Title:
Sumitomo Heavy Industries Ltd. v. Oil Gas Commission of India (1995)

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1. INTRODUCTION AND PROCEDURAL HISTORY

1.1. The Claimants (hereinafter "SHI") are a Company established under the laws of Japan.

1.2. The Respondents (hereinafter "ONGC") as an Indian statutory corporation, established under the Oil & Natural Gas Commission Act 1959 (Act 43 of 1959) of India.

1.3. By a contract dated 7th September 1983 (hereinafter "The Contract" or "The Head Contract") SHI (described in the Contract as "Contractor") agreed to install and commission on a turnkey basis, as Phase 2 of a Platform Complex at a site of the Respondents (described in the Contract as "Company") known as the Bombay High South Offshore Site about 100 miles north-west of Bombay ("the SH Complex") one SHD Well-Cum-Production Platform Dec, two Flare Tripods and Flare Bridges, one SBM System and some interconnecting submarine pipelines ("the Works"). The installation and commissioning of the Works was to include and cover detailed design and engineering, procurement, fabrication, inspection, testing and pre-commissioning, load-out, sea fastening, tow-out, installation at Offshore Site and Commissioning, and any other work necessary for the final completion of the Works.

1.4 Clause 17.1. of the Contract provided as follows:

17.1 Application laws

All questions, disputes or differences arising under, out of or in connection with this Contract, shall be subject to the laws of India.

1.5 Clause 17.2 of the Contract provided as follows:

17.2 Arbitration

If any dispute, difference or question shall at any time hereafter arise between the parties hereto or their respective representatives' or assigns in respect of the construction of these presents or concerning anything herein contained or arising out of these presents or as to the rights, liabilities or duties of the said parties hereunder which cannot be mutually resolved by the parties, the same shall be referred to arbitration, the proceedings of which shall be held at London, U.K. within 30 days of the receipt of the notice of intention of appointing arbitrators each party shall appoint, an arbitrator of its own choice and inform the other party. Before entering upon the arbitration, the two arbitrators shall appoint an umpire. In case the parties fail to appoint its arbitrator within 30 days from the receipt of a notice from the other party in this behalf or
if any dispute in selection of umpire, the president of International Chamber of Commerce, Paris, shall appoint the arbitrator and/or the umpire as the case may be.

The decision of the arbitrators and failing to an agreed decision by them, the decision of the umpire shall be final and binding on the parties.

The arbitration proceedings shall be held in accordance with the provision of International Chamber of Commerce and the rules made thereunder as amended from time to time. The arbitration proceedings shall be conducted in English language.

The arbitrators or the umpire, as the case may be, shall decide, by whom and in what proportion the arbitrators or umpires fees as well as the cost incurred in arbitration shall be borne.

The arbitrators or the umpire may, with the consent of the parties, enlarge the time, from time to time, to make and publish their or his award."

1.6. Disputes subsequently arose between the parties out of the Contract whereby SHI claimed certain sums from ONGC for which ONGC denied liability.

1.7. On or about 6 March 1991 Ince & Co., as SHI's Solicitors, served a Notice of Arbitration on ONGC and sent a Request for Arbitration to the International Chamber of Commerce ("ICC").

1.8. On or about II March 1991 Ince & Qo. appointed Mr. Robert A. MdcCrindle QC as Arbitrator on behalf of SHI.

1.9. On or about II May 1991 Messrs Desai & Diwanji (hereinafter 'D & D'). ONGCs lawyers in Bombay, appointed Mr. Justice Chandrashekhar (retired) as Arbitrator on behalf of ONGC.

1.10. The said Arbitrators are hereinafter referred to collectively as "The Tribunal".

1.11. On some date thereafter, as subsequently confirmed to the parties by Mr. MacCrindle on behalf of the Tribunal, the Tribunal appointed me, The Rt. Hon. Sir Michael Kerr, as Umpire pursuant to Clause 17.2 of the Contract.

1.12. On or about 27 January 1992 the Secretariat of the ICC wrote to the parties' lawyers to the effect that, since the ICC Rules do not provide for Umpires, and since the parties were unable to agree upon the status of the Umpire in the context of the ICC Rules, the arbitration would not be able to proceed under the auspices of the ICC.

1.13. On or about 16 March 1992 the Tribunal ordered that I should be invited to sit with the Arbitrators at all future hearings as Umpire in Order to avoid the risk of duplication of the hearings. On or about I April 1992 D & D wrote to the Tribunal on behalf of ONGC, refusing to agreed that I be invited to sit with the Arbitrators, despite the Tribunal's Order.

1.14. On or about 20 October 1992 a Preliminary hearing took place in London before the Tribunal at which SHI were represented by Ince & Co. and Mr. Cordara Q.C. as Counsel, and ONGC By D & D and by Mr. B. Datta, Senior Advocate, as Counsel. While admitting that a dispute had arisen within the terms of Clause 17.2 of the Contract, it was submitted on behalf of ONGC that the Arbitrators had not been duly appointed and that the arbitration could accordingly not proceed. The Tribunal rejected this submission and gave reasons for doing so.

On or about 30 October 1992 Ince. & Co. served SHI's Statement of Claim as directed by the Tribunal.

1.15. On or about 16 December 1992 ONGC petitioned the High Court in Bombay for an injunction to restrain SHI from taking any further steps in the arbitration. Mr. Justice Jhunjhunwala declined to grant any relief and adjourned ONGC's
Petition.

1.16. On or about 24 December 1992 Ince & Co. on behalf of SHI applied to the Commercial Court in London for leave to issue and serve on ONGC in India an Originating Summons seeking an Order under Section 5 of the English Arbitration Act 1979 to confirm the powers of the Tribunal to proceed with the arbitration in default of service of a Defence by ONGC. On or about 29 December 1992 the Hon. Mr. Justice Laws granted leave to SHI to issue and serve this Summons.

1.17. On or about 19 January 1993 D & D applied to the High Court in Bombay on behalf of ONGC for an Order that the arbitration be stayed pending the hearing and disposal of ONGC's Petition and for an injunction restraining SHI for proceeding with their Originating Summons in London.

1.18. On or about 22 January 1993 Mr. Justice Vyas of the Bombay High Court declined to grant any of the relief sought by ONGC.

