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TAX FLASH NEWS

6 November 2017

Mobilisation fees received for transportation of rigs for providing services and facilities in connection with the extraction of mineral oil in India are taxable under Section 44BB of the Income-tax Act – Supreme Court

Background

Recently, the Supreme Court in the case of Sedco Forex International Inc[1] (the taxpayer) held that the mobilisation fees for movement of rig from a foreign country to the off-shore site in India for providing services and facilities in connection with the extraction of mineral oil is taxable under Section 44BB of the Income-tax Act, 1961 (the Act). The Supreme Court observed that the High Court may not be entirely correct in law by not considering the provisions of Sections 5 and 9 in those cases where the assessment is opted by the taxpayer under Section 44BB of the Act. Thus, Sections 5 and 9 of the Act cannot be read in isolation. The provisions contained in Section 44BB has to be read in conjunction with Sections 5 and 9 of the Act. The amount paid to the taxpayer as mobilisation fee is treated as profits and gains from business and, therefore, it would be 'income' as per Section 5 the Act.

Facts of the case

- The taxpayer, non-residents, engaged in executing the contracts all over the world including India for providing services and facilities in connection with exploration and production of mineral oil. The provisions of Section 44BB of the Act are applicable to non-resident taxpayers engaged in the business of providing services and facilities in connection with exploration, etc. of mineral oil.
- The taxpayer entered into contracts with Oil and Natural Gas Commission (ONGC), Enron Oil and Gas India Ltd, for hire of their rig for providing services and facilities in connection with exploration activities in India. The aforesaid agreements provided for the scope of work along with separate consideration for the work undertaken.
- During the year under consideration, the taxpayers were paid a mobilisation fee for and on account of mobilisation/movement of rig from foreign soil/country to the off-shore site at Mumbai (India).
- The taxpayer did not include the amount received as mobilisation charges to the gross revenue for the purpose of computation under Section 44BB of the Act.
- The Assessing Officer (AO) included the amounts received for mobilisation/demobilisation to the gross receipts to arrive at the 'profits and gains' for the purpose of computing tax under Section 44BB of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] confirmed the action of the AO.
- The Income-tax Appellate Tribunal (the Tribunal) dismissed the appeal of the taxpayer and the action of the AO was upheld insofar as the mobilisation charges were concerned.
- The High Court held that the mobilisation charges reimbursed *inter alia* even for the services rendered outside India were taxable under Section 44BB of the Act as the taxability of such income is not governed by the charging provisions of Sections 5 and 9 of the Act.

[1] Sedco Forex International Inc., Transocean Offshore Inc, Sedco Forex International Drilling Inc. v. CIT (Civil Appeal Nos. 4906 of 2010, 4907 of 2010, 4915 of 2010) – Taxsutra.com

Issues for consideration

- Whether mobilisation fees is a reimbursement of expenditure actually incurred by the taxpayer?
- Whether taxability of mobilisation fees shall be examined only under Section 44BB of the Act or also under the provisions of Section 5 and 9 of the Act?

Supreme Court's decision

Mobilisation fee is not reimbursement of expenditure

- On reference to the agreement, it indicates that the taxpayer shall be paid 'mobilisation fee' for the mobilisation of drilling unit from its present location in Portugal to the well location designated by ONGC, offshore Mumbai, India. Fixed amount is agreed to be paid which is mentioned in the said clause. Similarly, on reference to the other clause of the agreement, which is also related to the mobilisation of the drilling unit, the 'mobilisation fee' was payable for mobilisation of the drilling unit from the place of its origin to the port of entry. What follows from the said clause is that a fixed amount of mobilisation fee was payable under the aforesaid contracts as 'compensation'.
- The amount which is paid to the taxpayers is towards mobilisation fee. It does not mention that the same is for reimbursement of expenses. In fact, it is a fixed amount paid which may be less or more than the expenses incurred.

Taxation of deemed income under Section 44BB(2) vis-à-vis charging provisions under the Act

- The High Court held that decision in the case of Ishikawajima-Harima Heavy Industries Ltd.[2] is not applicable to the facts of the present case. The High Court held that the provisions of Sections 5 and 9 of the Act are not attracted in the instant case, as the taxability of mobilisation charges are governed by Section 44BB of the Act. However, the Supreme Court held that the High Court may not be entirely correct in law in excluding the provisions of Sections 5 and 9 of the Act in cases where the assessment is opted by the taxpayer under Section 44BB of the Act.
- The Supreme Court observed that the provisions of Section 44BB of the Act is a special provision providing computation mechanism for computing profits and gains in case of non-resident taxpayer engaged in providing services and facilities in connection with the exploration and production of mineral oil, etc. At the same time, as per Sections 4, 5 and 9 of the Act which deal with charging section, total income and income of non-resident which arises or deem to arise in India cannot be sidetracked. These are the provisions which bring a particular income within the net of income tax.
- The Act follows a territorial system of taxation. As per this system only that income of a non-resident is taxable in India which is attributable to operations within the Indian territory. Therefore, in the first instance it is to be seen whether a particular income arises or accrues or deem to arise or accrue within India. Accordingly, in case of a non-resident, the principles contained in Section 9 of the Act have to be applied and only then it becomes an income taxable in India as per Section 9 of the Act. The question of computation of the said income would arise only after determining the taxable income in India as per the provisions of Section 9 of the Act.
- Section 44BB(2) of the Act makes certain receipts as 'deemed income' for the purposes of taxation in the said provision. Therefore, aid of this provision is to be necessarily taken to determine whether a particular amount will be 'income' within the meaning of Section 5 of the Act. Section 44BB(2) also acts as a guide to determine whether a particular income is attributed as income occurred in India.
- Section 44BB of the Act provides for special provision for computing profits and gains. However, that would not mean that if the income is to be computed under Section 44BB(2) of the Act, the provisions of Sections 5 and 9 of the Act should not be looked into. To this extent, remarks of the High Court may not be correct. Law with reference to this is settled by the decision of the Supreme Court in the case of A. Sanyasi Rao[3]. The Supreme Court observed that Sections 4, 5 and 9 of the Act are to be kept in mind even in those cases where assessment is done under Section 44BB of the Act.
- From the bare reading of the clauses of Section 44BB of the Act, the amount paid under the aforesaid contracts as mobilisation fee 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, falls under Section 44BB(2)(a) of the Act.

