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Payments to a foreign company for activities inextricably connected with prospecting, extracting or production of mineral oils are taxable under section 44BB and not under section 44D of the Act

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Synopsis

The Supreme Court in the case of Oil & Natural Gas Corporation Limited ('ONGC) held that the payments made by ONGC to foreign companies under the contracts /agreements for supervisory staff and services of personnel having experience and expertise for operation and management of drilling rigs, were covered under section 44BB and not under section 44D of the Act.

The Supreme Court examined the Contracts entered by ONGC and held that the Contracts indicated that substance of each contract was inextricably connected to the prospecting, extraction or production of mineral oil, and hence in the nature of 'mining projects' and not in the nature of fees for technical services explained under section 9(1)(vii) read with Explanation 2 read with section 44D of the Act.

Facts

- The taxpayer company, ONGC and a foreign company, M/s. Foramer France (foreign company) had entered into contract / agreement, wherein the foreign company had agreed to make available supervisory staff and personnel having experience and expertise for operation and management of drilling rigs.
- The taxpayer company made payments to the foreign company, as a consideration for operation and management of the taxpayer's rigs by the personnel of the foreign company.
- The taxpayer as an agent of foreign company submitted a return of income, for the assessment year 1985-86.
- The taxpayer submitted that the payment made to foreign company was not in the nature of fees for technical services and hence not covered under section 44D. The taxpayer submitted that the work / services to be rendered under the Contract, were inextricably linked to the prospecting, extraction or production of mineral oil and hence the payment made for such services was taxable as per provisions of section 44BB of the Act.

- The Assessing Officer (AO) observed that foreign company had entered into a contract with the taxpayer for supply of supervisory staff and personnel having expertise in operation and management of drilling rigs, for the assessment year 1985-86 and for operation and management of another drilling rig for the assessment year 1986-87.
- The AO, after going through the contract, recorded that the foreign company had provided technical expertise to the taxpayer for which taxpayer paid technical fees and hence the AO held that assessment for aforesaid payments should be made under section 44D of the Act. Thus the tax was levied on the amount of net receipts of the foreign company at 40 per cent, in view of the provisions of section 115A read with section 44D.
- The CIT(A) allowed the taxpayer's appeal and held that payment of technical fees was taxable under section 44BB of the Act. The Department filed an appeal before the Tribunal.
- The Tribunal dismissed the Department's appeal and held that the contract entered between the taxpayer and foreign company cannot be termed as merely contract for providing services by their technicians. Therefore, it was not a contract for technical services and accordingly held that the fees received by the foreign company was liable to be taxed under section 44BB and not under section 115A read with section 44D of the Act.
- The Department filed an appeal before the High Court. The High Court examined the Contract and the Explanation 2 to section 9(1)(vii) and observed that 'fees for technical services' will not include the consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.
- The High Court held that it had not been established by foreign company or the taxpayer that the payment was made under the head 'Salary' and held that it has clearly been mentioned in the contract /agreement that the fee shall be paid at the rate of USD 3,450 per day.
- The High Court held that the contract did not mention that the personnel of the foreign company was also carrying out the work of drilling of wells and therefore held that payments made by taxpayer were liable to tax under section 115A read with section 44D of the Act.

- The taxpayer filed an appeal before the Supreme Court against the decision of the High Court.

Issue before the Supreme Court

- Whether the amounts paid by the taxpayer to foreign companies for providing various services in connection with prospecting, extraction or production of mineral oil is chargeable to tax as “fees for technical services” under section 44D read with Explanation 2 to Section 9(1)(vii) or will such payments be taxable on a presumptive basis under section 44BB of the Act?

Ruling of the Supreme Court

- Section 44BB of the Income tax Act, 1961 (‘the Act’) is a special provision for computing profits and gains of a non-resident assessee, in connection with the business of exploration, etc. of mineral oils.
- As per section 44BB, if a non-resident assessee is 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; then the profits and gains from such business chargeable to tax is to be calculated at a sum equal to ten per cent of the aggregate of the amounts prescribed in section 44BB(2) of the Act.
- Section 44D of the Act relates to special provision for computing income by way of royalties, etc. in the case of foreign companies.
- Section 44D provides that if the income by way of royalty or fees for technical services of a foreign company with which the government or an Indian concern had an agreement executed before 1.04.1976 or any date thereafter, the computation of income would be made on net basis after considering expenses as contemplated

under the section 44D of the Act. The income earned by way of royalties, etc. by the foreign company is taxable under provisions of section 115A read with section 44D of the Act.

- Explanation to section 44D clarifies that the term 'fees for technical services' shall have the same meaning as in Explanation 2 to section 9(1)(vii).
- As per Explanation 2 to section 9(1)(vii), 'fees for technical services' means any consideration for rendering of any managerial, technical or consultancy services but does not include consideration for any construction, assembly, *mining or like project undertaken by the recipient*, or consideration which would be income of recipient chargeable under the head 'salaries'.
- The Apex Court examined provisions of section 44BB, 44D and 9(1)(vii) of the Act.
- The Apex Court observed that the Act does not define the expression 'mines' or 'minerals'.
- The Supreme Court further observed that 'mineral oils' is separately defined in section 3(b) of the Mines and Minerals (Development and Regulation) Act, 1957 to include natural gas and petroleum. It also referred to the definition of the term 'mines' and 'minerals' under the Mines Act, 1952 and the provisions of Oil fields (Regulation and Development) Act, 1948 specifically relating to prospecting and exploration of mineral oils.
- The Supreme Court held that in view of the said definitions in the Mines Act, 1952 and Oil fields (Regulation and Development) Act, 1948, it was clear that 'drilling operations for the purpose of petroleum shall clearly constitute mining activity or a mining operation.
- The Supreme Court referred to the CBDT Circular[1] dated 22.10.1990 clarifying that the expressions such as 'mining projects' or 'like projects' occurring in the Explanation 2 to section 9(1)(vii) of the Act shall cover, rendering of services like imparting of training and carrying out drilling operations for exploration of and extraction of oil and natural gas and hence payments made under such agreements to a non-resident / foreign company would be chargeable tax under section 44BB and not section 44D of the Act.
- The Apex Court examined the nature of work covered under each of the contracts, which included amongst others, drilling of exploration wells and carrying out seismic surveys for exploratory drilling, etc. and held that the nature of work specified in the

1 CBDT Circular No.1862 dated 22-10-1990 – Definition of 'fees for technical services' in Explanation 2 to section 9(1)(vii)

contracts indicate that the pith and substance of each of the contracts / agreements is inextricably connected with prospecting, extraction or production of mineral oil.

- The Apex Court held that payments made by the taxpayer and received by the foreign company under the respective contracts, were taxable under the provisions of section 44BB of the Act.

Comments

Supreme Court has held that payment made for activities inextricably linked with prospecting, extraction or production of mineral oil were eligible for presumptive taxation under section 44BB of the Act.

The Supreme Court referred to the dominant purpose of the contract though there may be ancillary services, to hold under which provision of the Act such income is appropriately assessable to tax.

Source: Decision of the Supreme Court dated 1 July 2015, in the case of Oil & Natural Gas Corporation Limited vs. CIT & ANR (Civil Appeal No. 731 of 2007).

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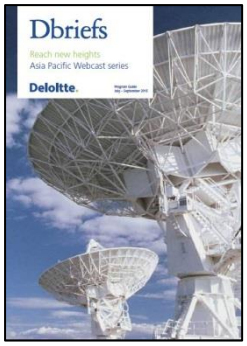

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