1.19. On or about 26 January 1993 SHI's Originating Summons was heard by Mr. Justice Cressell in the Commercial Court without ONGC having communicated with the Court or being represented, and he made certain orders defining the power of the Tribunal pursuant to Section 5 of the 1979 Act.

1.20. On or about 27 January 1993 D & D served ONGC's Defence in the Arbitration.

1.21. On or about 28 January 1993 ONGC gave notice of an appeal from the Order of Mr. Justice Vyas.

1.22. On or about 1 February 1993 ONGC's appeal was heard by the Hon. Chief Justice and the Hon. Justice Tipnis in the Bombay High Court, and the appeal was dismissed.

1.23. SHI's Reply had meanwhile been served on or about 11 February, and on or about 20 February, 1993 the pleadings in the arbitration were deemed to be closed in accordance with the Order for Directions made by the Tribunal on or about 20 October 1992.

1.24. On or about 8 March 1993 a summons was issued on behalf of ONGC in the Commercial Court to set aside the orders made under Section 5 of the 1979 Act and for other relief.

1.25. Between about 10 and 14 May 1993 ONGC's applications pursuant to the said summons were heard by Mr. Justice Potter in the Commercial Court. On or about 23 July 1993 the dismissed the Summons and ONGC's applications. He decided, among other matters, that the procedural law of the arbitration was English law and that the refusal of the ICC to continue to act in relation to the arbitration did not frustrate the reference. His Judgement is reported in (1994) 1 Lloyds Rep. 45.

1.26. Meanwhile, on or about 8 June 1993, a second hearing for directions was held before the Tribunal in London at which both parties were represented. The Tribunal thereupon made certain orders relating to discovery and evidence.

1.27. Between about 25 November 1993 and 5 March 1994 lists of documents and various witness statements were exchanged and other matters dealt with pursuant to a further order of the Tribunal made on or about 11 February 1994. On behalf of ONGC D & D maintained their refusal to permit the Umpire to sit with the Tribunal, and Ince & Co. reserved SHI's position as to costs in the event of disagreement between the arbitrators and the consequent need to re-hear the arbitration.

1.28. On or about 7 March 1994 the substantive hearing of the arbitration before the Tribunal began with the Umpire at Trinity House, London, and continued for 10 days. Both parties were again represented by the same Solicitors and
Counsel. Among others witnesses, Mr. Harish Salve, Senior Advocate and Chartered Accountant gave evidence on Indian law on behalf of SHI. In the course of the hearing the Tribunal made various orders concerning the conduct and future course of the arbitration, as well as orders relating to the evidence of witnesses, and adjourned the hearing until June 1994.

1.29. On or about 13 June 1994 the hearing before the Tribunal in London resumed and continued for a further 5 days. Among other witnesses, Mr. Salve gave further evidence, and on this occasion Mr. LLP. Ranina, Senior Advocate and Chartered Accountant, was called as a witness on Indian law on behalf of ONGC.

1.30. Following the conclusion of the hearing, on or about 4 July 1994 Mr. Chndrashekhah issued a Statement of Reasons rejecting SHI's claim. On or about 15 July 1994 Mr. MacCrindle issued Reasons stating why he would have wished to make an award in favour of SHI. On or about the following day the Arbitrators issued a joint Notice of Disagreement. I thereupon entered upon the reference as Umpire.

1.31. After various communications between the parties and myself, a hearing for directions took place before me in London on 3 October 1994 at which both parties were again represented by the same solicitors and counsel, and on the following day I issued an Order for Directions the contents of which had in substance been agreed between the parties and myself during the hearing. It was ordered, among other matters, that neither party would seek to adduce any further evidence, whether written or oral, and that the hearing before me would proceed and the transcripts of the earlier hearings before the arbitrators. Various other directions were given, and on behalf of ONGC it was made clear that their reservations as to the validity of the reference continued to be maintained. D & D subsequently made

it clear that ONGC also maintained all other matters previously raised in the course of this arbitration, and on 10 February 1995 I confirmed this position in relation to both parties. By my Order of 4 October 1994, the date of the hearing before me was fixed by agreement to begin on 8 May 1995 with an estimated duration of a maximum of 10 working days.

1.32. There followed a great deal of correspondence between the parties, all or most of it copies to me, about the preparations for this hearing and in particular the arrangement of the necessary documents. I gave various directions and guidance in connection with these matters in numerous letters between November 1994 and April 1995. During this period, and with the consent of both parties, the beginning of the hearing was postponed to Monday, 15 May 1995. In preparation for it, and pursuant to my directions I was helpfully supplied with Skeleton Arguments summarising the parties respective cases, and with a Chronology.

1.33. At the hearing before me the representation on the side of SHI was the same as before, but on this occasion ONGC were represented by Mr. M.K. Banerji, Senior Advocate and Attorney General of India, leading Mr. Datta as well as Mr. G.K. Benerji, all again instructed by D & D. Among others present on behalf of the parties, Mr. Salve and Mr. Ranina again assisted their respective clients.

1.34. On this occasion no further reference was made on behalf of ONGC to any jurisdictional issue concerning the arbitration, and there were no further objections or reservations concerning the continuation and conclusion of the arbitration or in relation to its binding nature. The submissions on both sides were confirmed to the substantive merits. It was made clear that the reservations referred to in 1.31 above were concerned solely with certain proceedings in the Indian Courts of which I have no knowledge. There was also no disagreement on any evidential issues and no need for me to give any procedural rulings in the course of the hearing.

1.35. The hearing continued for 10 working days and conclude on 26 May 1995. Mr. Cordara opened for about 4 Vi days, reviewing the whole of the earlier material in so far as it was relevant. Mr. M.K. Benerji, assisted by his Juniors, then made his submissions for about 3 Vi days and Mr. Cordara replied for about 1 1/2 days, with opportunities for Mr.” Benerji to intervene informally. He then replied about half a day to Mr. Cordara, raising a new point on the appropriate currency in wiclr damages (if any) would be recoverable, to which Mr. Cordara briefly replied. The hearing was then running out of
time, but the parties had still been unable to agree on issues of quantum and on any interest which SHI might be able to recover as part of their damages (if any), despite my requests that they should do so. Mr. Datta also said at the last moment that he wishes to reargue a point on limitation which had not previously been mentioned to me. I accordingly ordered that these matters should be covered in sequential written submissions within a time-table covering the following three weeks. Thereafter I received final written submissions from the parties on these aspects.

