



TAX FLASH NEWS

Consideration for providing various services in connection with prospecting, extraction or production of mineral oil are taxable on a presumptive basis under Section 44BB of the Income-tax Act

Background

Recently, the Supreme Court of India (Supreme Court) in the case of Oil & Natural Gas Corporation Limited¹ (the taxpayer) held that consideration for providing various services in connection with prospecting, extraction or production of mineral oil are taxable on a presumptive basis under Section 44BB of the Income-tax Act, 1961 (the Act) and not under Section 44D of the Act. The Supreme Court observed that each of the contracts/agreements entered into by the taxpayer with a foreign company are inextricably connected with prospecting, extraction or production of mineral oil. The dominant purpose of each such agreement was for prospecting, extraction or production of mineral oil, though there may have been certain ancillary works being contemplated there under.

Facts of the case

- The taxpayer and a foreign company had entered into an agreement by which the foreign company had agreed to make available supervisory staff and personnel having experience and expertise in reference to the operations and management of drilling rigs. The taxpayer had executed separate agreements for services to be rendered by such companies in connection with prospecting, extraction or production of mineral oils.

¹ Oil & Natural Gas Corporation Limited v. CIT (Civil Appeal No. 731 of 2007) (SC) – Taxsutra.com

- During the year under consideration the taxpayer made payments to foreign companies for providing various services in connection with prospecting, extraction or production of mineral oil.
- The Assessing Officer (AO) held that the said payment should be taxable as Fees for Technical Services (FTS) under Section 44D of the Act and not on a presumptive basis under Section 44BB of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] and the Income-tax Appellate Tribunal (the Tribunal) disagreed with the views of the AO and held the decision in favour of the taxpayer.
- The Uttarakhand High Court disagreed with the view taken by the CIT(A) and the Tribunal and held that the payments made by the taxpayer to foreign companies were taxable as FTS under Section 44D of the Act.

Supreme Court's ruling

- On examining the provisions of the Mines Act, 1952, it indicates that drilling operations for the purpose of production of petroleum would clearly amount to a mining activity or mining operations.
- It was observed that the works contemplated under an agreement, executed with a foreign company, with mining activity or mining operations was crucial for the determination of the question whether the payments made under such an agreement to the foreign company are to be assessed under Section 44BB or Section 44D of the Act.

- The Central Board of Direct Taxes (CBDT) issued an instruction² to the effect that mining operations and the expressions 'mining projects' or 'like projects' occurring in Explanation 2 to Section 9(1) of the Act would cover rendering of services like imparting of training and carrying out drilling operations for exploration of and extraction of oil and natural gas. Therefore, payments made under such agreement to a foreign company would be chargeable to tax under Section 44BB and not under Section 44D of the Act.
- The works or services mentioned under the agreement is directly associated or inextricably connected with prospecting, extraction or production of mineral oil.
- The above facts would indicate that the pith and substance of each of the contracts/agreements is inextricably connected with prospecting, extraction or production of mineral oil. The dominant purpose of each of such agreement was for prospecting, extraction or production of mineral oil though there may have been certain ancillary works being contemplated there under.
- Accordingly, it was held that the payments made by the taxpayer and received by the foreign companies under the said contracts were assessable under Section 44BB and not under Section 44D of the Act.

Our comments

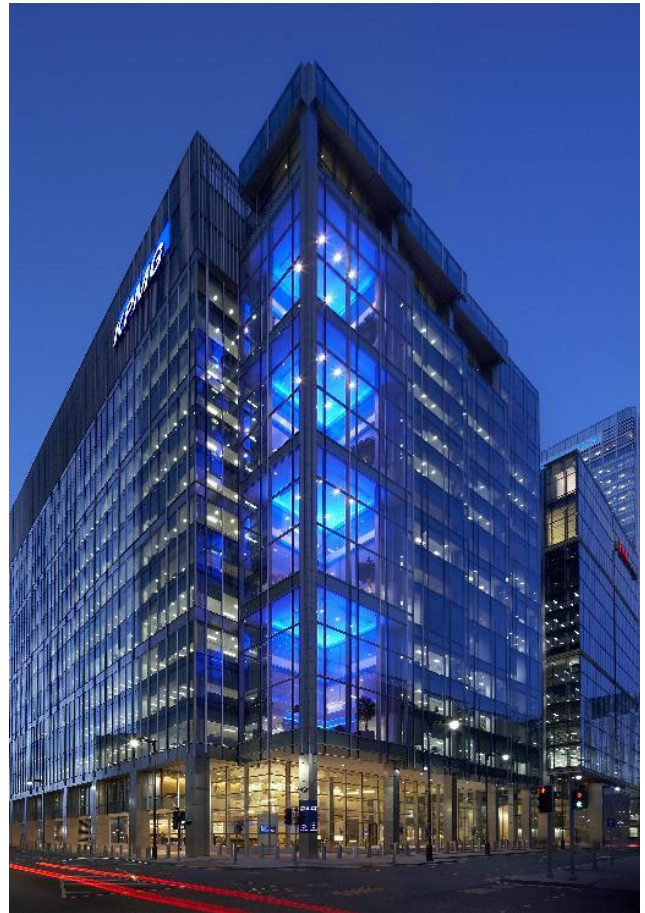
Taxability of income earned by foreign companies for providing services in connection with prospecting, extraction or production of mineral oil has been a subject matter of debate before Courts and the Tribunal.

The Delhi High Court in the case of OHM Ltd³ held that the income from geophysical services is taxable on a presumptive basis under Section 44BB of the Act and not under Section 44DA of the Act. The High Court observed that the provisions of Section 44BB are more specific to cover 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 including petroleum and natural gas.

The Supreme Court in this decision has held that consideration for providing various services in connection with prospecting, extraction or production of mineral oil are taxable on a presumptive basis under Section 44BB of the Act and not under Section 44D of the Act.

² CBDT instruction no. 1862, dated 22 October 1990

³ DIT v. OHM Ltd. [2013] 352 ITR 406 (Del)



www.kpmg.com/in

Ahmedabad

Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru

Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh

SCO 22-23 (1st Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai

No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi

Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad

8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi

Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata

Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai

Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida

6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune

703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010