MAKHIJANI GERA & ASSOCIATES LLP

Construction, Installation & Supervisory Permanent Establishment in India

FAQs on implications on executing EPC/ Turnkey Contracts in India

TAX · REGULATORY · COMPLIANCE

Foreword

India is undertaking a significant infrastructure push across multiple fronts — public investment in infrastructure, smart cities, defence corridors and public–private partnerships, alongside a strong private sector focus on manufacturing. This is driving robust demand for companies engaged in machinery, industrial equipment and large-scale project execution across sectors such as steel, power plants, transport infrastructure, roads and ropeways. Foreign companies are actively participating in such projects through EPC and turnkey arrangements.

While the opportunities are substantial, it is equally important for companies to familiarise themselves with India's tax, regulatory and compliance framework from the earliest stages of engagement. Early structuring and clarity can help avoid unintended exposures and ensure smoother project execution.

This guide provides a practical overview of the key considerations relevant to undertaking such projects in India — covering Construction or Installation Permanent Establishment (**PE**) triggers, profit attribution, Indian VAT (Goods and Service Tax or **GST**), customs and workforce-related matters. It is designed to help project teams, finance leaders and legal team to understand the operating landscape before entering into contractual commitments.

Given the evolving nature of India's tax and regulatory environment, readers should seek specific professional advice before structuring or executing projects.

Feel free to reach out to us for any clarification.

We wish you best for the India Project !

Team MGA

1. EPC in India – Overview & Structure

> An EPC (Engineering, Procurement & Construction) contract assigns a single contractor full responsibility for designing, procuring and building a facility to a defined specification. Their combined services-and-supplies scope creates complex tax and regulatory challenges in India.

Revenue Streams

Offshore Supply

Equipment manufactured outside India, sent to India

Onshore Supply

Goods sourced/delivered in India

Offshore Services

Engineering and design supplied from outside India

Onshore Services

Installation, commissioning, assembly or supervisory in India

Key Challenges

PE Exposure

Offshore Supply Tax Risk

Indian VAT & Customs

Transfer Pricing

Regulatory Compliance

2. Concept and Types of Permanent Establishment

What is Permanent Establishment (PE)?

A Permanent Establishment is a tax concept (not a legal entity) that describes a “taxable presence” of a foreign enterprise in India. It, *inter-alia,* arises when business activities are carried out through a fixed place, a project site, personnel or a dependent agent in India. Once a PE is constituted, India acquires the right to tax profits attributable to the Indian operations. PE status in itself does not require incorporation or registration of a separate Indian company or setting up a separate office in India. This decision depends on various surrounding factors such as tenure, GST registration requirement, Project Owner/ Indian customer specifications, etc.

What forms of PE are recognized in India under India-Germany DTAA?

- Fixed Place PE
- Construction / Installation / Assembly / Supervision PE
- Dependent Agent PE

Under the India-Germany DTAA, the threshold for a Construction / Installation PE is **six months**. This is notably shorter than the twelve-month threshold found in OECD.

German companies should not assume that limiting physical presence or structuring activities as 'supervision only' will avoid PE constitution. India-Germany DTAA specifically covers supervisory activities.

3. Creation of Construction / Installation / Supervision PE

When is Construction PE constituted?

A Construction / Installation / Assembly / Supervision PE arises where a building site, construction project, installation project, assembly project or supervisory activity connected thereto continues in India beyond the treaty-specified duration threshold. Under the India-Germany DTAA, that threshold is **six months**. The determination is fact-specific and covers the entire duration of site activities — from initial preparatory works through final commissioning and handover.

Can supervisory alone create a PE?

Yes. Pure supervisory activities — where German personnel are present on-site solely to oversee works performed by Indian contractors — may independently create a PE if they continue beyond the applicable duration threshold. It is a common misconception that supervision without physical construction work is exempt. The India-Germany DTAA expressly includes supervisory activities within the definition of construction PE.

Key Principle

The six-month threshold under the India-Germany DTAA applies to the **entire duration** of the project — not merely the days on which active work is performed. Breaks, waiting periods and temporary suspensions generally do not stop the clock from an Indian tax perspective.

4. Duration Computation — Key Questions

Whether only working day is considered ?
NO, threshold is computed on a continuous calendar-day basis, including weekends, public holidays and non-working days. These days are to be counted for the threshold.

When does the period commence?
Generally, when site-related activities begin, including preparatory activities that are integral to the project — such as site surveys, soil investigations, mobilization works, etc.