(There then followed references to various parties of the Contract which do not matter for present purposes, to parts of the Bid Package, and finally to SHI's Bid, but "for reference only").

1.36. For the purpose of making this Award I have carefully considered the whole of the foregoing material adduced on behalf of the parties, both orally and in writing, before, during and after the close of the hearing. In the course of the hearing both parties also made reference to the view expressed by Mr. Chandrashekhar and Mr. MacGrindle in their Reasons as referred to 1.30 above, and for the sake of completeness I will also briefly refer to these Reasons herein.

1.37. With the exception of statements containing conclusions of law, all the contents of this Award are to be treated as findings of fact.

2. THE CONTRACTUAL BACKGROUND

2.1.1. The essence of SHI's claim can be stated quite shortly. The Contract between ONGC and SHI was "tax protected", as is common place in contracts of this nature, and it also contained a provision - Clause 17.3 - which was designed to protect SHI against any economic effects of any changes in Indian Law after the close of their Bid. The bid had been submitted by SHI naming MacDermott International Inc. (hereinafter "MII"), Panamanian company with its head office in Belgium, as the main sub-contractor with the express approval of [...]

2.1.4. The issues accordingly turn on two broad aspects. First, on the complex history of MII's liability to income tax at different stages under the relevant Indian tax laws. Secondly, on an analysis of SHI's consequential rights, if any, against ONGC on the true construction of Clause 17.3 in the context of the Contract as a whole and of the surrounding circumstances at the time of its conclusion. In the latter connection, however, both parties made some reference to ONGC's Bid Package and SHI's Bid, and it is therefore necessary to make some brief references to these documents.

2.2. THE BID PACKAGE AND BID

2.2.1. ONGC issued its Bid Package in July 1982 with a closing date of 1 October 1982 which was subsequently extended to 11 October 1982. On or prior to this date SHI deposited its Bid, which was subsequently accepted in the form of the Contract referred to below.

2.2.2. The Bid Package and the Bid, as well as subsequently the Contract and Subcontract, contained may references to the components of the SH Complex (as described in 13 above) as "facilities" which were to be provided and installed. This term becomes important in the context of the tax laws referred to in Section 3 below. For instance, after referring to the "Existing Facilities" in Bombay High North and Bombay High South, the Bid Package described the components of Phase 2 of the South H (SH) Complex as further "Facilities" which [...]

might become payable by MII. This provision, which referred to MII as "Contractor" and SHI as "Customer" was in the following terms : "Any foreign (i.e. non-U.S.A.) taxes incurred by Contractor and Contractor's employees and which are imposed by or payable to any foreign governmental authority, whether by way of withholding, assessment or otherwise, for work performed hereunder shall be borne by Customer. Any such taxes which are paid directly by Contractor, shall be
reimbursed by Customer."

As will be seen hereafter, what became Clause 23 in the Head Contract and thus subsequently also in the Subcontract, was in different terms, but the substance was the same.

2.2.5. I then turn to the Contract and Subcontract against this background.

2.3. THE CONTRACT

2.3.1. The Contract was signed on 7 September 1983, but it recited that it had become effective as from 14 April 1983 when ONGC had accepted SHI's bid. It was for a lumpsum of Japanese Yen 10,823,237,000 stated at the hearing to be equivalent to about US $ 50 million. Pursuant to a requirement of the Bid Package, this lump sum had included an allowance for Indian income tax.

2.3.2. Its constructional and engineering content is for present purposes sufficiently indicated in 1.3 above. However, although SHI's claim was based primarily on Clause 17.3 and secondarily on Clause 5.11.7 of the General Conditions which cover somewhat similar ground, as pointed out. on behalf of ONGC these provisions must of course be seen in their context. To do justice to their arguments it is therefore necessary to set out many other Clauses as well.

2.3.3. The General Conditions to which attention has been drawn by either or both the parties were as follows:

1.0 DEFINITIONS AND INTERPRETATION

1.1.6. "Works" means all things, matters, structures and facilities to be engineered, designed, procured, fabricated, sea fastened, loaded out, towed-out, installed, inspected, tested, pre-commissioned and commissioned, made good and guaranteed by Contractor for the Company, including all incidental and temporary works as specified in the Contract specifications and drawings.

1.2.3 Should there by any conflicts, discrepancy or inconsistency between or amongst these contract conditions and other documents/drawings... of the Contract then interpretation shall be based on following priorities so as to comply with the requirement of the Contract.

(There then followed references to various parties of the Contract which do not matter for present purposes, to parts of the Bid Package, and finally to SHI's Bid, but "for reference only").

3.0 ASSIGNMENT AND SUBCONTRACTING

3.1. Assignment

The Contractor shall not, except with the previous consent in writing of the Company, transfer or assign their obligations or interest in the Contract or any part (hereof in any manner whatsoever.

3.2. Conditions for Subcontracting

Concerning the works and facilities covered by the Contract having to be executed and commissioned on turnkey basis by the Contractor, the following conditions shall apply as regards subcontracting of any portion of the Work entrusted to the Contractor.

i) In case of plant, equipment and allied requirement to be procured, installed and commissioned on the platform
structure for the purpose of receiving, processing, pumping, compressing etc. and also any other facilities to be provided thereon, the Contractor shall, subject to the limitations imposed on him with regard to the makes/manufacturer of certain plant and equipment specifically stipulated to be procured against this Contract, be free to sublet the work to the manufacturers/authorised agents of the respective plant and equipment for procurement of the necessary supplies. In respect of those stipulated items referred to above, the Contractor shall not arrange alternative makes other than those agreed already for procurement without the prior written consent of the Company.

ii) With regards to design, engineering, fabrication, erection, inspection, testing and commissioning of the Jacket/Platforms and other facilities as also the inspection, installation, testing and commissioning of the plant, equipment and allied facilities to be provided on the platforms, the Contractor may sublet any portion of the Work entrusted to them, only with the prior written consent of the Company.

iii) Subcontracting as mentioned herein shall not relieve the Contractor of his obligations and responsibilities under this Contract.

The extent of which the Contractor may sub-contract part of the Works shall be as stated in the Contractor and/or as subsequently discussed mutually and agreed to by the Company. Such agreement by the Company shall be binding on the Contractor.

