

OIL AND GAS INDUSTRY – ANNUAL DIRECT TAX AND REGULATORY UPDATE, 2011

Calendar 2011 was a year that witnessed several judicial decisions in respect of oilfield services, primarily upholding the contention of the non-resident taxpayers to deemed profit law. The Delhi Bench of the tax tribunal, however, has this week disputed the findings on seismic services. As tax litigation continues, with an increasing litigious tax office, taxpayers need to be watchful of the growing tax risks around cross border flow of projects and service contracts. There was no update on the ongoing tax controversy of whether natural gas is eligible for tax holiday. The anticipated introduction of General Anti-Avoidance Rules (GAAR) in 2012 is likely to heighten taxpayer concerns with the tax environment. Hopefully, the judiciary will continue to re-assure the taxpayers of a fair outcome.

This annual edition of Energy Buzz summarizes important court decisions and policy changes in the direct tax and regulatory environment during the period January 2011 to December 2011, relevant for the oil and gas industry.

For ease of reference, the Energy Buzz has been divided into three parts as follows:

Part I – Judicial decisions specific to the oil and gas industry

Part II – Judicial decisions having relevance to the oil and gas industry

Part III – Important tax and regulatory policy amendments / announcements

PART I – Judicial decisions specific to the oil and gas industry

Fee for conducting seismic data acquisition activity for oil exploration project should be taxed under section 44BB of the Income-tax Act, 1961 (“the Act”)

The Applicant, a non-resident, engaged in the business of providing seismic data acquisition and processing services to exploration companies on a worldwide basis,

BMR Insights

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Contacts

Gokul Chaudhri

T: +91 124 339 5000

F: +91 124 339 5001

gokul.chaudhri@bmradvisors.com

was awarded contracts by Oil and Natural Gas Corporation Limited (“ONGC”) and Cairn Energy to undertake seismic data acquisition and onboard processing. The Applicant applied to the Authority for Advance Rulings (“AAR”) for determining whether the income derived by the Applicant under the contracts will be computed by applying the provisions of section 44BB of the Act.

The AAR observed that the Applicant specializes in identifying the surface of the ocean for tapping oil and gas reserves. The location of oil and gas reserves in the surface of the ocean would not be possible without undertaking seismic survey activities. The activities performed by the Applicant amply demonstrate that the activities undertaken are for prospecting for mineral oil.

The AAR, relying on the earlier decision in the case of *Seabird Exploration* (320 ITR 286) and *Geofizyka* (320 ITR 268), held that income derived by the Applicant under the contracts would be computed by applying the provisions of section 44BB of the Act.

Global Geophysical Services Limited, in re (332 ITR 418) (AAR)

For the special edition of Energy Buzz (dated March 22, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

Disallowance under section 43B cannot be made in case income is taxed under section 44BB of the Act

The taxpayer, a non-resident company, filed its return of income computing a loss. The Revenue authorities (“RA”) invoked provisions of section 44BB and brought to tax 10 percent of the gross receipts as deemed income. Subsequently, the RA issued notice under section 154 of the Act, ie for rectifying mistake apparent from record and sought to disallow certain amounts under section 43B. The taxpayer contended that section 43B cannot be applied when income is computed under section 44BB.

On appeal, the Income-tax Appellate Tribunal (“ITAT”) observed that while computing income under section 44BB of the Act on deemed basis, no separate claim for expenditure is allowable under the general provisions of the Act. Application of section 43B can only arise when there is an amount claimed as deduction otherwise allowable under the Act. Since income has been determined on presumptive basis under section 44BB, section 43B cannot be applied. Moreover, section 154 can be invoked only in a situation where there is an error apparent on record and not in the present case as applicability of section 43B (on facts of the case) was a debatable question. The ITAT accordingly held that disallowance under section 43B cannot be made in the present case.

Clough Projects International Pte Ltd vs DDIT (2011 TII 18) (ITAT Mumbai)

Payments for provision of vessels on time charter for drilling operations are taxable under section 44BB of the Act

The Applicant, a company incorporated under the laws of Singapore, is engaged in

providing comprehensive range of offshore service vessels to the oil and gas industry globally. The Applicant entered into an agreement for hire of vessels on a time charter basis with Transocean Offshore International Ventures Ltd. ("Transocean").

Transocean is engaged in providing offshore drilling and support services in India to ONGC. As per the agreement, the operation and services of the vessel were to be rendered as per Transocean's requirements. The entire operation, navigation and management of the vessel remained under the exclusive command and control of the Applicant.

The Applicant sought an advance ruling on the question whether the aforesaid services rendered by the Applicant would be taxable under section 44BB of the Act.

The AAR held that payments received for provision of offshore service vessels on time charter basis for drilling and marine operations fall within the ambit of 'supplying of plant on hire' for use in connection with prospecting, extraction or production of mineral oil, and are therefore taxable under section 44BB of the Act.

Reliance was placed on AAR's own ruling in the case of *Geofizyka Torun SP z o o* (320 ITR 268).

Bourbon Offshore Asia Pte Ltd, in re (337 ITR 122) (AAR)

Wireline logging services amount to manufacture / production of article or thing

The taxpayer, an Indian company, is engaged in providing oilfield services to its clients in relation to exploration and production of hydrocarbons. The taxpayer had entered into contracts with Oil India Ltd and ONGC to provide wireline logging and perforation services. The taxpayer claimed investment allowance (prescribed under the erstwhile provisions of section 32A) and tax holiday under sections 80IA / 80IB of the Act available to undertakings commencing manufacture / production of article / thing prior to April 1, 1995. The taxpayer further claimed depreciation at the rate of 100 percent as prescribed under the Income-tax Rules, 1962 ("Rules") on equipments used below the earth surface for the purpose of carrying on its operations as prescribed for 'mineral oil concern'.

