

## Vessels engaged in seismic surveys on the high seas, in connection with the exploration of mineral oil/natural resources, constitute fixed place PE under the India-UAE tax treaty

### Background

Recently, the Authority for Advance Rulings (AAR) in the case of SeaBird Exploration FZ LLC<sup>1</sup> (the applicant) held that the vessels engaged in seismic surveys on the high seas, in connection with the exploration of mineral oil/natural resources, through which applicant carries on its business, constitutes fixed place Permanent Establishment (PE) in India under Article 5(1) of India-UAE tax treaty (tax treaty). It is immaterial that the period of their operation was only 113 days, as a PE need not be permanent or for all times. Hence, the income arising from the PE shall be subject to tax in India as business income of the applicant.

### Facts of the case

- The applicant is a UAE company engaged in the business of rendering geophysical services to the oil and gas exploration industry. Its core business activity involves 4C-3D seismic data acquisition and processing, which are aimed at increasing the exploration success of its oil and gas clients and maximising their production.
- In India, the applicant has rendered these services to Oil and Natural Gas Corporation Ltd (ONGC) and other oil companies operating in India. It had entered into a contract with ONGC for 4C-3D seismic data acquisition, processing, and interpretation in the Mumbai High Field.
- Its activities are therefore intrinsically connected with oil and mineral exploration, and which ultimately go to assist in oil and mineral extraction, and the same are carried out through its survey and seismic vessels.

- The applicant filed an application before the AAR seeking ruling for the determination of tax liability in respect of revenue received from ONGC under the said contract.

### AAR ruling

#### *Permanent Establishment*

- Irrespective of the facts of ruling in the case of Fugro Engineers<sup>2</sup> or before the decision of the Madras High Court in the case of Poompuhar Shipping Corp. Ltd.<sup>3</sup>, the criterion laid down therein for deciding whether there was a PE or not, are applicable to the present case as well. The same are reinforced by the Supreme Court in the case of Formula One World Championships Limited<sup>4</sup> which deals with respect to the requirements for constituting a PE when considered in the backdrop of Article 5(1) of the tax treaties.
- In view of these decisions, it is clear that the vessels used by the applicant on the Mumbai High Seas pass all the three tests for constituting a PE, i.e. (i) there is permanence of duration to the extent that is required by the business, and not meaning forever, (ii) there is a fixed place which are the vessels in the High Seas in a definite and composite geographical area, and from which its business of survey in connection with exploration is carried out (iii) this place is at the disposal of the applicant. Thus, if Article 5(1) of the India-UAE tax treaty alone is considered, there is PE in this case.

<sup>1</sup> SeaBird Exploration FZ LLC (AAR No. 1295 of 2012) – Taxsutra.com

<sup>2</sup> Fugro Engineers B.V. v. ACIT [2009] 122 TTJ 655 (Del)

<sup>3</sup> Poompuhar Shipping Corp. Ltd. v. ITO(IT) [2014] 360 ITR 257 (Mad)

<sup>4</sup> Formula One World Championships Limited v. CIT [2017] 80 taxman.com 347 (SC)

