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Section 44BB sails through the ups and downs of a mineral oil stream

JEETAN NAGPAL
CA

PALLAVI
CA

Section 44BB of the Income Tax Act ('Act') which contains special provision for computing profits and gains of non-residents service providers in connection with exploration, exploitation and production of mineral oils has been subject of judicial scrutiny perhaps much more than any other provision dealing with taxation of non-residents.

The Honourable Authority for Advance Ruling ('AAR') has, on an application filed by Hyundai Heavy Industries Company Limited, Korea ('HHI') *(Application no. 1122 of 2011)* brought more clarity on various some pertinent but contentious issues under section 44BB. The following paragraphs explain the Ruling which has in one go dealt with multifarious issues involved in section 44BB, including the definition of the term '*mineral oils'* in the context of the aforesaid section and also has taken a well reasoned view on the often debated question that whether the scope of section 44BB is restricted to upstream activities, i.e. production of crude oil at the well-head or does it also extends to the mid-stream activities (i.e. transportation of crude oil from well-head to refinery) and the downstream activities (i.e. wherein crude oil undergoes myriad of processes for getting refined into Diesel, Motor spirit, Gasoline, Jet fuel etc.)?

1. *Factual panorama of the case:*

- HHI is a tax resident of South Korea engaged in executing turnkey projects involving designing, engineering, procurement, installation and commissioning of offshore and onshore facilities primarily for oil and gas companies in India.
- Indian Oil Corporation Limited ('IOCL') has a refinery complex at Paradip port in Orissa and the major products produced at the refinery included Liqufied Petroleum Gas (LPG), Jet Fuel, Kerosene, Diesel etc.. For enhancing the crude handling capacity, IOCL is setting up an integrated offshore crude oil unloading facility.
- HHI was awarded a contract by IOCL primarily to install Single Point Mooring ('SPM') system, sub-sea offshore & onshore pipelines and associated facilities for integrated offshore crude oil

unloading facilities.

- For execution of the contract HHI had set up a Project Office in Paradip which was to last for more than nine months and therefore HHI conceded that its project office was a permanent establishment within the meaning of Article 5(3) of the Indian Korean Tax Treaty.
- HHI's stated stand was that the entire scope of work under the contract involving installation and commissioning of the SPM and pipelines was to be executed in India, there being no element of offshore supplies or services under the contract, and therefore the entire profits from the subject contract was taxable in India as business income. Further the services rendered by HHI were in connection with production of mineral oils as envisaged under section 44BB of the Act and therefore the special provisions of section 44BB were applicable for taxability of the profits in India.

2. *The question before the AAR:*

- HHI preferred an application before the AAR u/s 245(1) of the Act, seeking a ruling on the following question –

  "Whether on the stated facts and in law the profits derived by the installation Permanent Establishment of the applicant, for executing contract awarded by Indian Oil Corporation Limited (IOCL) for installation of SPM systems, is assessable to tax in India as per the provisions of section 44BB of the Income Tax Act, 1961 ('Act')."

3. *Legal Issues*

With the given factual backdrop, while dealing with the question before it AAR went into following legal aspects:

3.1 Issues involved:

- The main issues before the AAR were whether LPG, Jet Fuel, Kerosene, Diesel etc. produced by IOCL at its Paradip refinery would fall within the definition of the term *mineral oil* as defined in Explanation ii to section 44BB or not and if so whether the services rendered by HHI would be in connection with the production of mineral oils?

3.2 Meaning of the term '*mineral oils" in the context of section 44BB.*

- Section 44BB of the Act reads as under:

  "(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"

  Provided that this sub-section shall not apply in a case where the provisions of section 42 or section 44D or section 44DA or section 115A or section 293A apply for the purposes of computing profits or gains or any other income referred to in those sections.

  ....

  Explanation.—For the purposes of this section,—

....

(*ii*) *"mineral oil" includes petroleum and natural gas."*

- Opposing the applicability of special provision of section 44BB to the given facts, the Revenue's main line of argument was that the term mineral oils, as used in section 44BB, means only crude oil, or at best petroleum after removal of impurities i.e. upstream actitivies. That the liquid products produced by a refinery, though derived from petroleum, is not mineral oil.

In support of the proposition, the Revenue relied on:

(*a*) Circular No. 495 of 1987. The Revenue relied upon its often repeated argument that section 44BB deals only with upstream activities in oil sector (i.e. prospecting, exploration, extraction or production of crude oil upto the level of oil head) and that any activity of midstream sector (i.e. transportation of crude oil to the gas processing plant) or downstream sector (i.e. process carried out to get refined crude oil to get gasoline, petroleum, diesel fuel, etc.) is not covered by the special provisions of the section. Therefore, the assessee would not be covered u/s 44BB.

(*b*) The Petroleum Tax Guide and the Model Production Sharing Contract for definitions of the terms '*production operations*' and '*Development operations*', and contended that the production operations cover only the production from the oil well, and that the mid-stream activities are covered under 'development operations' and that both the terms have been consciously defined separately with separate meanings dealing with separate activities and therefore having regard to the two definitions, products obtained after post-mining activities are not mineral oils.