Any such assignment/subcontracting shall not absolve the Contractor from any of his obligations and responsibilities under this Contract.

5.11. Law/Regulations

5.11.7. In the event of any change or amendment of any law, rule or regulations of any Government or Public Body or Company of the Republic of India which becomes effective after the date of the Tender and which results in any increased costs exceeded US $ 100,000 in the aggregate to Contractor or any delays in completion of the Works, Contractor shall be indemnified for any such costs by Company and the completion schedule shall be extended as required.

8.6. Certificate of Completion & Acceptance of the Work

9.1 Guarantee Conditions

(These were standard conditions, unnecessary to set out, providing for a Certificate for Completion of the Works to be issued by ONGC, followed by detailed provisions as to SHI's obligations during the subsequent 12 months Guarantee Period. There then followed provisions concerning the Discharge Certificate on which ONGC relied, as follows.)

13.0. CONTRACT PRICE / DISCHARGE CERTIFICATE

13.2. Payment Procedure

(A Group of sub-clauses follows this heading, which explains their nature, viz. they deal with the prescribed administrative procedures concerning the payment of invoices during the progress of the works and the consequences of any breaches of these procedures, The following two were referred to in the course of the hearing.)

13.2.3. The Company shall arrange remittance to the Contractor of the undisputed amount of all Work covered by the Scope of Work under the Contract as well as for any extra capital work and Change Orders ordered by the Company for which invoices are submitted by the Contractor and approved by the Company. In the event that payment of the undisputed amounts of the invoices is not received by the
Contractor within 30 days of submittal of the invoice by the Contractor, interest shall accrue on all amounts due at the rate of 1.25% per month.

13.2.7. The Company shall not be responsible/obligated for making any payments or any other related obligations under this Contract to the Contractor's Subcontractor/Vendors. The Contractor shall be fully liable and responsible for meeting all such obligations and all payments to be made to its Subcontractors/Vendors and any other third party engaged by the Contractor in any way connected with the discharge of the Contractor's obligation under the Contract and in any manner whatsoever.


13.3.1. The Contract shall not be considered as completed until a Discharge Certificate has been signed by the Company's Representative on behalf of the Company and delivered to the Contractor stating that the Works have been completed in accordance with the Contract.

13.3.2. The Discharge Certificate shall be issued by the Company's Representative (28) twenty eight days after the expiration of the Guarantee Period (or if different Guarantee Periods become applicable to different parts of the Works then, without prejudice to the Company's Representative's rights, upon the expiration of the latest of those periods) or as soon thereafter as any Works ordered during that period have been completed in accordance with the Contract.

13.3.4. Neither the Company nor the Contractor shall be liable to the other for any matter or thing arising out of or in connection with the contract or the doing of the Works unless the party asserting the liability has given the other party written notice of its claim before the issue of the last Discharge Certificate under this Clause.

13.3.5. Notwithstanding the issue of the Discharge Certificate the Contractor and the Company shall (Subject to Sub-clause 13.3.4) remain liable for the fulfillment of any obligation incurred under the provisions of the Contract before the issue of Discharge Certificate which remains unperformed at the time the certificate in question is issued, and for the purposes of determining the nature and extent of any said obligation the Contractor shall be deemed to remain in force between the parties.

17.0. LAWS/ARBITRATION

17.1. Applicable Laws

See paragraph 1.4 and 1.5. above.

17.2. Arbitration

17.3. Change of Law

Should there be, after the date of bid closing a change in any legal provision of the Republic of India or of any political subdivision thereof or should there be a change in the interpretation of the said legal provision by the Supreme Court of India and/or enforcement of any such legal provision by the Republic of India or any political subdivision thereof which affects economically the position of the Contractor; than the Company shall compensate Contractor for all necessary and reasonable extra cost caused by such a change.

23.0. Duties and Taxes
Indian Customs Duties, if any, levied upon fabricated structures, subassemblies and equipment and all components which are to be incorporated in the Works under the contract shall be borne by the Company. The Company shall bear all Indian income taxes levied or imposed on the Contractor under the Contract, on account of its or their offshore personnel while working at offshore or on account of payments received by Contractor from the Company for work done under the contract. Notwithstanding the foregoing, the Company shall have no obligation whatsoever in respect of the Contractor's onshore employees whether they may be expatriate or nationals."

27.0. CONSEQUENTIAL DAMAGES

27.2. The Company shall in no event be responsible for or liable to the contractor or its Subcontractors for consequential damages suffered by the Contractor or its Subcontractors including without limitation, business interruption or loss of profits, whether such liability is based or claimed to be based upon (i) any breach by the Company of its obligations under the Contract or (ii) any negligent act or omission on the part of the Company or any of its employees, agents or appointed representative in connection with the performance of the Work."

2.4. THE SUB-CONTRACT

2.4.1. In the same way as the Head Contract (see 1.3 above), this also referred to the Subcontract as being "on as turnkey, basis" and described the general scope of the Work as follows:

"In general the Work to be carried out under Phase 2 of the Bombay High "SH" Complex can be described as follows:

- The installation of drilling/production facilities on the SHD platform
- The fabrication, transportation and installation of two tripod platforms which support flare bridges with flare stack connected to the SHD production facilities.
- Installation of two (2) flare bridges.
- The installation of one (1) SBM System to be used with the early production system.
- Removal of a temporary deck and transportation to Bombay Port or MDL NHAVA yard.
- The installation of pipelines for gathering and transportation of oil and gas."

2.4.2. The price to be paid by SHI to MII for the Subcontract was a lump sum price of US $ 15,154,300 payable outside India. Although the Scope of Work included the fabrication transportation and installation of the main parts of the platform and other facilities, this amount was only about 30% in terms of money of the price of the Head Contract.

The reason, as can be seen from the later provisions, is that the Subcontract included substantially no obligations on the part of MII as regards the procurement or supply of materials, in particular of the necessary steel work. With the exception of consumables such as grouting for joining pipelines and welding rods, which were to be charged as labour, the materials to be provided by MII amounted to only about 0.1 % of the Subcontract price. This aspect plays some part in one of ONGC submissions concerning MII's position under the relevant Indian tax laws. The Subcontract provided that all materials necessary for the fabrication of the Subcontract Works were to be delivered by SHI to MII on terms of CIE Dubai free port. There was no provision in the Subcontract which had the effect of transferring the property in any of the materials from SHI to MII.

