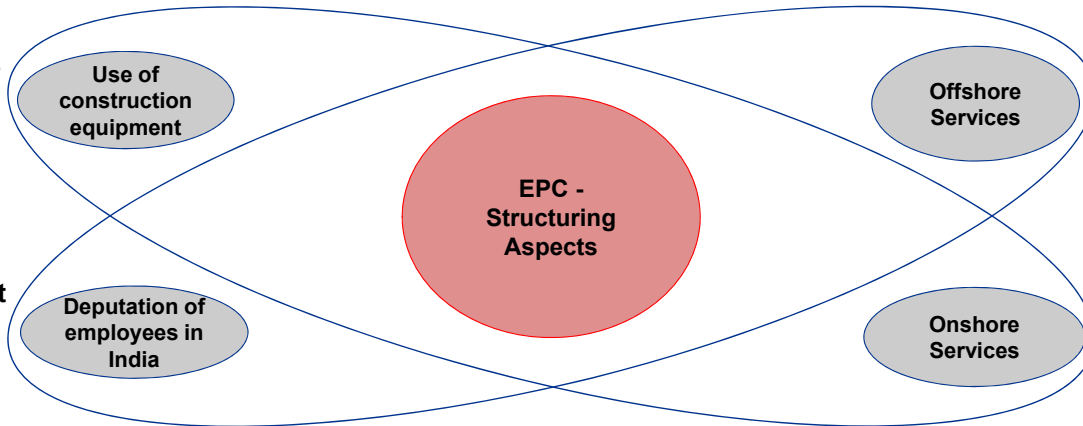
EPC Contract Structuring - Web of Issues

- Impact of performance guarantee
- Firewalls against being considered composite contract
- Impact of GAAR?



- Leasing v/s actual purchase
- Use of commission payments
- Effect of withdrawal of beneficial circulars

- Dry lease vs. wet lease



- Technical services v/s business income
- Withholding tax impact

- Service PE exposure
- Analyzing Secondment vs. Deputation vs. Cross Charge

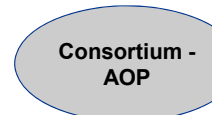
- Segregation – especially installation services
- Minimise PE exposure

Designs and Drawings

- Royalty / fees for technical services / business income

Sale v/s licence

- Royalty v/s business income
- Standardised v/s customised



- Analysing AOP exposure and mitigating it
- Tax issues of AOP

EPC Contracts – Direct Tax issues

Choosing Act Vs. tax Treaty:

- Beneficial tax treatment provided in the Act – exclusion of few contracts from FTS, lower rate of tax on royalties and FTS, lower rate of tax on foreign debt funding, etc.
- Gross basis taxation with lower threshold – 44BB (Oil Exploration) or 44BB (Civil construction for Power Projects), etc.

Eligibility of Tax Treaty Benefits

- The tax residency certificate and eligibility criteria to be satisfied
 - Interposing an intermediary company for supply and services:
 - Whether the objective is to avoid tax or minimize tax
 - What is the substance at an intermediary company level
 - Whether the services are provided through an intermediary services company which does not have substance – Expatriates from different entities are seconded / deputed / provided through such company?
-

EPC Contracts - Direct Tax issues

Constitution of Permanent Establishment ('PE'):

- Whether business conducted through any fixed place like branch or office or any site in India
- Number of days of presence in India and duration of activities carried out in India by foreign company as well as affiliates whether for connected or unconnected projects – whether exceeds prescribed threshold
- Extent of supervision and control exercised by foreign company
- Whether employees of foreign company are seconded/deputed to Indian group company
- Splitting-up of contracts between foreign company & its Indian affiliates whether artificial or genuine
- How Contract is secured and negotiated in India? Through an agent or by foreign company itself
- Effect of Force of Attraction Rule
- Interplay between Fixed Place PE – Construction PE - Service PE – Subsidiary PE
- Pre-commencement activities and post project completion activities

EPC Contracts – Direct Tax issues

Split Contracts v/s Composite Contract

- Can corporate veil be lifted to read all contracts as one and whether dissecting approach to be disregarded?