(*c*) The provisions of section 80-IB(9) to argue that whereas clause (i) and (ii) of said section grant deduction for production of mineral oil, clause (iii) grants deductions for refining of mineral oil and therefore, the business of refining of petroleum is distinct from that of production of mineral oil for the purposes of section 80-IB(9) and should be so treated under the scheme of section 44BB also.

(*d*) The definition of the term 'minerals' under the Mines Act, 1952 and contended that section 2(jj) of the Mines Act defines minerals to be those substances which can be obtained from the earth by way of mining or other processes, and that the processes mentioned in the said section does not include refining.

(*e*) The following judicial precedents

- *Worley Parsons Services Pte. Ltd.,* In re [2008] 301 ITR 54/170 Taxman 91 (AAR)

  In this case, the applicant was providing services to GAIL for transportation of gas from its premises. The question raised before the Authority was whether the receipts from the said contract are in the nature of Royalties, and if not, whether the same are to be treated as business profits under Article 7 of the DTAA and to what extent? The Authority ruled that the receipts of the applicant would be taxable in India as business profits and only those profits would be taxable which were attributable to PE in India.

- *Global Industries Asia Pacific Pte Ltd.,* In re [2012] 343 ITR 253/205 Taxman 273/18 taxmann.com 243 (AAR - New Delhi)

  The Applicant Company had entered into a contract with IOCL and also with ONGC for installation of SPM. The scope of work under the IOCL contract also included installation of anchor chains, floating and subsea hoses as subordinate activities to the main activity of allowing use of equipment. The Hon'ble Authority, in its ruling, held that the receipts of the applicant from IOCL have to be bifurcated in two parts, one part to be taxed as royalty u/s 9(1)(vi) of the Act and the other as Fee for technical services u/s 9(1)(vii) of the Act.

- *Oil & Natural Gas Corporation Ltd.* v. *CIT* [2015] 376 ITR 306/233 Taxman 495/59 taxmann.com 1 (SC)

  In this case, it was held by the Hon'ble Supreme Court that section 2(j) and 2(jj) of the Mines Act, 1952 define 'mines' and 'minerals' respectively and that the drilling operations for the purpose of production of petroleum clearly amounts to a mining activity or a mining operation.

  - HHI's arguments were that the production of petroleum products by refining crude oil constitutes production of mineral oils as envisaged in section 44BB.
  - In support of its contention, HHI relied on

    (*a*) The following judicial rulings:

    - *Goa Carbon Ltd.* v. *CIT* [2011] 332 ITR 209/[2010] 195 Taxman 1 (Bom).
    - *Burmah Shell Refineries Ltd.* v. *ITO* [1966] 61 ITR 493 (Bom)
    - *Addl. CIT* v. *Distillers Trading Corpn.* [1982] 137 ITR 894/8 Taxman 16 (SC)
    - *CIT* v. *Venkateshwara Hatcheries (P.) Ltd.* [1999] 237 ITR 174/103 Taxman 503 (SC)
    - *Padmasundara Rao* v. *State of Tamil Nadu* [2002] 255 ITR 147 (SC)
    - *Oil & Natural Gas Corpn. Ltd.* (*supra*)
    - *Global Industries Asia Pacific PTE Ltd.* (*supra*)
    - *Worley Parsons Services Pte Ltd.* (*supra*)

    (*b*) CBDT Circular no. 57 dated 23.3.1971 which dealt with the issue that whether the activity of refining of crude oil could be regarded as manufacture/production of mineral oils for the purpose of levy of surtax. The said Circular reads as under:

    "1. A question has been raised whether a company carrying on the business of refining crude oil into motor spirit, aviation spirit, kerosene and allied articles can be said to be engaged in the manufacture or production of "mineral oil" for purposes of calculating the super tax rebate under the Finance Act, 1964 and the Finance Act, 1965. The Board have been advised that the term "mineral oil" covers both crude oil (crude petroleum) and the liquid products derived from crude petroleum which are in the nature of mixtures of hydrocarbons, namely, motor spirit, kerosene and other allied articles. It, therefore, follows that the profits and gains attributable to the business of refining of crude oil would qualify for higher rebate in respect of super tax available in relation to the profits and gains attributable to the business of manufacture and production of mineral oil under the Finance Act, 1964, and the Finance Act, 1965, provided the other conditions specified in this behalf are fulfilled.

    2. On a parity of reasoning, the business of refining of crude oil will be regarded as priority industry for purposes of section 80-I and section 80M and also as business of manufacture or production of mineral oil,

for purposes of calculating the development rebate in respect of machinery and plant under section 33."

(*c*) CBDT Circular no. 495 of 1997 which explained the legislative intent behind then newly introduced section 44BB and stated that the section covered the business of exploration and exploitation of mineral oils. Also the Circular did not make any distinction between upstream, midstream or downstream activities.