2.4.3. It is unnecessary to set out any further provisions from the Subcontract save to say that it incorporated all the relevant General Conditions of the Head Contract on a back-to-back basis. These included a particular Clause 5.1 1.7, though without any reference to US $ 100,000 Clause 23 dealing with tax protection, and also Clause 17.3.

2.4.4. As a link between the Contract and the Subcontract, in addition to the matters already referred to in 2.2.4 above, it should also be mentioned that part of the Contract Price Schedule, incorporated into the […]

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3.2. THE INCOME TAX ACT 1961

3.2.1 For present purpose, the relevant provisions of the 1961 Act were then as follows:

Section 5

Scope of total income

(2) Subject to the provisions of the Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which-

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Section 9

Income deemed to accrue or arise in India

(a) The following incomes shall be deemed to accrue or arise in India-

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India

Explanation

-for the purpose of this clause-

(a) In the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of [...]
3.3.1. This was introduced by the Finance Act, 1987 passed in May 1987 and was backdated retrospectively to 1 April 1983, the date when the Notification had come into force. It had originally applied to residents as well as non-residents, but was subsequently limited to the latter because it had been found to cause unintended hardship to the resident taxpayers.

see the Memorandum explaining the provisions of the Finance Bill 1988 (170 ITR).

3.3.2. Its material terms were as follows:

"44BB Special provision for computing profits and gains in connection with the business of exploration etc. of mineral oils.

(1) Notwithstanding anything to the contrary contained in Section 28 to 41 and Sections 43 and 43 A, (in the case of an assessee being a non-resident) engaged in the business of providing services or facilities in connection with, or supplying plant and machinery on hire used, or to be used, in the prospecting for, or extraction or production of, mineral oils, a sum equal to ten per cent of the aggregate of the amounts specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head 4 profit and gains of business or profession.

(2) The amounts referred to in sub-section

(1) shall be the following, namely:

(a) the amount paid or payable (whether in or out of India) to the assessee or to any person on his behalf on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of, mineral oils in India;

and

(b) the amount received or deemed to be received in India by or on behalf of the asscsstQ on account of the provision of services and facilities in connection with, or supply of plant and machinery on hire used or to be used in the prospecting for, or extraction or production of, mineral oils outside India.

Explanation - For the purpose of this section -

(i) "plant" includes ships, aircrafts, vehicles, drilling units, scientific apparatus and equipment, used for the purposes of the said business;

(ii) "mineral oil" includes petroleum and natural gas.

3.4. THE CIRCULAR

3.4.1. Shortly after the enactment of Section 44 BB, an instruction was issued by the Foreign Tax Division of the Department of Revenue in the Ministry of Finance, which was referred to throughout as the "Circular". It is not clear whether the final version or merely a draft was in evidence; thus it was merely added "Instruction No .... " and dated "the .... July, 1987", and in some places the text appeared to be corrupt. Since ONGC relied strongly on this Circular it is necessary to set out nearly all of it, although in my view it was of no more than administrative relevant in relation to the present issues.

3.4.2. It was addressed to all Commissioner of Income-tax under the heading:

"Taxability of foreign contractors engaged in the business of exploration and exploitation of Oil and Natural Gas in India Guidelines of for (sic) computation of income.

1. The question of taxability of the income of non-resident contractors engaged by resident organisation like ONGC carrying on the business of oil exploration and production in India, for the execution of turnkey projects involving work to be carried out in India as well as outside India, for a lump sum consideration, has been examined by the C.B.D.T., in consultation with the Ministry of Law. [...]"

2. It has been seen that most of the agreements entered into by these non-resident contractors relate to fabrication and installation of various facilities like off-shore platforms and pipelines, terminals, treatment plants on-shoe, rigs, etc. for exploration and production of Oil and/or Natural Gas. In these contracts the equipment by way of platform, rig or any other facility is fabricated by the foreign contractors as per specific requirement of the Indian Company or
organisation as engaged in such exploration or production. The major part of the work, namely, design, engineering, procurement and fabrication contractor. In certain cases, ownership in the facilities is also seen to have been transferred abroad. Because of the size and complicated nature of the platform etc., it is fabricated and transported in modules, for example jacket, piles, deck, top-side equipment modules, etc., to the actual off-shore site where these are then installed. The transport and installation of the facilities is at times undertaken by the same Contractor who had done the engineering, procurement and fabrication and in certain cases by other enterprises. After installation, the work on hook-up and commissioning is generally done by the fabrication contractor himself because that is invariably an essential part of the satisfactory completion of the contract itself.

3. On these facts, it is clear that income accruing or arising to the non-resident contractor should be appropriated between the various activities carried on by it, some of which would be within India and some outside. Where the ownership in the platform, terminal treatment plant or other facilities passed outside India, the non-resident will be taxable only in respect of the activities performed in India by way of installation, hook-up and commissioning etc. of the facilities acquired by the Indian enterprises engaged in oil exploration or production. Where, however, the sale has taken place in India, there will be two elements of income that should be brought to tax. One would relate to the proportion of profits on the entire value of the contract which can be said to be attributable to the activity of the sale itself and the other would be in respect of the activities like installation, hook-up, commissioning etc. actually performed in India as part of the total works contract.

4. The question of determining a reasonable percentage of gross receipts as profits/income was discussed, inter-alia, with the Ministry of Petroleum, in the light of the importance of the oil sector to the Indian economy and taking into account the fact that oil industry is now passing through a very difficult period, resulting in idle capacity all round. Taking all these factors into account, it has been decided to adopt 10 percent of the gross receipts from the contract as the net income of the contractor. It has also been decided that out of the income so computed, 10 percent (i.e. 1% of the gross receipts) would be attributable to the activity of sale itself and that the balance would be attributable to the other manufacturing etc., (i.e. other than sales) activities.