Depending on inter-linkage of agreements between group companies, the way a particular contract is assigned/sub-contracted, existence of supervision and control, etc – determines whether it is a genuine split contract or a composite contract and thus important to structure the contract;

- Characterization of income w.r.t all components of work
 - Exposure of offshore supply and services being charged to tax in India
 - Applicability of GAAR provisions in India as well as BEPS Action plans
 - Exposure to form Permanent Establishment ('PE') and/or business connection in India;
 - Attribution of profits to such PE in India – FAR Analysis is a MUST?
 - Application of Transfer Pricing Principles – Defense against contract price allocation
-

EPC Contracts – Direct Tax issues

Taxability of Supplies – Split Contract

▪ **Offshore supplies:**

- Situs of performance determinant for trigger of tax liability;
- Whether transaction is conducted on “principal to principal” basis
- Whether risk and title is transferred outside India – Relevance of INCOTERMS
- Whether sale consideration is received outside India
- Crucial to examine formation of PE in India
- whether any activities performed in India? If yes, by a foreign company or its agent or its associate company in India
- Interplay between Direct taxes and Indirect taxes laws – Conflicting Objectives

▪ **Onshore Supplies:**

- Whether onshore supplies made by non-resident contractor himself or by an Indian sub-contractor acting as an agent of a foreign company
 - Taxable on net basis @ 40% if attributable to foreign company
-

EPC Contracts – Direct Tax issues

Taxability of Services – Split Contract:

▪ **Offshore services:**

- Characterisation of income whether business income or royalty or Fees for Technical Services (FTS)
- Whether provision of services is inextricably linked to supply of goods,
- Whether such services are technical in nature and whether effectively connected to PE in India?
- Whether services are covered under restricted scope of 'make available' under respective Treaty
- Whether services qualify as construction services and covered under exclusion provided under provisions of the Act
- Applicability of Rule 44DA – Taxation on gross basis for foreign companies?

▪ **Onshore Services:**

- Whether onshore services provided by non-resident contractor himself or by an Indian sub-contractor acting as an agent of a foreign company
- Liability to tax in India on net basis

EPC Contracts - Direct Tax issues

Consortium Arrangements and AOP exposure:

- **Whether Consortium of foreign company with or without Indian Company constitutes an AOP?**
 - In order to construe a consortium to be an AOP, any of the following indicative factors must co-exist:
 - Two or more persons voluntary associate themselves in an income producing activity;
 - There is a common activity;
 - The parties come together for a common purpose or a common object intending to jointly make profits or gains;
 - There is joint management, joint control of affairs and joint participation;
 - Joint and several liability resulting in sharing of profits and losses;
 - Existence of umbrella/master agreement;
 - Thrust is on the intention of the parties. Division of profits amongst the members receiving income jointly may not be a determinative factor
 - **Tax perils of an AOP :**
 - Where AOP is a resident, its worldwide income taxable in India;
 - Treaty benefits jeopardized;
 - Payments of interest, bonus, commission, remuneration to members not deductible in the hands of AOP;
 - Set -off of losses against income of members will not be available to members;
 - Difficult for foreign company to get tax credit in its home country for taxes levied on income of AOP in India;
 - Cash trap - on account of multiple withholding of taxes at PO and AOP level
-

EPC Contracts – Direct Tax issues

Withholding tax issues on payments in EPC

- Can the deductor bifurcate the payments relating to supply and service arrangements?
- What if the characterization is altered by the Revenue, would the deductor be called an 'Assessee-in-default' to the extent of short deduction (if any)?
- Complexity arises in case of withholding from payments to consortium – applicability of tax treaty, rate of withholding tax, etc.
- Possibility of obtaining 'nil'/lower withholding tax' order or advance ruling

Tax Incentives to Contractors and sub-contractors in EPC

- Eligibility to claim deduction under section 80IA
- Eligibility to claim deduction under section 35AD