- The applicant contended that it cannot be considered as having a PE since it is covered by the specific clause under Article 5(2)(i) of tax treaty requiring a minimum period of operation to be more than nine months to qualify it as a PE. It was contended that special clause under Article 5(2)(i) would take precedence over a general provision of Article 5(1) of the tax treaty. However, the AAR observed that the applicability of the said dictum would depend upon the facts of the case and the ratio of a case must be understood having regard to the fact situation obtaining therein.
- The decisions<sup>5</sup> relied on by the taxpayer are distinguishable on facts of the present case. In the case of National Petroleum, the activities of the taxpayer were covered by the specific provisions of Article 5(2)(h) of the India-UAE tax treaty since the taxpayer was engaged in installation of petroleum platforms. Similarly, in the case of Cal Dive Marine Construction (Mauritius) Ltd., the taxpayer's activities being laying of pipelines and constructing the structures inclusive of pre-commissioning of the pipelines were held to be covered by specific provisions of Article 5(2)(i) of the India-Mauritius tax treaty. Thus in both the cases, the nature of activities referred to in the different paras and sub paras of Article 5 were found to be similar to those of the taxpayer in those cases. Therefore, the AAR will have to first see whether the facts of the applicant's case fit into the sub para under which it is seeking shelter, namely Article 5(2)(i)<sup>6</sup> of the India-UAE tax treaty.
- The services of the applicant are not carried on mainly by employees/personnel but primarily by the vessels and equipments mounted thereon and deployed in the ocean. Such are not the services contemplated under Article 5(2)(i) of the India-UAE tax treaty.
- If the states are signing the tax treaty intended to include in Article 5(2)(i) of the tax treaty, the activities in connection with exploration, exploitation or extraction of mineral oil, etc., the sub para would have said so. Tax treaties are not to be interpreted like laws passed by Parliament that encompass a wide range of situations and require one to examine and debate the legislative intent, as against the literal interpretation. Tax treaties are entered into between executives of two states after consciously considering the business reality specific to the two states.
- Klaus Vogel in his Commentary on Double Taxation Conventions<sup>7</sup> with regard to Article 5(2)(f), stated that the sub para does not include exploration and only refers to extraction of natural resources, and since it has not been possible to arrive at a common view on the basic questions of attribution of taxation rights and of the qualification of the income from exploration activities, the contracting states may agree upon the insertion of specific provisions<sup>8</sup>.
- Whenever two states wanted clarity with regard to taxability of income arising from activities in connection with the exploration of mineral oil, subject to a duration clause, would incorporate a specific clause to that effect.
- Under India-Singapore tax treaty, in Article 5(2)(j), it is stated that a PE would be constituted if an installation or structure is used for the exploration or exploitation of natural resources but only if so used for a period of more than 120 days in any fiscal year. This is in addition to sub para (f) where it is mentioned that a mine, and oil or gas well, a quarry or any other place of extraction of natural resources. Similarly, the AAR also referred specific clauses provided in the India-USA, India-Netherlands, India-Japan, India-U.K. tax treaty.
- The AAR observed that in contrast to the above provisions in different tax treaties, in the case of the India-UAE tax treaty, no such provision has been made with regard to the activities in connection with exploration or connected activities. It is therefore clear that as far as the services and activities of the applicant are concerned, there is no specific provision with respect to the services carried out by the applicant in connection with the exploration of mineral oil on the high seas.
- The services rendered by the applicant are not covered by any of the sub paras of Article 5(2) or any other para. The activities undertaken by the applicant are considered as being in connection with extraction of mineral oil, then the closest provision in the India-UAE tax treaty would be Article 5(2)(f) of the tax treaty, wherein there is no mention of any duration, and hence does not come to the help of the applicant.

<sup>5</sup> National Petroleum Construction Company v. DIT [2016] 383 ITR 648 (Del), Cal Dive Marine Construction (Mauritius) Ltd. v. DIT [2009] 315 ITR 334 (AAR)

<sup>6</sup> The furnishing of services including consultancy services by an enterprise of a contracting state through employees or other personnel in the other contracting state, provided that such activities continue for the same project or connected project for a period or periods aggregating more than nine months within any twelve-month period.

<sup>7</sup> Third Edition (para 44, page 294)

<sup>8</sup> They may agree, for instance, that an enterprise of a contracting State, as regards activities of exploration of natural resources: (a) shall be deemed not to have a permanent establishment in that State; or (b) shall be deemed to carry on such activities through a permanent establishment in that other state; or (c) shall be deemed to carry on such activities through a permanent establishment in that other State if such activities last longer than a specified period of time.

- Accordingly, the AAR has to follow Article 5(1) of the tax treaty which provides an overarching definition of 'permanent establishment'. All the ingredients necessary to constitute a PE find a place in the nature of services undertaken by the applicant through its vessels and equipments under its agreement with ONGC, with no qualification of duration.
- The AAR held that the applicant has a fixed place PE in India under Article 5(1), in the form of its vessels engaged in seismic surveys on the high seas, in connection with the exploration of mineral oil/natural resources under an agreement with the ONGC, through which it carries on its business. It is immaterial that the period of their operation was only 113 days, as conveyed by the Applicant, as a PE need not be permanent or for all times, as decided in the various cases discussed above and also held in the case of Formula One World Championships. Hence, the income arising from the PE shall be subject to tax in India as business income of the applicant.

### **Royalty and FTS**

- On reference to the nature of activities and decision of the Supreme Court in Oil & Natural Gas Corporation Ltd.<sup>9</sup>, the payment received by the applicant cannot be considered to be Fees for Technical Services (FTS) within the meaning of Section 9(1)(vii) of the Act. The AAR also referred applicant's own ruling<sup>10</sup>.
- ONGC has not paid the consideration for any rights of survey or exploration transferred to it by the applicant. Since ONGC does not use or obtain the right to use the vessels/equipment of the applicant, receipts from ONGC cannot be termed as Royalty either.