5. On this basis, where the sale takes place outside India, only 10 percent of the gross receipts in respect of the activities of installation, hook-up, commissioning etc., performed in India will be taxable here. Where, however the sale takes place within the country, apart from the 10 percent in respect of gross receipts for activities by way of installation etc. performed in India, the income arising from the activity of sale itself will have to be brought to tax. This will be done by estimating the income from such sale at 1% (10% of 10%) of the gross receipts in respect of all activities performed outside India. The activities performed in India are excluded for this purpose because the entire income from such activities would already have been included as indicated in the preceding sentence. A hypothetical example is given below to clarify the matter. For this purpose it is assumed that the gross payment for fabrication and including installation, commissioning etc. is awarded to a non-resident for a total consideration of $10 m. It is further assumed the $8 m relates to fabrication etc. done abroad and $2 m to work done in India (on or off-shore). In such a case, if the sale is in India, Taxable Income will be calculated as under :-

I. Income in respect of work done in India -

\[
10\% \text{ of } $2,000,000 = $200,000
\]

II. Total consideration for work done abroad: $8 m

\[
10\% \text{ of } $8,000,000 = $800,000
\]

Therefore, profit on the sale at 10 per cent: $800,000

\[
\text{Income attributable to activity of sale in India at 10% of above: $80,000}
\]

III. Income assessable in India (I + II): $2,800,000

If, in this example, the sale is also outside India, only $2,000,000 would be taxable in India.

8. These guidelines will be applicable to all such contracts for a period of 3 years, beginning from Assessment Year 1987-88 and for earlier assessment years, if the tax has not already been deducted at source. The guidelines, however, will not be applicable to the following:

- The sale of existing business or plant or equipment
- The sale of shares or debentures

9. These guidelines will be applicable only if the non-resident company agrees to taxation on this basis and does not dispute it in any manner whatsoever. In case where tax has already been deducted on a different basis, the non-resident company may apply retrospectively for relief.
file a return of income disclosing income calculated on the basis of (the guidelines discussed above. In such cases assessment may be completed expeditiously and refund granted.

10. This may be brought to the notice of all Officers working in your charge, particularly assessing and appellate authorities dealing with cases of non residents."

3.5 SECTION 293 A AND 44 BB

3.5.1. I set out these further provisions, which were also added to the Income Tax Act 1961, because Mr. Ranina relief upon them in his evidence on behalf of ONGC, though in my view they are of no relevance for present purposes.

3.5.2. 293 A Power to make exemption, etc., in relation to participation in the business of prospecting for, extraction, etc., of mineral oils.

(1) If the Central Government is satisfied that it is necessary or expedient so do to in (the public interest, it may, by notification in the Official Gazette, make an exemption, reduction in rate or other modification in respect of income tax in favour of any class of persons specified in sub-section (2) or in regard to the whole or any part of the income of such class of persons.

(2) The persons referred to in sub-section (1) are the following, namely

(a) persons with whom the Central Government has entered into agreements for the association or participation of

that Government or any person authorised by that Government in any business consisting of the prospecting for or extraction or production of mineral oils.
(b) persons providing any services or facilities or supplying any ship, aircraft, machinery-or plant (whether by way of sale or hire) in connection with any business consisting of the prospecting for or extraction or production or mineral oils carried on by that Government or any persons specified by that Government in this behalf by notification in the Official Gazette; and
(c) employees of the persons referred to in Clause (a) or Clause (b)."

3.5.3."44 BB."Special provision for computing profits and gains of foreign companies engaged in the business of civil construction, etc., in certain turnkey power projects.

Notwithstanding anything to the contrary in Sections 28 to 44 AA, in the case of an assessee, being a foreign Company, engaged-in the business of civil construction or the business of erection of plant or machinery or testing or commissioning thereof, in connection with a turnkey power project approved by the Central Government in this behalf and financed under any international aid programme, a sum equal to ten per cent of the amount paid or payable (whether in or out of India) to the said assessee or to any person on his behalf on account [...]

4.2. The Guarantee Period under Clause 9 of the Head Contract then ran from 14 April 1984 to 13 April 1985 and was satisfactorily completed by SHI.

4.3. ONGC alleged that on 18 May 1985 a Discharge Certificate-was issued pursuant to Clause 13.3.2 of the Contract. There were some unsatisfactory features about the production of this document, and SHI were not prepared to admit the authenticity of the copy which was eventually produced. However, I declined to accept the implied suggestion that it may have been a fabrication and therefore proceed on the basis that valid Discharge Certificate was issued and received on 18 May 1985. Its terms were as follows:

"This is to certify that the Works for Phase 2 of SH Complex have been completed in accordance with the Contract on 14th April 1984 and the Guarantee Period of the Works has been expired on 13th April 1985. This Discharge Certificate is issued under Section 13.3.2 of the Contract."

4.4. I then turn to a summary of Mil's fiscal history in relation to the Subcontract during the subsequent years. This is highly complex and lengthy, terminating only - so far as presently known - with a lengthy reasoned decision by an Income Tax Appellate Tribunal in 1994. In concerns MI's assessment year 1984-85 and 1985-86.
4.5 The details of the many assessments, appeals to Tax Commissioners, revised assessments, further appeals to Appellate Tribunals and further revisions, do not matter as such and I will only mention a few salient milestones and dates. The complexity of the documents and figures was increased by the act that the assessments related throughout to other MII contracts and subcontracts as well as the present subcontract, which was No. D 2206. Originally, in particular at the hearing before the Tribunal in March 1994, ONGC did not challenge the evidence of Mr. Salve on Indian Law confirming the validity of the ultimate assessments imposed on Miland SHI's liability to indemnify Mil in respect of them under Clause 23 of the Subcontract. ONGC merely challenged the authenticity of the documents and the figures, intimating some collusion or conspiracy between SMI and MII, though without any evidence whatever to support such allegations. With the advent of Mr. Ranina at the hearing before the Tribunal in June 1994, there were then for the first time numerous challenges to Mr. Salve's evidence on Indian Law which do not appear to have occurred to anyone before, and for which Mr. Ranina still remains the sole proponent. Thereafter, at the hearing before me, the challenges to the authenticity of the documents and figures were rightly abandoned by Mr. Banerji, who only argued the legal position, though still based on Mr. Ranina's evidence and with his assistance. On the side of SHI, Mr. Cordara continued to rely on the evidence and assistance of Mr. Salve, who refuted Mr. Ranina at virtually every point of his argument.