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[2] Ishikawajima-Harima Heavy Industries Ltd v. DIT [2007] 288 ITR 408 (SC)

[3] UOI v. A. Sanyasi Rao [1996] 3 SCC 465 (SC)

- Thus, the provisions of Section 44BB has to be read in conjunction with Sections 5 and 9 of the Act and Sections 5 and 9 of the Act cannot be read in isolation. The aforesaid amount paid to the taxpayers as mobilisation fee is treated as profits and gains of business and, therefore, it would be 'income' as per Section 5 of the Act. This provision also treats this income as earned in India, fictionally, thereby satisfying the test of Section 9 of the Act as well.

- The Supreme Court held that amount received for mobilisation of a rig was to be included to the gross revenue to arrive at the 'profits and gains' for the purpose of computing tax under Section 44BB of the Act.

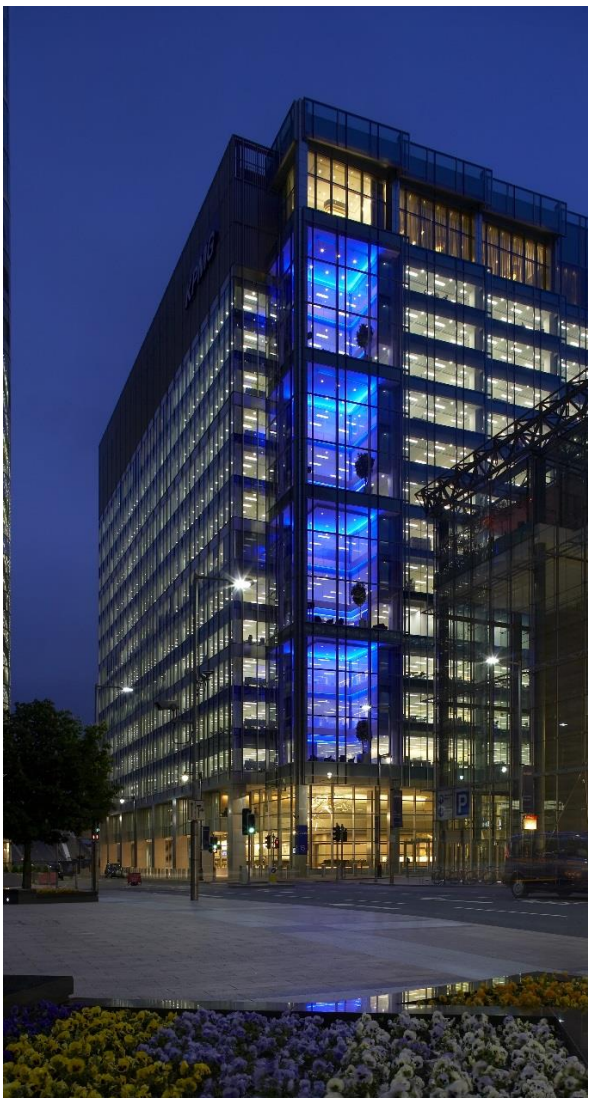
Our comments

The issue with respect to taxability of mobilisation/demobilisation charges under Section 44BB of the Act has been a matter of debate before the Courts/Tribunal.

The Delhi Tribunal in some of the cases[4] held that receipt on account of mobilisation/demobilisation outside Indian territorial waters was to be included in gross receipt under Section 44BB of the Act. However, the Mumbai Tribunal in the case of Jindal Drilling Leasing[5] held that mobilisation charges in respect of voyage outside the territorial water of India are not taxable in view of Section 5 read with Section 9 of the Act. Similarly, the Third Member of the Delhi Tribunal in the case of Saipem S.P.A.[6] held that the mobilisation charges in respect of the transportation of a rig outside the territorial water of India are not taxable since they do not accrue or arise in India or deemed to accrue or arise in India under Section 5(2) of the Act.

The Supreme Court in the present case observed that the Act follows a territorial system of taxation. As per this system only that income of a non-resident is taxable in India which is attributable to operations within the Indian territory. Therefore, in the first instance it is to be seen whether a particular income arises or accrues or deem to arise or accrue within India. In the case of a non-resident, the principles contained in Section 9 of the Act have to be applied and only then it becomes an income taxable in India as per Section 9.

The Supreme Court held that provisions of Section 5 and 9 of the Act cannot be read in isolation but have to read along with Section 44BB of the Act. Therefore, the mobilisation fees are treated as income under Section 5 of the Act and taxable as 'profit and gains from business' under Section 44BB of the Act.



[4] Transocean Offshore International Venture Ltd. v. ADIT [2013] 144 ITD 389 (Del), Western Geo International Ltd v. ADIT [2014] 150 ITD 283 (Del)
[5] ACIT v. Jindal Drilling Leasing (ITA No. 6452/Bom/91, dated 30 April 1998) (Bom)
[6] Saipem S.P.A. v. DCIT [2004] 88 ITD 213 (Del) (TM)

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