### **Section 44BB of the Act**

- The income derived by the applicant from its PE would be computed in accordance with provisions of Section 44BB of the Income-tax Act, 1961 (the Act). Since the AAR has examined and found that the activities of the applicant are in connection with the exploration of mineral oils, the special provisions of Section 44BB of the Act apply, and the income of the applicant would be computed as laid out therein. This is in line with applicant's own case wherein for similar activities the AAR had held that Section 44BB of the Act would apply.

<sup>9</sup> Oil & Natural Gas Corporation Ltd. v. CIT [2015] 376 ITR 306 (SC)

<sup>10</sup> Seabird Exploration FZ LLC, In re [2010] 187 Taxman 37 (AAR)

### **Our comments**

The taxability of income from seismic surveys on the high seas, in connection with the exploration of mineral oil/natural resources vis-à-vis its formation of PE under the tax treaty has been a matter of debate before the Courts/Tribunal.

The Mumbai Tribunal in the case of Renoir Consulting Ltd<sup>11</sup> observed that the word 'permanent' means there must be a certain degree of permanence and a fixed place would include a movable place of business.

Some of the Courts<sup>12</sup> have observed that the expression 'fixed' indicates a considerable or reasonable period in existence of the place of business in the source state and hence, in order to constitute a PE, the presence of the foreign enterprise in the source state must be more than merely temporary or transitory or tentative or for a short while. Various international Courts<sup>13</sup> have observed that in the context, the expression 'permanent' is a relative term used in contradistinction to something intermittent, transient, temporary, casual, occasional or isolated.

On the other hand, some of the Courts<sup>14</sup> have held that a stall or pitch in the market constitutes a place of business. Similarly, Courts<sup>15</sup> have also held that a sales booth (erected using collapsible/mobile equipment) at an exhibition constitutes a place of business. The Court of First Instance of Rhineland-Palatinate<sup>16</sup> has held that a hotel room also constitutes a place of business.

The Supreme Court in the case of the Formula One World Championship Ltd.<sup>17</sup> has dealt with the conditions for the constitution of PE at length. The Supreme Court held that the entire event in India is taken over and controlled by the taxpayer and its affiliates in India and hence international circuit was at the disposal of the taxpayer

<sup>11</sup> Renoir Consulting Ltd. v. DDIT [TS-211-ITAT-2014(Mum)]

<sup>12</sup> Golf in Dubai LLC, In re [2008] 306 ITR 374 (AAR), P No. 24 of 1996, In re [1999] 237 ITR 798 (AAR), PGS Geophysical AS v. Government of Norway (2004) IBFD Case No. 2004-01003-A, (sak nr. 2003/1311) (Supreme Court of Norway), IBFD Case No. II R 12/92 (Federal Tax Court, Munich), Sunbeam Corporation (Canada) Ltd. v. Minister of National Revenue (1963) S.C.R. 45 (Supreme Court of Canada), Golf in Dubai LLC, In re [2008] 306 ITR 374 (AAR), Cal Dive Marine

<sup>13</sup> Transvaal Associated Hide and Skin Merchants v. Collector of Incometax (1967) 29 SATC 97 (Court of Appeal Botswana), Shahmoon v. Her Majesty the Queen (1976) C.T.C. 2364 (Tax Review Board of Canada), IBFD Case No. IR 274/82 (Federal Tax Court of Germany), Fiebert v. Her Majesty the Queen (1986) 1 C.T.C. 2034

<sup>14</sup> Rolls Royce Plc v. DDIT [2008] 113 TTJ 446 (Del) [affirmed in Rolls Royce Plc v. DIT [2011] 339 ITR 147 (Del), Galileo international Inc v. DCIT [2007-TII-40-ITAT-Del-Intl], Golf in Dubai LLC, In re [2008] 306 ITR 374 (AAR)

<sup>15</sup> Fowler v. Her Majesty the Queen (1990) 2 C.T.C. 2351 (Tax Court of Canada)

<sup>16</sup> IBFD Case No. 4 K 2608/95 (Court of First Instance of Rhineland-Palatinate)

<sup>17</sup> Formula One World Championship Ltd v. CIT [2017] 394 ITR 80 (SC)

through which it conducted business. Therefore, international circuit shall constitute a fixed place PE under the India-U.K. tax treaty even though the duration of the event was only three days.

The AAR in the present case has held that the vessels engaged in seismic surveys on the high seas, in connection with the exploration of mineral oil/natural resources, through which applicant carries on its business, constituted fixed place PE in India under Article 5(1) of the tax treaty. This is an important ruling from the perspective of determination of PE in India especially when the foreign enterprise operates in India for a short duration.

Even though the decision of the AAR is legally binding only on the parties involved in a particular case, the ruling would have a persuasive value in similar matters before the Indian tax authorities and Courts.



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