When does the period end?
Upon completion of all construction or installation activities, including testing, commissioning and final acceptance. Handover to the customer is typically the end-point. Clear Final Acceptance is important. Minor remarks ideally does not impact the end date.

Do temporary suspensions interrupt the period?
No. Temporary suspensions — even of several weeks — ordinarily continue to be counted towards the six-month threshold. In few cases where complete demobilization has to be undertaken and German company had no access – position of excluding such time may be explored.

Are demobilization and warranty activities included?
Demobilization may be included if closely linked to the project. Tax authorities often rely on complete demobilization / employee exit from India to mark end of PE. Warranty activities are generally excluded unless they involve continuous site presence.

Do preparatory site activities count?
Yes, see our response for "when does the period commence", above.

Is post-FAT training relevant?
Only if site-based and directly /linked to commissioning. Remote or off-site training is generally not included in the computation.

4. Duration Computation — Key Questions (contd.)

Typical project schedule looks like this (assuming threshold creates a PE)

1. **Site Surveys & Mobilization** — Clock STARTS; preparatory works count from day one
2. **Civil & Foundation Works** — Months 1–2; access roads, temporary utilities included
3. **Mechanical & Electrical Installation** — Months 2–4; equipment assembly and installation
4. **Programming & Test Runs** — Months 4–5; software, test runs and commissioning
5. **FAT / SAT & Commissioning** — Months 5–6; clock continues until handover
6. ⚠️ Six-Month Threshold Crossed — PE CONSTITUTED; **tax obligations arise retroactively from day one.**
7. Handover to Customer — Clock ENDS
8. Demobilisation — May be included if closely linked to the project
9. Warranty Period — Generally excluded unless continuous site presence maintained

5. Appointing Sub-contractor - Issues

Is sub-contractor time attributable to the foreign enterprise?
Yes. Time spent by sub-contractors on-site counts toward the principal's 6-month threshold. For example: a German company's own personnel are on-site from 1 January to 30 April (4 months). A foreign sub-contractor performs mechanical installation from 1 May to 31 July (3 months). Although the German company's own presence is only 4 months, Indian tax authorities will aggregate both periods — the project clock runs from 1 January to 31 July (7 months) — a PE is constituted. Only where the complete work is outsourced to a sub-contractor can a position be taken that the general contractor does not create a PE in India.

Does it matter whether the sub-contractor is Indian or foreign?
For computation of the PE threshold, it does not matter whether the sub-contractor is foreign or Indian. However, appointing a foreign sub-contractor introduces an additional layer of tax cost that the general contractor must factor in.

A foreign sub-contractor performing work in India may itself create a PE in India — in which case its profits attributable to India will be taxed at the standard corporate rate (~38% effective). If it does not create a PE, its receipts will still be subject to Indian withholding tax:

- If the foreign sub-contractor's home country has a tax treaty with India, the withholding rate on technical/installation services is typically **10%**
- If no treaty applies, the domestic withholding rate of **20%** applies, with surcharge and cess taking the effective rate to approximately **21.84%**

In either case, the foreign sub-contractor will typically seek to pass this tax cost on to the general contractor through the contract price or a gross-up clause. German companies should therefore assess the sub-contractor's tax residency and treaty position at the time of appointment — and factor the resulting withholding cost into project pricing.

6. Aggregation of Contracts and Multi-Year Projects

Can multiple contracts be aggregated?
In some case, yes - where separate contracts are commercially connected — for example, installation of similar equipment across multiple units of the same facility, or a series of supply-and-install contracts with the same customer — Indian authorities may treat them as a single project.

Can a PE arise across multiple assessment years?
Yes. PE determination is project-specific and cumulative, not confined to a single tax year. A project spanning two financial years is assessed across its full duration.

⚠ Multi-phase EPC contracts and repeat engagements with the same Indian customer carry significant aggregation risk — even where no single contract exceeds six months. German companies should assess the full picture of their India activities before signing each new contract.

7. Taxability of Offshore Supply

Offshore supply is one of the most commercially significant and actively contested tax issues in EPC contracts in India. It must be carefully analysed and structured before any contract is signed.

What is the general position?
Where title to goods passes outside India and payment is received in an offshore account, the supply should not be taxable in India — even where a PE exists for onshore installation activities. The legal basis is that the supply transaction has no Indian source, and the existence of a PE for onshore work should not extend India's taxing jurisdiction to a separate, independently priced offshore transaction.