(*d*) Constitution of India – Entry 53 of the Union List treats 'oil field' and 'mineral resources' specifically wherein Entry 54 deals with 'mines and mineral'. Entry 23 of the State list provides for regulation of mines and minerals subject to Entry 54 of the Union List. However, mineral oil and oil field are not included in the State List. Therefore, even the Constitution of India treats 'mineral' and 'mineral oil' as two different commodities.

(*e*) That the term mineral oil is an elastic term and its meaning depends on the context in which it is used. As u/s 44BB, 'mineral oil' is defined to include petroleum and natural gas, its meaning is wider to also include such products of petroleum which in commercial and ordinary parlance are understood to be mineral oil.

3.3 Whether the doctrine of *noscitur a sociis* applies to the terms '*prospecting for', 'extraction', 'production'* of as used in section 44BB?

- The Revenue's argument was that the doctrine of *noscitur a sociis* applied in the present case and the word '*production*' would take colour from the associated words *prospecting for* and *exploitation of* as used in section 44BB. In the opinion of the Revenue the word production should be assigned a restrictive meaning and would only apply to upstream activities.
- On the other hand HHI's contention was that the *doctrine of noscitur a sociis* has no application because:
  (*a*) the word *'production'* has a well understood meaning which is independent of the words *prospecting* and *extraction*. For the purpose HHI relied on the dictionary meaning of the words prospect, extract/extraction, produce to emphasise that the three words have altogether meanings.
  (*b*) In section 44BB the use of words '*or*' between the words prospecting for, extraction, production contradistinguishes the meaning of the said words. That restricting the scope of the section will reduce the meaning of the word '*production*' to redundancy, which is not permissible.

3.4 FTS v/s business income – the debate continues

- As per the Revenue, the contract of the HHI involved work which was in the nature of royalty/ FTS and that being a composite contract, it should be covered under section 44DA/ 115A of the Act, and therefore, the assessee's case is not covered u/s 44BB. Revenue second argument on this issue was that even if the contractual revenues were not taxable as FTS they should be taxed under the normal provisions of the Act and not u/s 44BB.
- HHI's countered the contention – s.44BB prevails over s.44DA – The applicant contended that section 44BB, being a self-contained provision, which specially deals with the taxability of non-

residents for providing services in connection with production of mineral oil, shall prevail over the general provisions of section 44DA of the Act. Reliance was placed on the decision of the Hon'ble Authority in the case of *OHM Ltd.*, In re [2011] 335 ITR 423/200 Taxman 7/11 taxmann.com 95 (AAR) which was also upheld by Delhi High Court.

4. AAR's ruling

4.1 Based on following reasoning AAR arrived at the ruling:

- That in CBDT Circular no. 495 of 1997, in the context of section 44BB, the word 'exploitation' has been added deliberately to clarify that extraction of mineral oil and its exploitation both are covered. The use of the word 'exploitation means that all products derived from crude oil would be included in the ambit of section 44BB.
- Vide Circular no.57 of 1971 the CBDT has categorically mentioned that the term mineral oils cover both crude oil and liquid products derived from crude petroleum which are in the nature of mixture of hydrocarbons like motor spirit, diesel, kerosene etc..
- When CBDT itself has given a wider meaning to the term mineral oil, the same cannot be restricted by referring to the Petroleum Tax Guide.
- Explanation (ii) to section 44BB reads that mineral oil includes petroleum and natural gas and by the term 'includes' gives a wider meaning to mineral oils
- Bombay High Court in Burmah Shell's decision and Delhi High Court in *Addl. CIT* v. *Distillers Trading Corporation Ltd.* [1982] 8 Taxman 161
- In Global Industries case, installation activities under the IOCL contract was ancillary and subsidiary to the use of equipment and therefore the revenues were taxable as FTS, which was not so in the case. Also, section 44BB was a special provision and self contained code and prevails over the general provisions including that of section 44DA.

4.2 Accordingly AAR ruled that the consideration received by HHI in respect of contract with IOCL would be chargeable to tax under the provisions of section 44BB of the Act.

5. To conclude

5.1 The ruling has with great reasoning dealt with the following contentions issues in section 44BB:

- The definition of the term *mineral oils* as been examined in the context of section of section 44BB perhaps for the first time by a higher forum and with great reasoning has been held to extend to not just the crude oil at the well-head but also products derived from refining of crude oil.
- The word '*production*' as used in section 44BB has to be read independently from the words 'prospecting for' and 'extraction' and it does not take colour from the other two words.
- The Revenue's often stated position that the special provisions of the section 44BB have no applicability beyond the upstream activities did not find favour with the AAR even in the present case.
- In the debate over section 44BB v/s 44DA it is once again ruled that former prevails over latter.
- And lastly, it is earnestly hoped that the Revenue accepts the Ruling and does not litigate any further for this is a case where a non-resident is willing to pay its taxes in India (@ 4.223% (present rate of tax) of its total contractual consideration) under the deeming provision of section 44BB of the Act merely to save itself from the rigors of maintaining/producing books of accounts and being subjected to scrutiny by the tax department. Such a gesture by the Revenue would go a

long way in reinforcing the Government's stated stand that India welcomes non-resident companies to do business in India.