4.6 For the reasons explained in section 5 below I have no hesitation in accepting the evidence of Mr. Salve and rejecting the evidence of Mr. Ranina on every relevant point of difference between them. However, before coming to the issues of law on the tax aspects which separate the parties, I must briefly summarise the history.

4.7 MII made losses for the assessment years 1984-85 and 1985-86. The extension of fiscal India to Bombay High by the Notification of 31 March 1983 accordingly made no difference to them and did not result in Mil incurring any liability for income tax by reason of the Subcontract. On 13 December 1985 and 24 October 1986 MII filed Tax Returns showing losses for these years and a net loss to be carried forward. There is nothing in the evidence to cast any doubt on the accuracy of these figures or to suggest that they would not have been accepted as accurate by the tax authorities.

4.8 However, the enactment of section 44 BB on 1 April 1987, with retrospective effect to 1 April 1983, had the effect that Mil were thereupon legally obliged to file revised Tax Returns for these years. They ultimately did so, after taking advice from lawyers and accountants, and after lengthy discussions with the tax authorities in which they were represented by a Chartered Accountant, a Mr. R.D. Hingwala, a partner in Price Waterhouse since 1990, who also represented them in the subsequent lengthy history of assessments and appeals. I am satisfied on his evidence, which accorded entirely with [...]

4.9. The important matter for present purposes is that MII were undoubtedly assessed on a notional profit of 10% of their cash receipts from SHI under the Subcontract by virtue of section 44 BB, and additionally to a further notional profit of 1% (10% of 10%) under the Circular. Thus, a typical set of figures in one assessment which was referred to by way of illustration throughout the hearing, and which recurred many times on the same basis (with different figures) in other assessments and decisions, was as follows:

**Contract No. D-2206 (SHI) (tax protected)**

| Gross receipts relating to work done in India | US $ 3,80,500 |
| Gross receipts to work done outside India | US $ 29,946 |

10% of above as deemed profit u/s US $ 38,050

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The relevant tax rate was then applied to the resulting figure.

4.10. On behalf of MII, Mr. Hingwala did not seek to challenge this basis of assessment on the grounds which have since been advanced by Mr. Ranina in this arbitration. In my view he was quite right not to do so, and they probably never occurred to him, because none of them would have had the slightest prospect of success. However, for the sake of completeness I should mention the main grounds of objection which were advanced on behalf of MII, in some cases achieving important successes.

1. It was argued - unsuccessfully - that MII's receipt under the Subcontract should be taxed on a "completed contract" and not on a "cash" basis.

(ii) The application to Mil of the Notification and of section 44 BB was challenged, unsuccessfully, on the following grounds:

(a) That MII were not the Head Contractors for whom these provisions were designed, but only Subcontractors.

(b) That MII's operations under the Subcontract were not referable to "the extraction or production of mineral oils", because they all had to be completed before the stages of extraction and production could begin.

(iii) However, MII argued, successfully, that in its entirely, any multiple grossing up of the tax receivable by MII and SHI was impermissible under sub-section (iv) under sub-section (I). After many appeals, resulting in many closely reasoned decisions, this position was ultimately accepted by the tax authorities and succeeded in saving MII - and thereby SHI - considerable sums of money.

(iv) MII were also successful in eliminating Surtax perquisite and in resisting assessments to any interest or penalties on unpaid tax.

4.11 This fiscal history of Mil's assessments years 1984-85 and 1985-86 began with the first of many assessment orders on 18 March 1988 and ended -apparently- with the last of many appeals by an order of an income tax Appellate Tribunal (ITAT) dated 21 February 1994. It would serve no purpose to go through the hundreds of pages of documents covering this history, which also dealt with other contracts apart from the present subcontract. However, I have been able to follow it with the aid of a helpful schedule provided on behalf of SHI, and there has been no criticism of the figures as such on the part of ONGC.

4.12. Contemporaneously with these events, ONGC were dealing in a similar way with the tax affairs of SHI, as they were obliged to do under Clause 23 of the Head Contract. This parallel history is of no direct relevance for present purposes save that the principles of the assessments, on the basis of 10% under section 44 BB and an additional 1% under the Circular as illustrated in 4.9 above, were equally applied to SHI, and that Mr. Raniana's arguments to the contrary evidently equally failed to occur on ONGC.

4.13. Against this background, I then turn to a summary of the history of the claims by Mil against SHL under Clause 23 of the subcontract. These began with an intimation of future claims in July 1987, soon after section 44 BB had been enacted, and continued to be made formally under Clause 23 as the various assessments on MII were raised. SHI at first declined all liability and asked for detailed information. But solicitors then intervened on behalf of MII in 1990, and after further discussions and a negotiating meeting in Manila, agreement in principle was reached in December 1990. A formal agreement of Settlement was then concluded on 11 March 1991 whereby SHI admitted liability for the amount of the assessments made on MII, but successfully excluded any liability for interest.

4.14 As the result of these negotiations and the Agreement, SHI made the following payments to MII in US Dollars:
4.15. I am satisfied that MII had been legally liable to pay the equivalent sums in Rupees to the tax authorities in respect of the present Subcontract, as they did, and that SHI were also legally liable to refund the equivalent sums in US dollars to MII under Clause 23 of the Subcontract.

4.16. I also find that on the occasion of each of these payments, SHI had to sell Japanese Yen in order to buy the necessary Dollars, since they had no available Dollar funds for this purpose. The sums expended by SHI in Yen in order to make these payments were respectively Yen 38,456,407, Yen 7,313,271 and Yen 106,126,029, making a total of Yen 151,895,707.

4.17. Contemporaneously with the course of these events, SHI made claims against ONGC pursuant to Clause 17.3. of the Head Contract. All these claims were refuted by ONGC on the ground that their sole liability in relation to tax was in respect of SHI's own tax liabilities under Clause 23. Ultimately, as already mentioned, Ince & Co. served Notice of Arbitration on behalf of SHI on 6 March 1991, and the Arbitrators were appointed respectively on 11 March and 11 May 1991. The amounts claimed in the arbitration were the foregoing [...] amount in Yen or alternatively in Dollars. However, during the course of the arbitration, and following the last decision of an ITAT on 21 February 1994 eliminating any liability for multiple grossing up, there was a repayment to MII. In the result, the above mentioned totals were reduced to Yen 129,764,453 and US $ 898,928.84 respectively. These are the sums now claimed by SHI, and I am satisfied that they are correct as figures, subject to consideration of the legal issues discussed in the following sections.