Why do disputes arise?
Indian tax authorities have increasingly challenged this position. The most common allegations are:

- The supply and onshore installation form part of a single indivisible contract — making the entire contract value taxable in India
- The Indian PE played a role in the supply — for example, by coordinating delivery, managing customs clearance or supervising unloading at the Indian port — thereby giving the supply an Indian source

What should be kept in mind at the contracting stage?
Given the sensitivity of this issue, it is important that the commercial and contractual arrangements genuinely reflect the nature of the transaction. Key considerations include:

- Supply and installation should be separately scoped and priced in the contract
- Incoterms should reflect where title and risk actually pass
- Indian PE should not be involved in the supply transaction
- Supply payments should flow to an offshore account

7. Taxability of Offshore Supply (Protocol benefit)

The India–Germany DTAA contains a Protocol provision that offers additional protection to German companies on the taxability of offshore supply — going beyond the general position available under other treaties.

What does the Protocol say?

The Protocol to the India–Germany DTAA provides that profits of a enterprise attributable to a PE in India shall NOT include amounts paid to the enterprise for equipment delivered from Germany — whether:

1. in connection with the PE's activities, or
2. independently of the PE's activities.

Why does this matter?

The Indian tax authorities often allege that offshore supply is connected to onsite PE activities and therefore taxable. The India–Germany Protocol directly addresses and support— at least at the treaty level — by expressly covering both connected and independent supplies.

A note of caution

⚠ Lower-level tax officers may still allege that offshore supplies and services are connected to onsite work and therefore taxable — disregarding or narrowly reading the Protocol. Litigation risk at the assessment stage remains real. However, the Protocol language could be relied upon by the German companies. A well-structured contract and robust documentation remain essential to defend this position.

German companies should ensure their contracts are structured to clearly reflect the offshore nature of supply and services.

8. Offshore Services and PE Profit Attribution

How are offshore design and engineering services taxed?
The key question is whether the services are tied to the offshore supply or stand alone.

If the design is embedded in and inseparable from the equipment, it follows the same tax treatment as the supply — so if the supply is not taxable in India, the linked design services are not taxable either.

If the services are independent — for example, standalone engineering consultancy or remote feasibility work — they are not attributable to the PE, but may still be taxable as Fees for Technical Services (FTS) under the India-Germany DTAA. The treaty rate is 10%. Services provided from HQ but linked to PE could be claimed as not taxable under the Protocol under India-Germany DTAA.

How are PE profits attributed?
India does not apply the Authorised OECD Approach (AOA) — it does not treat the PE as a fully separate and independent entity. Instead, under Article 7 of the India-Germany DTAA, the arm's length principle applies to determine the PE's profit: the PE profit must be computed on an arm's length basis.

In practice, assembly and installation services performed in India by the PE are treated as routine, execution-level functions. Indian tax authorities therefore expect the PE to earn a profit margin comparable to what an independent Indian assembly or installation service provider would earn in a similar situation — typically benchmarked using a cost-plus or transactional net margin method.

The German company should prepare a P&L for the Indian PE covering: onshore service revenues; direct costs (personnel, equipment, sub-contractors, legal cost); and a documented allocation of relevant head office overheads. The FAR analysis — functions performed, assets used and risks borne in India and an aligned economic analysis/ benchmarking — determines what is attributable. Percentage-of-completion accounting typically applies where the project spans more than one tax year.

9. Tax Rates & Withholding

What tax rates apply to PE profits?

PE profits are subject to Indian corporate tax at 35% (plus surcharge and health and education cess) for companies, and approximately 33% for partnerships. These rates apply to net profits after allowable deductions attributable to the PE. Additional levies include surcharge (2%–5% depending on taxable income) and health and education cess (4%), taking the effective rate to approx. 38%for companies.

Where no PE exists — for example, on short-duration projects — technical service fees may still be taxable in India at 20% under domestic law. Under the India-Germany DTAA, this rate is capped at 10%, provided the German entity furnishes a valid Tax Residency Certificate and files Form 41 with the Indian tax authority.

How does the Indian customer withhold tax?

The Indian customer must deduct tax at source on all payments to the German enterprise. Where a PE exists, withholding is ~38% (see next page for option of obtaining a lower withholding tax certificate). Where no PE exists, the rate is 10% under the India-Germany DTAA, or the domestic rate if no treaty benefit is claimed.

What are No-PE Certificates?

Indian customers often ask foreign suppliers to provide a so-called "No-PE Certificate" confirming no PE exists in India. This is a contractual document — not an official tax authority certificate — and signing it without proper analysis carries risk. If a PE is later found to have existed, the German enterprise faces risk of Indian customer requiring them to indemnify for tax, interest and penalties as basis the no PE certificate they would have undertaken a wrong withholding of tax. These should only be signed after careful review.