EPC Contracts - Indirect Tax Issues



EPC Contracts – Indirect Tax issues

- **Shift from multiple taxes to single tax – impact on existing contracts**
 - Transition Issues:
 - Carry forward of service tax, VAT and other credits in respect of stock lying on GST Regime
 - Under construction “civil structures” to qualify as “semi finished good” eligible for carry forward of input credit
 - Impact of “change in law” clauses
 - Need for Split Contracts – Offshore Vs. Onshore under GST
 - **Reverse Charge Mechanism under GST**
 - **Transfer of Title, risk and ownership in goods supplied – Change in the concept of “Place of Supply” Rules**
 - **Input credit under GST – Utilization mechanism for IGST, CGST and SGST – avoid leakage of taxes**
 - Input credit – Watch out for restrictions and prohibitions
-

EPC Contracts – Indirect Tax issues

- Exemptions and Benefits – Changing Scenario and impact thereof
- Need for Split of Contracts under GST Scenario especially in relation to “Works Contracts” resulting into creation of Immovable Property
- Change in the rates of taxes of various products and services
- **“Change of Law” Clause in EPC Contract documents – A major “Savior”**
- Specific Indemnities and Obligations for Damages under contracts
- Compliance Aspects – Need for obtaining registrations in India and its impact on PE for foreign players
Can the deductor bifurcate the payments relating to supply and service arrangements?

EPC Contracts - Impact of recent developments



Recent Developments – impact on EPC Industry

- Recent Circulars of CBDT in relation to taxability of EPC Contracts
 - Introduction of Thin capitalization regime u/s. 94B in respect of debt funding from foreign AEs as part of BEPS Action Plan
 - Foreign Tax Credit Rules notified demystifying foreign tax credit aspects in respect of income from overseas sources
 - POEM Rules notified to tax overseas income arising through India management and strategic actions
 - Extension of concessional tax rate of 5% on foreign currency funding as well as Rupee Denominated Bonds
 - LLP Regime more liberalized – both from FDI and taxation stand point
 - **GAAR made effective from 1 April 2017 – impact on structuring of Split Contracts**
 - CbyC Regime formalized and implementation rules introduced
 - Indian Government's active participation in BEPS Action Plans and implementation thereof
 - Indian Governments position on Multi Lateral Instruments - strong reservations on some of the aspects
 - Implementation of IndAS and ICDS – Added complexities
 - Implementation of RERA
-

Withdrawal of Instruction No. 1829

- Provided guidelines on taxability of non-residents engaged in execution of hydro electric power projects on turnkey basis ; binding on Revenue
- Instruction discussed taxability in case of the following:
 - ✓ Consortium of companies involved in executing individual scopes of work
 - ✓ Presence of coordination agreement to ensure guaranteed performance
 - ✓ Clubbing of distinct scope of work
 - ✓ Existence of overall coordination agreement
 - ✓ **Accrual of income from equipment sale on FOB basis if title to goods pass outside India**
 - ✓ **Planning, design and engineering services rendered in India / abroad**
- Though originally intended for turnkey hydro-power project, taxpayers rely on the Circular while executing other projects

Circular 7 of 2016 does not provide guidelines for aforesaid issues

Courts have relied on the Instruction in case of taxpayers undertaking activities other than setting-up of power projects

Withdrawal of CBDT Circular No. 23 of 1969

**'Business connection' to be decided on the facts & circumstances of each case
[CIT VS RD Aggarwal – 56 ITR 20 (SC)]**



CBDT issued **Circular 23 (July 3, 1969)** clarifying aspects pertaining to BUSINESS ACTIVITIES of the non-resident

Offshore supplies not liable to tax in India, if following conditions are satisfied:

- Transfer of title (ie risk and ownership) in the equipment and materials passes to the buyer outside India, preferably at the port of shipment
- Entire sale consideration is received outside India by the seller
- Sale is at arms length
- Contract for supply of equipment is signed outside India

Supreme Court in Ishikawajima Harima Heavy India Ltd (288 ITR 487) HELD

Offshore supplies not liable to tax in India, if title in goods has transferred outside India and sale consideration has been paid outside India – PROVIDED no activity in relation to such supplies is performed in India

Withdrawal of CBDT Circular No. 23 of 1969

CONSTRUCTION / INSTALLATION PE – Impact on taxability of offshore supplies



CIT VS Hyundai Heavy Industries Co Ltd (291 ITR 482) – SC

- Tax implications considered in terms of India-Korea DTAA in case of designing, fabrication, hook-up, installation and commissioning of offshore oil drilling platform
- 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

DCIT VS Roxon Oy (103 TTJ 891) – Mumbai Tribunal

In the context of India-Finland DTAA, Tribunal held that profits from the supplies of the equipment under the turnkey contract cannot be attributed to the Installation PE of the non-resident, since the coming into the existence of the PE was a stage posterior to the conclusion of the transaction giving rise to the equipment supplies.