5. THE ISSUES UNDER THE INDIAN TAX LAWS

5.1. I can by summarising my conclusion. I see no reason whatsoever for doubting the correctness of MII's assessments to tax pursuant to the Notification, Section 44 BB and the Circular in the manner set out in Section 4 above. Indeed, independently on my own view, I would regard it as my duty to accept these decisions as correct statements of the position in Indian law, since they emanate from the highest tax tribunals and have not been contradicted in any way by any High Court or other authority cited to me. Furthermore, on the principles concerning the application of Section 44 BB and the Circular (there was no issue about the Notification) they were well reasoned and persuasive, and I will briefly quote from the final ITAT decision later on in this section. However, for the sake of completeness I must deal with a series of submissions to the contrary which were made to me on behalf of ONGC, but which I found frankly surprising, contrived and wholly unconvincing.

5.2 The upshot of these submissions was to the following effect. First, MII were never taxable under Section 44 BB. Secondly, they were taxed under the Circular, both as regards the 10% and additional 1%, but the Circular had no connection with Section 44 BB. It was based on an administrative process of apportionment pursuant to Explanation (a) of Section 9 (1) of the Income Tax Act 1961. Thirdly, the tax authorities failed to appreciate that this was the true legal position, and their repealed references to Section 44 BB throughout their decisions were no more than what Mr. Banerji referred to as "Mechanical repetition". Fourthly, MII could and should have refused to permit themselves to be taxed on the basis of the Circular, since they had the option of refusal under its paragraph 9. What MII could and should have done was to maintain their stance that, having made losses and no taxable profits in the years in question, they were entitled to escape all tax liability by virtue of Sections 5, 9 and 28 of the Act. Fifthly and sixthly, the following consequences accordingly applied:
(a) There was no relevant "change in any legal provision" for the purposes of Clause 17.3 of the Contract and therefore no liability on the part of ONGC to SHI, quite apart from their submissions under the Contract itself.

(b) The payments made by MII to the tax authorities and by SHI to MII were made voluntarily and erroneously a matter of law.

5.3 I must now deal briefly with the detailed steps in the arguments advanced by Mr. Ranina which led to these remarkable conclusions. As already mentioned, they were refuted by Mr. Salve at every point, in my view with complete justification. I have underlined certain words and phrases for easier understanding of the reasoning.

5.4 The first step was that, in relation to their operations under the Subcontract, MII were not "engaged in the business of providing services or facilities..." for the purposes of section 44 BB. This conclusion was said to flow from the following arguments. First, it was claimed that the "Provision of facilities" could not include cases which involved transfers in the property of the facilities in question, and therefore not in the case of the present Subcontract since this was described as a "turnkey" contract, which is a type of contract which necessarily involved a transfer in the property of the subject matter. It was claimed that contracts which had these features were not subject to section 44 BB because this referred throughout to "supplying plant and machinery on hire...", without any reference to any sale, and because turnkey contracts involving an element of sale or transfer of property were referred to as such in other legal provisions. These were the Notification and section 293A, both of which referred to "sale or hire", section 44 BBB which referred to "turnkey power project", and the Circular winch dealt specifically with cases of sales under turnkey projects. The submission was that when the legislature intends to deal with turnkey projects and/or contracts involving sales, this was done under specific provisions. In relation to cases such as the present subcontract this had been done by the Circular, which had legislative effect, but only on an optional basis, and section 44 BBb had no application.

5.5 I have no hesitation whatever in rejecting these arguments at every point and accepting the evidence of Mr. Salve to the contrary. My reasons are briefly as follows, though it is hard to know where to start.

(1) The arguments entirely ignore the reference to the provision of "services" as well as "facilities" in section 44 BB. Since the present Subcontract involved virtually no procurement or supply of materials by MII, its character can be accurately described as substantially no more than the provision of services.

(2) Furthermore, given that it was common ground that "facilities" in this context referred to the physical constructional components of the Complex, such as the platform deck, jacket, pipelines, etc., there is no reason whatever for concluding that the "provision" of such facilities would not include cases in which the property passed before or as the result of construction. I can see no sense or logic in Mr. Ranina's argument that if there were a transfer of property of even no more than 1% of the subject matter - as opposed to a lease for, say, 999 years - the section 44 BB could not apply.

(3) As regards the omission of any reference to "sale" in the parts of section 44 BB which deal with the supply of plant and machinery, it may well be that this difference from the other provisions referred to was the result of an oversight, though I accept, of course, that speculations about the reasons for this difference should be excluded and that the section must be construed as it is. However, for present purposes this apparent anomaly makes no difference whatever. The Subcontract was not concerned with the supply of any "plant and machinery" and it is only in this context that this difference in phraseology appears. It has no bearing on the earlier phrase concerning the provision of "services and facilities", which is the relevant part.

(4) In any event, as regards about 99.9% of the structures, etc. constituting the "facilities" referred to in the Subcontract, the remainder being irrelevant as de minimis, it was not shown that there was any transfer of any property from MII to SHI, since all these materials had been provided by SHI to MII free of charge. The fact that the Subcontract was described as "turnkey" does not necessarily make any difference. It merely
The proper construction of Section 44 BB is in no way affected by the references to "turnkey" projects or contracts in the other sections already mentioned. On the contrary, it is perfectly clear from the terms of Section 44 BB, the facts, and the terms of the Subcontract that Mil were engaged in the provision of services and facilities within the letter and spirit of section 44BB. The legislative and fiscal purpose of this provision was clearly designed precisely for cases such as this, whereas the construction advanced by Mr. Ranina would have the effect that this legislation entirely missed its target. References to "turnkey projects" are of no significance, since this is merely a general phrase descriptive of projects which are to be constructed, completed and commissioned in every respect without any contribution from the employer or owner.

I agree that the Circular is badly phrased, and I have already pointed out that we may not have its final text. The Circular was not independent from section 44 BB but based on its then recent enactment. The description of the target operations in its paragraph 2 is precisely in line with section 44 BB and with contracts such as the Subcontract in the present case. The purpose of the Circular was to deal administratively with one

Referring Principles:

IV.5.1 - Intentions of the parties

IV.5.2 - Context-oriented interpretation