10. Reduced Withholding Application

By default, the Indian customer withholds tax on the gross amount of each payment — not on the net profit. For EPC contracts, where the gross contract value is large but the actual taxable profit is a fraction of that (which is generally the case), withholding on gross receipts can create a significant cash flow burden and effectively block working capital for the duration of the project.

What is a Section 395 certificate?
Section 395 allows a foreign enterprise to apply to the Indian tax authority for a certificate authorising the Indian customer to withhold tax at a reduced rate — computed on the expected net profit of the project rather than on gross receipts. Once granted, the certificate is furnished to the Indian customer, who then withholds at the certified reduced rate.

Why does it matter — a practical example:
Consider a German company with a total contract value of EUR 10 million for onshore installation services in India. Without a Section 395 certificate, the Indian customer withholds ~38% on payment — meaning on a payment of EUR 10 million, EUR 3.80 million is withheld. If the actual net profit margin on the onshore services is 10%, the taxable profit is only EUR 1 million on the full contract — and the tax thereon at 38% is EUR 380,000 in total. Without Section 395, the German company would have EUR 3.8 million withheld for actual tax liability of EUR 380,000, with the excess refundable only after filing an Indian tax return — which can take 12–24 months. With a Section 395 certificate, withholding is applied only to the net profit, dramatically improving cash flow.

How is the application made?
The German company files an application with the jurisdictional Indian tax authority, providing details of the project, expected revenues, costs and projected net profit. The authority reviews the application and issues a certificate specifying the reduced withholding rate. The certificate is then provided to the Indian customer before payments commence. It is advisable to apply early — ideally before the first invoice — as the certificate applies prospectively.

11. Compliance Obligations of an Indian PE

Once a PE is constituted in India, the German company must fulfil a range of ongoing tax and compliance obligations. These can be broadly grouped into three stages: initial registrations, ongoing operational compliance, and annual tax filings.

1. Initial Registrations

The first step upon PE constitution is to obtain a Permanent Account Number (PAN) — India's tax identification number — and a Tax Deduction Account Number (TAN), which is required to deduct and deposit withholding tax. Both should be obtained promptly at the start of the project, as PAN is required for virtually all tax interactions in India. Procedures for PAN and TAN is now more complex than earlier. While PAN requires an authorized representative in India; TAN now requires supporting documentation for proof of identity, proof of incorporation and proof of address.

2. Ongoing Operational Compliance

On an ongoing basis, the PE must maintain proper books of account and undertake regular bookkeeping reflecting the Indian operations. This includes recording all revenues attributable to the PE, direct costs, and allocated overheads. Payroll must be processed for employees working in India, with withholding tax (TDS) deducted on salary payments — including the India-attributable portion of salaries paid offshore. Withholding tax must also be deducted and deposited on all other payments made by the PE, including sub-contractor payments (Indian and foreign), legal and professional fees, and rent and other contractual payments. TDS must be deposited with the Indian tax authority on a monthly basis, and quarterly TDS returns must be filed. Failure to deduct or deposit TDS on time attracts interest and penalties (even prosecution in same case), and PE may be disallowed the deduction for the relevant expense.

11. Compliance Obligations of an Indian PE (contd.)

3. Annual Tax Compliance

At the end of each Indian financial year (31 March), the PE must file

- An Annual Income-tax return
- Tax Audit
- Form 48 — Accountant's Report certifying that inter-company transactions have been undertaken at arm's length; must be filed together with the income tax return
- Local File (Transfer Pricing Documentation) — required where the aggregate value of international transactions with associated enterprises exceeds INR 10 million in a financial year; must be maintained contemporaneously and produced on request by the tax authority
- Master File — required for large multinational groups meeting specified thresholds; contains high-level information on the group's global operations, transfer pricing policies and value chain, etc.

Where the PE has obtained a separate GST registration — for example, where a Project Office has been set up and is making taxable supplies in India — monthly or quarterly GST returns (GSTR-1 and GSTR-3B) must also be filed and input tax credits reconciled.

> ⓘ India's financial year runs from 1 April to 31 March.

12. Key transfer pricing issues in EPC projects?

Split of consideration between offshore work and onshore work

The allocation of contract value between offshore and onshore components must reflect reasonable allocation & arm's length pricing.

Attribution of profits to the PE in India

The PE must be remunerated as if it were a separate enterprise.

