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Tax Flash News

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A permanent establishment is formed when the oil rig entered into the Indian water and not when actual drilling work commenced

To determine whether a foreign company has a Permanent Establishment (PE) in India is a complex and fact-driven exercise. Further different types of business transactions and processes undertaken by foreign companies in India make this task more difficult. In terms of services or facilities in connection with the exploitation, exploration, or extraction of mineral oil, it has been observed that such businesses require aid from foreign companies who are having expertise in offshore drilling services and having advanced equipment for the same. Determination of PE in such cases has been a matter of debate especially when such equipment enters Indian water however remains in repairs, fabrication and positioning till actual work begins[1].

Recently, the Bombay High Court in the case of Deep Drilling 1 Pte. Ltd.[2] (the taxpayer) dealt with the issue of determination of a PE of a Singaporean company in relation to the activities of offshore drilling services in India under the India-Singapore tax treaty (the tax treaty). The High Court held that the Singaporean company had a PE in India because it provided services or facilities in India for a period of more than 183 days in a fiscal year in connection with the exploration, etc. of mineral oils. The High Court observed that the actual contract was entered into with the Indian entity only on 18 June 2010, and the drilling work actually commenced on 3 December 2010. However, the fact that as on 27 April 2010, as the rig was undergoing necessary upgrades/repairs to meet the Indian company's requirements, the rig was already in India for providing the services or facilities in connection with the exploration, etc. of mineral oil. Therefore, the period of 183 days is to be counted from 27 April 2010 i.e., when the rig entered into the Indian water and not from the date when actual drilling work was commenced.

Facts of the case

- The taxpayer, a Singapore-based company, engaged in the business of providing offshore drilling services for the purpose of prospecting for, exploration, exploitation and extraction of minerals oils and natural gas. For this purpose, it deploys its equipment (mainly drilling rig) and personnel at offshore locations.
- The taxpayer entered into an agreement with an Indian entity on 18 June 2010 for providing a jack up drilling unit and platform well operations at the Indian offshore. The rig was brought into India on 26 April 2010. However, the actual services under the contract with the Indian entity commenced on 3 December 2010 and continued till the end of the financial year.
- For AY 2011-12, the taxpayer received contractual income from the Indian entity. However, the same was not offered to tax in India since the actual service was rendered only for a period of 119 days and therefore, there was no PE in India by virtue of Article 5(5) of the tax treaty.
- The Assessing Officer (AO) held that the income earned by the taxpayer for the provision of services was taxable in India under Section 44BB[3].

[1] Article 5(5) of the India-Singapore tax treaty - An enterprise shall be deemed to have a PE in a Contracting State and to carry on business through that PE 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

[2] Deep Drilling 1 Pte. Ltd. v. DCIT (ITA No. 315 of 2018) – Taxsutra.com

[3] Section 44BB - Special provision for computing profits and gains in connection with the business of exploration, etc., of mineral oils.

- The Income-tax Appellate Tribunal (the Tribunal) held that the taxpayer constituted a PE in India.

- Before the High Court, the taxpayer contended that the drilling rig was brought into India on 26 April 2010, but the actual operations commenced on 3 December 2010. Until December 2010, the drilling rig underwent necessary upgrades/repairs to meet the requirements of the Indian entity and therefore there was no PE in India. Accordingly, the taxpayer was not liable to tax in India.

High Court's decision

- Under the India-Singapore tax treaty, to form a PE in respect of the exploration, exploitation or extraction of mineral oils in other state, the condition of 183 days needs to be satisfied. In the instant case, if the date on which the count of 183 days was to be started was the date when the rig actually begins to perform work under the contract i.e., on 3 December 2010, then there was no need to bring the rig into India in April 2010. Further, there was no need to hold meetings with the Indian entity in April 2010. The fittings could have been made outside India and the rig could be brought into India later.

- Therefore, even though the actual contract was entered into with an Indian entity only on 18 June 2010, and the drilling work actually commenced on 3 December 2010, the fact that as on 27 April 2010, the rig was undergoing necessary upgrades/repairs to meet the Indian company's requirements, and 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.

- The High Court concurred with the Tribunal's decision that the taxpayer constituted a PE in India. Thus, the income was taxable under Section 44BB. The Tribunal had held that:

  - Immediately after the arrival of the drilling rig on 27 April 2010, operations started on the rig to make it suitable to perform the activities contracted.

  - For providing the service and facility to the Indian company, rig was required to properly position, fabricate and modify as per the needs of the Indian entity. Thus, the taxpayer had a PE in India to carry on business from the day when it commenced operations in India like fabrication, upgradation, to position and enable the rig to perform the drilling activity.

  - Hence, when the rig had entered Indian waters and it was undergoing fabrication, upgradation, etc, it can be said that the PE was formed in connection with the exploration, exploitation or extraction of mineral oils.

- It is settled law that the use of the expression 'in connection with' in Section 44BB expands the horizon of the services or facilities, provided by a non-resident taxpayer if they have a connection with the exploration, extraction or production of mineral oils.

- Based on the above, the foreign company was having a PE in India and the income was taxable under Section 44BB.

Our comments

The Bombay High Court in this decision strictly interpreted the language of the PE article of the India-Singapore tax treaty to hold that the foreign company had a PE in India from the day when it entered Indian water and performed activities like fabrication, upgradation, etc. to position and enable the rig to perform the drilling activity.

On the other hand, the Delhi bench of the Tribunal in the case of R & B Falcon Offshore Ltd[4], had held that an installation or a structure could become a PE only if it is actually used for the exploration or exploitation of natural resources for a period of more than the specified threshold. The activities of repairs and mobilisation of the rig were not for exploration or exploration of natural resources. That activity was a preparatory activity so as to make the rig fit for the exploitation of natural resources. The rig could be said to be used for the exploitation of mineral oil only when it was positioned at the appointed place for the exploitation of mineral oil.

It would be interesting to see how the other Courts will deal with this matter and whether they would consider the period of repairs and mobilisation of the rig to calculate threshold required for constituting an installation PE in India.

[4] R & B Falcon Offshore Ltd vs. ACIT [2010] 42 SOT 432 (Del)

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