Generally incase of turnkey projects, PE is set up at the installation stage while sale of equipment is finalized before that thus setting up of the PE is subsequent to the conclusion of the contract

**No attribution of profits from the supplies to the PE – UNLESS SUPPLIES ARE NOT AT ARM'S LENGTH
(even if supplies are integral for the purpose of installation activity)**

CBDT Circular No 7 of 2016 on AOP

- **CBDT has issued a circular providing that a consortium arrangement for providing EPC / Turnkey which has certain attributes may not be treated as AOP.**
- The Circular lays down guidelines based on which a consortium arrangement for executing EPC / Turnkey contracts having the following attributes may not be treated as an AOP:
 - Clear demarcation in the work and the costs between the consortium members;
 - Expenditure incurred by member only in his specified area of work;
 - Profits / losses of the members is based on the performance of the contract falling strictly within its scope of work;
 - Men and material for the defined scope of work are under the risk and control of the respective members;
 - Common management for the consortium is only for administrative convenience.
- Other factors apart from above may also justify that the consortium is an AOP.
- **Circular is not applicable if all or some of the members of consortium are associated enterprise within meaning of Section 92A of the Act.**

Special Leave Petition filed by the tax department in the case of DIT vs. Linde AG Linde Engineering Division dismissed as withdrawn in view of Circular no. 7 of 2016.

In the specific context of EPC contracts / Turnkey projects there are several contrary rulings of various courts on what constitutes AOP. Above guidelines will reduce litigation

Recent Developments - BEPS Action Plan 7 r.w. MLIs

BEPS Action Plan 7 r.w. Multilateral Instrument ('MLI') Articles 12 to 14 deals with preventing the artificial avoidance of PE status. Some of the BEPS recommendations discussed below will have impact on EPC structures in India:

Spitting of contracts:

- Recommends that PE shall be formed by disregarding artificial splitting-up of contracts between foreign company & its affiliates if - Installation activities performed by affiliates are connected to foreign company activities and duration of each such activity (i.e. of foreign company as well as affiliates) exceeds 30 days
- In order to address mispricing of a transaction, BEPS recommends preventing the granting of treaty benefits if **one of the objectives** of the transaction is to avail tax benefits

Preparatory or Auxiliary activities:

- Recommends that activities of foreign company need to be tested on individual as well as collective basis for meeting 'Preparatory and auxiliary test'.
- A combination of preparatory or auxiliary activities which may result into cohesive business operation will not be eligible for exclusion and result into PE exposure for foreign players

Recent Developments - BEPS Action Plan 7 r.w. MLIs

Agency PE:

- Scope of PE expanded to include agent playing principal role, leading to routine conclusion of contracts, without material modification.
- Agent acting exclusively or almost exclusively on behalf of one or more closely related enterprises not to be considered independent
- Therefore, activities done by liaison office / marketing support services rendered by subsidiaries need to be re-assessed in view of extended definition

Service PE: Changes ????????

Impact of POEM for Indian Companies having overseas EPC contracts

- Income of overseas companies could get taxed in India – Intermediary company structures could get impacted
- Tax Treaty benefits between Intermediary Company and ultimate target company could be denied
- No clarify on credit of taxes paid in overseas jurisdictions in India
- Grey areas could lead to litigation with the India tax authorities
 - Compliance with the Indian tax withholding provisions by the overseas entities treated as resident in India under POEM
 - Compliance with other Indian tax regulations by the overseas entities treated as resident in India under POEM
 - Multiple taxation of the same income
 - Applicability of deemed dividend, taxability of foreign dividends in India,
 - Applicability of Indian Transfer Pricing Regulations to the transactions among the overseas entities overseas, etc.