Procurement of goods/services from related parties

Must be benchmarked as per arm’s length basis

Supply of manpower/technicians

Secondment arrangements and cost-sharing must be documented and priced at arm's length.

Option of an Advance Pricing Agreement (APA)?

APAs provide certainty and reduce litigation risk. For recurring EPC projects, an APA may be a cost-effective risk management tool.

⚠ Transfer pricing disputes are among the most common and costly tax controversies for foreign companies in India. Closure may takes 5-8 years due to protracted litigation. Early planning and robust documentation are essential.

13. Indian VAT (GST) &Customs Duty issues in EPC Project ?

Customs Duty

Customs duty is levied on the import of equipment, machinery and materials into India. It is payable by the importer and, if not managed carefully, becomes a direct cost.

The German company must therefore be deliberate about the contractual arrangement and Incoterms — who bears the import obligation determines who bears the duty cost. This also aligns with the offshore supply structuring position.

GST

Imports of goods and services into India attract GST on a reverse charge basis — payable by the Indian importer. The importer can generally claim input tax credit on such GST paid, making it a cash-flow item rather than a cost. However, where the Indian customer is a government entity or otherwise exempt, GST paid on reverse charge may not be creditable — there is no taxable output to offset it against. In such cases, GST becomes an outright cost and must be factored into pricing at the bid stage.

It is also important to note that GST on the onshore portion of an EPC contract is applicable only where the foreign company has a "fixed establishment" in India. A fixed establishment is a concept distinct from a PE — it arises when the foreign company has an actual physical presence in India, such as a Project Office. The mere existence of a Construction PE for income tax purposes does not automatically create a fixed establishment for GST purposes. German companies should assess this distinction carefully, as it determines the scope of direct GST obligations on onshore services.

Indian sub-contractor providing onsite services for PE will levy a GST of 18%. This will become cost for the German Company, unless it has a GST registration in India.

14. Immigration and Labour Law

When are German employees taxable in India?

If a Construction PE exists and the employee's work is attributable to it, Indian tax applies from day one in India. The German company must withhold tax on India-attributable salary, and employees may need to file Indian tax returns if their income exceeds the exemption threshold. They need to apply for PAN at the earliest.

What visa and immigration requirements apply?

In practice, Indian authorities often issue a Project visa for German employees.
It is recommended to check with local Indian Embassy for clarity.

Do Indian social security and labour laws apply?

Social security laws will apply only if German company creates an establishment (opens a separate office in India). Labor law broadly will not apply if you do not have physical office space required for registration however some provision may still apply. This must be checked basis structured planned.

What is the FRRO registration requirement?

Expatriate employees must register with the FRRO within 14 days of arrival if their stay exceeds 180 days. Registration is tied to the Visa and must be maintained throughout the assignment.

15. Practical Project Planning and Risk Mitigation

Pre-Bid Stage

- Separate and price offshore supply, installation and supervision services distinctly
- Build Indian tax costs, customs duty exposure and GST implications into the bid price
- Assess PE risk based on project duration
- Check whether the customer is a government/exempt entity

PE Set-up Stage

- Check for six-month PE threshold (consider some reasonable delays)
- Initiate PAN, TAN and GST registrations promptly once PE risk is confirmed
- Apply for a Section 395 reduced withholding certificate
- If a Project Office is set up, assess fixed establishment implications for GST

Execution and Closing Project Stage

- Carry out book-keeping in India
- Complete all compliance — tax returns, WHT filings and transfer pricing documentation
- File Indian tax returns and prepare Transfer pricing documentation

How MGA Can Help:

Makhijani Gera & Associates LLP (MGA) provides specialised advisory and implementation support across the full EPC project lifecycle — from preparation to completion.

Advisory Services

Pre-Bid & Structuring

Contract structuring, business model assessment

Tax & Transfer Pricing

PE analysis, profit attribution, transfer pricing support

GST & Customs

Indirect tax structuring, input credit optimisation and customs duty planning

Regulatory & Compliance

Registrations, withholding tax orders, advance rulings and liaising and representation with tax office

Implementation Services

PE / Project Office Set-Up

Regulatory approvals, PAN/TAN/GST registrations and corporate law filings

Payroll & Expatriate Tax

Payroll processing and employee tax filings, FRRO registration

Accounting & Reporting

PE Bookkeeping & MIS/ Tracker

Ongoing Compliance

Annual tax returns, WHT filings, 48 and exchange control filings (if any)

Contact Us

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