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Tax alert: PE construed from day oil rig enters Indian territory, initial repair / upgrade days in India considered

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The Bombay High Court, based on facts, has held that the date on which the rig (for drilling operations) entered India is the date on which the count of 183 days would begin for the purpose of determining permanent establishment [under Article 5(5) of the India-Singapore tax treaty], in connection with the exploration, exploitation, or extraction of mineral oil.

In a nutshell

For providing the service and facility, it was required to properly position the rig, fabricate and modify the same as per the needs of the Indian company (A Co). It was only after the fabrication, upgradation and enabling operations were carried out, that, further drilling operations commenced and continued till the end of the financial year.

The rig was undergoing necessary upgrades / repairs to meet the A Co's requirements. Thus, the rig was already in the contracting state for providing the services or facilities in connection with the exploitation, exploration or extraction of mineral oil.

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Background:

- The taxpayer[1] is a company incorporated in Singapore and is a tax resident of Singapore. It is engaged in the business of providing jack up drilling unit and platform well operations services.
- During the Financial Year (FY) 2010-11, corresponding to Assessment Year (AY) 2011-12, the taxpayer entered into an agreement in June 2010 with an Indian company (A Co) for providing jack up drilling unit and platform well operations offshore, pursuant to the exploration contract awarded by the Government of India to A Co.
- The taxpayer earned contractual income from A Co under the contract. However, the taxpayer did not offer any income to tax in India, on the following grounds:
  - The service or facility provided by the taxpayer was in connection with the exploration, exploitation and extraction of mineral oil and was covered by section 44BB [relating to special provision for computing profits and gains in connection with the business of exploration, etc., of mineral oils] of the Income-tax Act, 1961 (ITA).
  - Though rig had entered India's territorial waters sometime in April 2010, it was undergoing necessary upgrades / repairs to meet the requirements of A Co. As per the contract with A Co and after the upgrades and repairs were completed, actual drilling began only on 3 December 2010.
  - The actual service was rendered only from 3 December 2010 until 31 March 2011. Therefore, the drilling services were continued only for a period of 119 days during AY 2011-12.
  - Hence, the services were not covered under Article 5(5) [relating to permanent establishment (PE)] of the India-Singapore tax treaty which required provision of service or facility for a period of more than 183 days in the fiscal year.
- In the course of audit proceedings for the FY 2010-11, corresponding to AY 2011-12, the Assessing Officer (AO) subjected the income from contract with A Co to tax in India. While holding the same, the AO:
  - Noted that the activities carried out by the taxpayer as per the contract were covered by the provisions of section 44BB of the ITA.
  - Till AY 2010-11, the taxpayer had consistently offered its revenue for taxation under section 44BB of the ITA.
  - Noted the minutes of meeting held between A Co and the taxpayer on 27 April 2010.
- Aggrieved, the taxpayer filed an appeal and in the course of appellate proceedings the matter reached before the Bombay High Court (HC).

Relevant provisions in brief:

Relevant extract of section 44BB of the ITA

"(1) Notwithstanding anything to the contrary contained in sections 28 to 41 and sections 43 and 43A, 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 "Profits and gains of business or profession""

[1] Deep Drilling 1 Pte Ltd. vs. DCIT [2023] 153 taxmann.com 377 (Bombay HC)

Relevant extract of Article 5(5) of the India-Singapore tax treaty

"5. Notwithstanding the provisions of paragraphs 3 and 4, and enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in that Contracting State for a period of **more than 183 days** in any fiscal year in connection with the exploration, exploitation, or extraction of mineral oils in that Contracting State."

Decision of the HC:

The HC noted that the point, which was required to be considered, was that the time of 183 days would begin when the actual services under the contract began or from the moment the rig entered Indian territory for the purpose in connection with exploration, exploitation, or extraction of mineral oil. In other words, when should an enterprise be considered to have rendered services or facilities. In this regard, the HC observed the following:

- If stand of the taxpayer was accepted, that the date on which the count of 183 days would begin was only when the rig actually began to perform under the contract, i.e., 3 December 2010, then
    a. there was no need to bring rig into the country in April 2010,
    b. there was no need to hold meetings with A Co in April 2010,
    c. the fittings could have been made outside the country and the rig could have been brought into India later, and
    d. it would not stop the taxpayer from saying that in the middle of the contract of drilling the rig broke down, and it was off-hire and, therefore, those days should not be added in counting 183 days.
- Therefore, even though the actual contract was entered into with A Co only on 18 June 2010, and the drilling work actually commenced on 3 December 2010, still the fact was that as on 27 April 2010 the rig was undergoing necessary upgrades / repairs to meet the A Co requirements. Thus, the rig was already in the contracting state for providing the services or facilities in connection with the exploitation, exploration or extraction of mineral oil as early as on 27 April 2010.
- The Income-tax Appellate Tribunal (ITAT) had also come to the same conclusion:
    — For providing the service and facility, it was required to properly position the rig, fabricate and modify the same as per the needs of the A Co. It was only after the fabrication, upgradation and enabling operations were carried out, that, further drilling operations commenced and continued till the end of the FY.

    Thus, the taxpayer was having PE in India to carry on business from the day when it commenced in India the operation to fabricate, to upgrade to prepare, to position and to enable the rig to perform the drilling activity.

    — Hence, when the rig had entered Indian waters and it was undergoing fabrication, upgradation and positioning for the drilling activity for A Co, it could be said that the PE was there in connection with the exploration, exploitation or extraction of mineral oils.

    — The operation on the rig to upgrade it, to prepare, and to enable it to perform the drilling activity and the actual drilling activity could not be considered in isolation for considering whether the taxpayer was having a PE which could be said to be in connection with the exploration, exploitation or extraction of mineral oil in India.

    Thus, the day from which such fabrication, positioning and upgradation, activity started, the taxpayer was having an establishment in connection with its services and activity for A Co.

In view of the above, the HC dismissed the appeal filed by the taxpayer against the ITAT's order.

Comments:

Determination of whether a PE exists in the source country jurisdiction is a fact-based exercise and has been a subject matter of litigation. Further, the manner in which number of days' needs for which services or facilities (in connection with the exploration, exploitation, or extraction of mineral oils) were provided in the contracting state, may also be relevant in certain cases for determining the existence of PE.

The High Court, based on facts in this case, while holding that the date on which the rig entered India would be the date on which the count of 183 days would begin for the purpose of determining PE [under Article 5(5) of the India-Singapore tax treaty], in connection with the exploration, exploitation, or extraction of mineral oil has held / upheld the following:

- For providing the service and facility, it was required to properly position the rig, fabricate and modify the same as per the needs of the A Co. It was only after the fabrication, upgradation and enabling operations were carried out that further drilling operations commenced and continued till the end of the FY.
- The rig was undergoing necessary upgrades / repairs to meet the A Co's requirements. Thus, the rig was already in the contracting state for providing the services or facilities in connection with the exploitation, exploration or extraction of mineral oil.

Taxpayers may want to evaluate the impact of this ruling to the specific facts of their cases.

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