Impact of IndAS on EPC Industry

- Change in fundamental concepts – “Historical Cost” to “Fair Value” or “Present Value”
 - Accounting of Construction Contracts
 - Recognition of Retention Money
 - Fair Value of Claims
 - Provision for anticipated losses
 - Treatment of incidental income earned during project under construction
 - No Threshold for Revenue Recognition for Construction Contracts
 - **Artificial Split of Project for Self Consumption - Recognition of revenue by the Project Owner**
 - Accounting of Concessionaire Contracts – Financial Asset Vs. Physical Assets Tax
 - **Accounting of Hybrid Projects like HAM – Financial Asset V.s Intangible Asset**
 - **Concept of “Other Comprehensive Income - OCI” and its implications under MAT – Explanation to Section 115JB**
 - **Concept of “Transition Amount” and its taxability under MAT**
 - Accounting of Government Grants
 - Fair value of the non-monetary asset is assessed and both grant and asset are accounted for at fair value
 - Grant in respect of depreciable and non-depreciable assets – Different accounting options
 - Accounting of borrowing cost – Specific borrowings Vs. General borrowings
-

Impact of ICDS on EPC Industry

- ICDS I - Concept of Prudence and Materiality removed – recognition of MTM losses or profits
 - Applicability of ICDS III (Construction Contracts) Vs. ICDS IV (Revenue Recognition)
 - **ICDS III - Specific issues**
 - Taxability of retention money
 - POCM and early recognition of revenues
 - Possible to adopt project completion method?
 - Reduction of incidental income from project cost vs. taxability thereof
 - Cumbersome disclosure requirements
 - ICDS IV - Specific issues
 - Possible to adopt project completion method?
 - Recognition of interest income during project progress period
 - Cumbersome disclosure requirements
 - ICDS VI - Foreign currency transactions – allowability of forex loss
 - ICDS VII - Government Grants – recognition & taxability of Government grants
 - ICDS IX - Capitalization of “Borrowing costs” – Concept of “Qualified asset” introduced to limit deduction
 - ICDS X – Provision for Onerous contracts, contingencies & provisions, etc.
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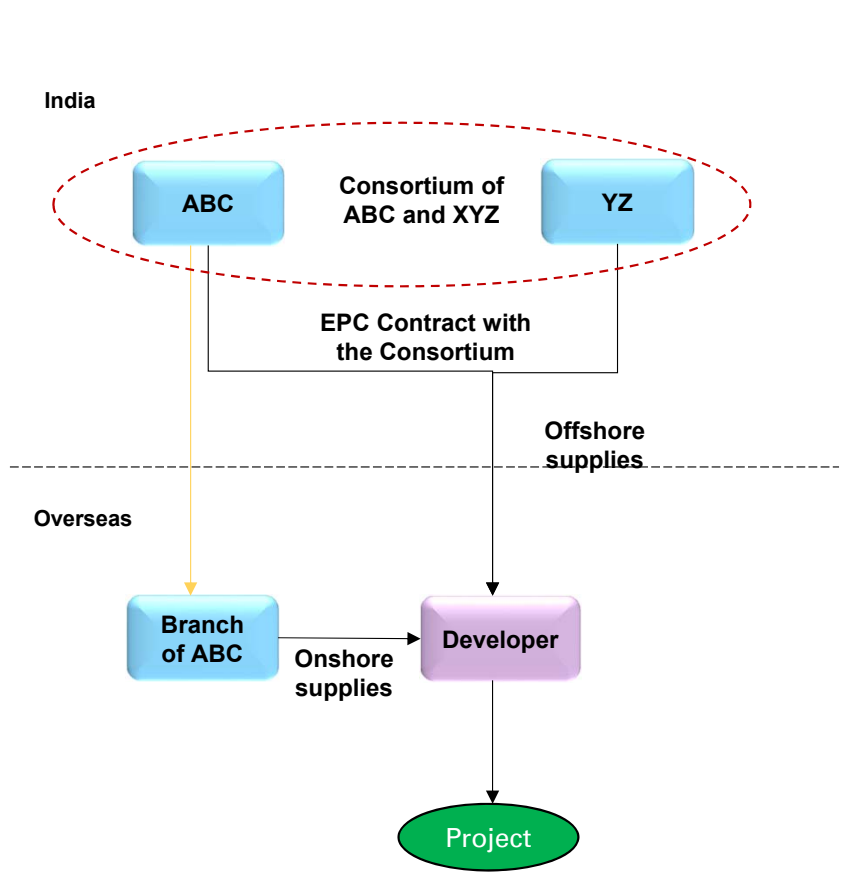
Impact of RERA on EPC Industry

