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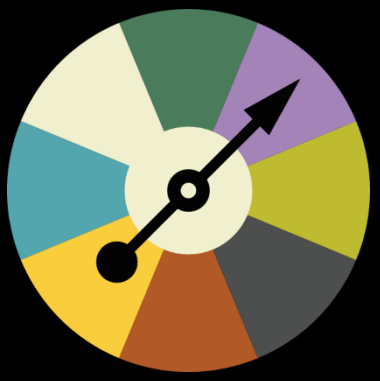

Global Business Tax Alert
Sharp Insights

[1]Supreme Court holds that mobilisation fees received by non-resident for transportation of drilling units is taxable in India under section 44BB of Income-tax Act

Issue no: GBTA/63/2017

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[1] Sedco Forex International Inc. and Others vs. Commissioner of Income-tax [Civil Appeal No. 2166 of 2012 & others]

Background/Facts

- Sedco Forex International Inc., Transocean Offshore Inc., Sedco Forex International Drilling Inc., ["the taxpayer(s)"], (the lead matters in the bunch of appeals heard), are engaged in executing contracts for exploration and production of mineral oil.
- The taxpayer(s) are companies incorporated outside India and, are therefore, non-residents for the purposes of the Income-tax Act, 1961 ["the Act"].
- They had entered into agreement(s) with Oil and Natural Gas Corporation and Enron Oil and Gas Ltd. ["operator(s)"], for hire of their rigs for carrying out oil exploration activities in India.
- In terms of the aforesaid agreement(s), the taxpayer(s) were *inter-alia* eligible to receive mobilisation fees for mobilisation (movement) of rigs from foreign soil / country to the off-shore drilling sites in India.
- In addition to the above, the taxpayer(s) also received amounts from the operator(s) towards reimbursement of expenses like catering, boarding/lodging, fuel, customs duty, supply of material, etc.
- In the tax return filed by them, the taxpayer(s) had computed their taxable income in accordance with the provisions of the section 44BB of the Act. However, the amount(s) received towards mobilisation charges were not included in the gross revenue for computing the taxable income for the year(s).
- The Assessing Officer ["AO"] included the said mobilisation fees to the gross revenue to arrive at the "profits and gains" for computing the tax liability.
- The Commissioner of Income-tax (Appeals) ["CIT(A)"], the Income-tax Appellate Tribunal ["Tribunal"] and the High Court confirmed the action of the AO.
- In addition, the High Court also held that the reimbursement of expenses incurred by the taxpayer(s) was to be included in the gross receipts for the purposes of computing the income u/s. 44BB of the Act.
- Before the Supreme Court, the taxpayer(s) argued that the mobilisation fees received by it were in the nature of reimbursement of expenses which cannot be included while computing income. Other arguments put forth by the taxpayer(s) before the Supreme Court were:
  - India follows a territorial system of taxation especially qua income of non-residents, which is taxed only to the extent it is attributable to the operations within the Indian territory;
  - The scope of total income for non-residents in terms of the Act, provides for taxation of income which is received or deemed to be received in India or accrues or arises in India or is deemed to accrue or arise in India;
  - The income in the instant case is taxable in India, only to the extent to which it is attributable to the operations carried out in India;
  - In so far as mobilisation fees is concerned, it is neither income received nor deemed to be received in India. It is in respect of services rendered outside India and, therefore, it does not even accrue or arise in India nor can it be deemed to accrue or arise in India;
  - It is only when it is established that the income is received or is deemed to be received in India, that the computation mechanism in section 44BB can be triggered;

- The actual expenditure incurred by the assessee for the mobilisation of rigs was higher than the amount reimbursed. Hence, the reimbursement of actual expenses does not represent "income" and therefore cannot be taxed and the normal concept of income cannot be taken away by presumptive provisions;

- Major arguments put forth by the Revenue were:
  - The taxpayer(s) had entered into a composite / indivisible contract with the operator(s), to provide a drilling unit to carry out drilling operations;
  - Hence, it was not open to the taxpayer(s) to claim that mobilisation fees should not be included in the aggregate receipts for the purposes of section 44BB;

The taxpayer(s) had a business connection in India through the equipment owned by it, operating in India and its employees, experts, etc. working in India, which proved that they had territorial nexus in India.

Issues for consideration

Whether mobilisation fees received by the taxpayer(s) are to be included as a part of the gross revenue for computation of deemed profits and gains of the business under section 44BB of the Act?

Ruling of the Supreme Court

- The Supreme Court after considering the arguments of the taxpayer(s) and the tax department, decided against the taxpayer(s) holding that mobilisation fees have to be considered as "deemed profits and gains of the business, for the purposes of section 44BB of the Act".

The Supreme Court accepted the argument of the taxpayer(s) that observed as under:

- it is only after it is determined that the income is chargeable to tax, that the aid of section 44BB can be taken to determine whether a particular amount will be "income" within the meaning of the said section.
- However, based on the following important facts of the case, the Supreme Court held that:
  - in terms of clause 3.2 of the agreement entered into between the taxpayer and the operator(s), a fixed amount of mobilisation fees was agreed to be paid as "compensation";
  - Clause (a) of sub-section (2) of section 44BB relates to amount paid or payable by a taxpayer on account of provision of services and facilities in connection with or supply of plant and machinery on hire used or to be used in prospecting for, or extraction of production of mineral oils in India;
  - Clause (b) deals with the amount received or deemed to be received in India in connection with the stipulated services and facilities;
  - Thus all amounts pertaining to the said activity which are received on account of provisions of services and facilities in connection with the said facility are treated as profits and gains of business;
  - Thus, mobilisation fee received on account of provision of services and facilities in connection with the extraction, etc. of mineral oil in India and

against the supply of plant and machinery on hire used for such extraction, attracts the aforesaid clause;

- Accordingly, the aforesaid amount paid to the taxpayer(s) as mobilisation fee is treated as profits and gains of business and, therefore, it would be "income";

Addressing the argument of the amount being in the nature of reimbursement, the Supreme Court held that the agreement entered into by the taxpayer(s) does not mention that, the amount which is paid to the taxpayer(s) towards mobilisation fees, is towards reimbursement of expenses. The Supreme Court noted that, in fact, the mobilisation fees is a fixed amount paid which may be less or more than the expenses incurred and hence, incurring of such expenses is not material at all.

Conclusion

The view of the Supreme Court that mobilisation fees received by non-resident taxpayer(s) for transportation of oil rigs from outside India to designated drilling places in India will be taxable in India, is in light of the fact that the receipt is on account of provision of services and facilities in connection with the extraction, etc., of mineral oil in India and against the supply of plant and machinery on hire used for such extraction. The Supreme Court has also taken note of the fact that the said amount was not for reimbursement of any expenses. In fact, the amount paid could be more or less than the expenses incurred.

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