- Risk of group contractor/EPC company to be regarded as “Promoter”
- Back to back financials obligations that could be fastened by the Developers
 - Obligation of completing the project within the declared time line – penalty for delayed performance
 - Extended warranty of 5 years for the project delivered – additional provision for contingencies
 - Financial liability or compensation for defects or quality issues raised by the buyers
 - Additional funding could be required to execute the project – mobilization advance may become challenge
 - Stringent penalties for various defaults if attributed to contractors

EPC Contracts – Key considerations for overseas projects



Structure and background of the arrangement (1/2)



- The Consortium of ABC and XYZ is awarded a large EPC contract by Overseas Developer ('the Developer') with a joint and several responsibility of ABC and XYZ. In case of failure by ABC to complete the Project, XYZ would be responsible to complete the contract;
- The mechanics of such EPC arrangement would be as under:
 - Offshore Work – Agreement to be executed by the Developer with ABC & XYZ. Each of the member to raise separate invoice for their share of offshore work on the Developer and Developer to directly pay each party;
 - Onshore Work – Agreement to be executed by the Developer with the Branch/WOS of ABC. Branch/WOS of ABC to invoice for the Onshore work to the Developer and Developer to pay the Branch/ WOS of ABC;
 - Co-ordination Agreement – to be executed between the Developer, ABC and XYZ for joint and several responsibility of the EPC Contract and ABC will be the lead entity to co-ordinate for the entire contract;
 - Internal Agreement – to be executed between ABC and XYZ to split the scope of work and specifically set out roles and responsibilities of each party; Further such division of roles and responsibilities to be done based on the capabilities of each party and considering arm's length factors; Ideally, the developer to be made a signatory to this agreement if commercial possible. If not, a copy of such internal agreement to be submitted with the Developer;
 - ABC and XYZ to provide guarantee for the performance of entire project to the Developer; XYZ to have a back to back guarantee arrangement with ABC wherein if the guarantee is invoked by the Developer on XYZ for the scope of work allocated to ABC then the ABC shall indemnify XYZ for all the costs incurred by it;

EPC Contracts - Key considerations for overseas projects

- FEMA Regulations – Use of alternate routes i.e. PEM, Outbound Investment Regime or Branch Regulations
 - Local requirements as regards Entity and shareholding structuring
 - Entity Structure from Owners perspective and Indian regulations – issues around joint and several liability
 - Need for establishing overseas procurement company or Intermediary Holding cum Operating Company
 - Repatriation of contract price/ profits as well as remuneration of expatriates
 - Guarantee by the Indian Parent – financial guarantee vs. performance guarantee – multiples of contract value
 - Applicability of POEM and GAAR
 - Similar tax issues relation to split contract Vs. Composite Contract
 - Withholding tax on gross consideration under domestic tax laws – refund from overseas country vis-à-vis foreign tax credit in India
 - Need for obtaining AAR or similar rulings and APA
 - Expatriate deputation and secondment issues – salary repatriation and tax equalization, etc.
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Summing Up



Summing Up....

- Assessment of various aspects for structuring of EPC Contrast – Economical & Political Environment, Government Policies, Fiscal Policies, taxation Policies etc.
- Entity Structure and Funding Structure critical
- Careful evaluation of EPC contract structuring and components thereof from taxability standpoint including from PE standpoint
- EPC contract needs to be structured very carefully to optimize various tax implications
- The contractual documents to be carefully drafted to manage taxation and litigation risk
- Maintenance of robust documentation and Carrying out Transfer Pricing Study upfront
- Evaluate obtaining an AAR Ruling and Advance Pricing Agreements upfront to avail certainty in taxation matters
- Continuously evaluate the impact of various developments and the need for renegotiating contracts
- Continuous monitoring of projects and managing/mitigating various risks on an ongoing basis
- Some different considerations while executing projects overseas

Thank You

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Annexure 1 - Meaning of AOP

- Under the provisions of the Income-tax Act, 1961 ('the Act'), the term 'person' includes an AOP. AOP is taxed as distinct entity separate from its members. However, the term 'AOP' is not specifically defined in the Act
- Based on the principles laid down by various judicial precedents¹, the following broad parameters (indicative parameters and not exhaustive) needs to be analyzed for deciding constitution of an AOP:
 - Voluntary combination / volition of two or more persons;
 - A common purpose or common action with the object to produce profits or gains or income through collective efforts;
 - Common stream of payment;
 - Sharing of profits and losses;
 - Joint and several liability of the members;
 - Joint execution of work;
 - Scheme for common management; etc.

¹ *Commissioner of Income-tax vs Indira Balkrishnan* [(1960) 39 ITR 546 (SC)]; *B. N. Elias & Ors In re* [(1935) 3 ITR 408 (Calcutta High Court)]; *In re, Dwarakanath Harischandra Pitale* [(1937) 5 ITR 716 (Bombay High Court)] ; *CIT vs Laxmidas Devidas* [(1937) 5 ITR 584 (Bombay High Court)]; *Geoconsult ZT GmbH, IN RE* [(2008) 304 ITR 283 (AAR)] and *Linde AG, Linde Engineering Division and Anr.* (W.P (C) No. 3914/2012 & CM No. 8187/2012)

- Recently the Central Board of Direct Taxes ('CBDT') has issued Circular No. 07 dated 07 March 2016 clarifying the taxability of consortium members formed for the purpose of Engineering, Procurement and Construction ('EPC') contracts. As per the said CBDT circular, the Consortium agreements for executing EPC/ turnkey contracts with following attributes may not be treated as an AOP:
- Each member is independently responsible for executing its part of work through its own resources and also bears the risk of its scope of work i.e. there is a clear demarcation of the work and costs between the consortium members and each member incurs expenditure only in respect of its specified area of work;
 - Each member earns profits or incurs losses, based on performance of the contract falling strictly within its scope of work. However, consortium members may share contract price at gross level only to facilitate convenience in billing;
 - The men and materials used for any area of work are under the risk and control of respective consortium members;
 - The control and management of the consortium is not unified and common management is only for the inter-se coordination between the consortium members for administrative convenience;
 - **However, it has been clarified that the Circular is not applicable in cases where the parties to a consortium arrangement are 'associated enterprises';**
 - In such scenario, it has been clarified that the Assessing Officer will decide the AOP existence keeping in view the relevant provisions of the Act and judicial jurisprudence on this issue.

Annexure 2 - Adverse tax implications of AOP

- The entire project profits to get taxed in the hands of a notional entity namely AOP;
- Taxation could be at the maximum marginal rate of 30% plus applicable surcharge and education cess;
- MAT liability could continue in the hands of ABC and XYZ as both would account for their respective share of income in the Contract Price;
- Tax Treaty benefits could be denied;
- ABC and XYZ may not be able to carry forward and set off losses of consortium;
- WHT and Advance Tax credit of ABC and XYZ may not be available to AOP;
- Withholding tax credit – whether and how available to AOP, if payment made to ABC and XYZ;
- Payments to ABC and XYZ to be regarded as payment to members of the AOP and not allowable in the hands of AOP at a lower level – Reimbursement argument may not be accepted;
- AOP would be required to carry out necessary tax compliances like obtaining tax registration number, filing of return of income, payment of advance tax, maintaining of books of accounts, getting tax audit done (if applicable) etc.;
- In the event, AOP is dissolved, each and every members of the AOP are jointly and severally liable for the payment of tax demand;