The RA, at the initial level, disallowed the above claims on the ground that the taxpayer is not an industrial undertaking engaged in the 'manufacture' or 'production' of any 'article' or 'thing'. The claim for higher depreciation was disallowed on the ground that the taxpayer was not a 'mineral oil concern'.

The High Court ("HC") observed that the process undertaken by the taxpayer involved conversion of raw information regarding the physical property of the rocks, which was unreadable and unusable, into scientific data using sophisticated scientific tests and calculations. Accordingly, the process resulted in change in the character and identity of the raw data as compared to the end product generated by the taxpayer, which would tantamount to manufacture / production of article or thing. Regarding the claim for higher depreciation, the Court observed that the Rules provide for special rates of depreciation on machinery and plant with reference to the nature of a particular asset and the character of its user, including the type of business in which it is used, and not with reference to the ownership of assets. Accordingly, the Court held that since the

taxpayer was the owner of the assets which were similar to those owned by mineral oil concerns, depreciation at a higher rate would be allowable on such assets.

CIT vs HLS India Ltd (335 ITR 292) (Delhi)

For the special edition of *Energy Buzz* (dated May 25, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

Mobilization and demobilization revenue attributable to distance travelled outside

Indian territorial waters by the vessel deployed for seismic data acquisition activities is taxable on presumptive basis under section 44BB of the Act

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The Applicant before the AAR is an oilfield services company engaged in providing geophysical services to oil and gas industry. The Applicant entered into a contract with Cairn Energy Private Limited to carry out 3D marine seismic data acquisition services in offshore blocks in coastal areas of Andhra Pradesh and Tamil Nadu.

The Applicant sought ruling on:

- (1) Whether the revenue earned by the Applicant under the seismic data acquisition and processing contract are taxable under section 44BB of the Act (ie on deemed profit of 10 percent of the gross revenue)?
- (2) Whether the entire mobilization / demobilization revenue received under the contract is taxable in India or only the revenue attributable to the distance travelled by the vessel in the Indian territorial waters would be taxable in India?

The RA contended that the deeming provisions of section 44BB of the Act exclude from its purview income in the nature of fee for technical services ("FTS"). The services rendered by the Applicant are in the nature of technical services and will be taxable on net income basis under provisions of section 44DA of the Act.

The AAR, relying on its ruling in the case of *Geofizyka Torun Sp.zo.o* (320 ITR 268), accepted the claim of the Applicant and held that the consideration received from rendering seismic data acquisition and processing services would be taxable on a deemed profit basis under section 44BB of the Act. As regards the second question, the AAR held that there is no scope under the provisions of section 44BB to split the revenue attributable to activities in India and outside India, where the income is offered to tax on deemed profit basis. The AAR accordingly held that in case the Applicant opts to offer to tax income on deemed profit basis, the entire mobilization and demobilization revenue (including the revenue attributable to the voyage outside India), would need to be considered. The AAR held that the question of taxability of revenue attributable to voyage outside of India would arise only in case the Applicant opts to offer income on net income basis under section 44BB(3) of the Act; and that such question was not being answered by the AAR, since it was not finally sought by the Applicant.

Bergen Oilfield Services AS, in re (337 ITR 167) (AAR)

For the special edition of Energy Buzz (dated May 25, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

Similar ruling has been pronounced by the AAR in the case of **OHM Limited, in re (335 ITR 423)** and **Western Geco International Ltd, in re (338 ITR 161)**.

Even though taxpayer had bifurcated its total contract price into two segments to be assessed at two different rates, section 44BB of the Act would be applicable to the entire activity

The taxpayer, being a non-resident entity, entered into turnkey contracts with ONGC. The taxpayer, in its return of income, bifurcated the total receipts (being composite payments) of the contracts into two portions – one relating to supply of spares and the other relating to services rendered by the taxpayer in respect of repair / revamp of cranes installed at rigs. For the supply of spares, the taxpayer offered its related income to tax at the rate of 1 percent of the gross receipts, whereas for the other portion the taxpayer offered its income to tax at the rate of 10 percent of the gross receipts under section 44BB of the Act on presumptive basis. The Assessing Officer (“AO”) rejected the taxpayer’s claim in respect of first portion and computed the income at the rate of 25 percent by referring to section 9(1)(i) of the Act.

On appeal, the Dispute Resolution Panel upheld the action of the AO. On further appeal, the taxpayer decided to forego its claim of being assessed at the rate of 1 percent and claimed that its entire receipts should be made subject to provisions of section 44BB(1) of the Act and taxed at the presumptive rate of 10 percent instead of 25 percent.

The ITAT held that supply of components was indivisible part of the entire contract. ONGC was certainly engaged in the activity of prospecting for, or extraction or production of mineral oils and any amount received by the taxpayer being a non-resident engaged in the business of providing services or facility in connection with, or supplying plant and machinery on hire, used or to be used in such activity would be governed by the provisions of section 44BB of the Act. Therefore, it held that the entire receipts of the taxpayer were assessable at the rate of 10 percent as described under section 44BB of the Act.

G & T Resources (Europe Ltd) vs DDIT (45 SOT 135) (ITAT Delhi)

Other decisions

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- The Finance Act, 2010 has amended sections 44BB and 44DA to provide that section 44BB shall not apply in respect of income covered by section 44DA. The Uttarakhand High Court has held that these amendments are prospective and would apply in relation to assessment year 2011-12 and subsequent years. – **BJ Services Company Middle East Ltd vs DDIT (201 Taxman 188) (Uttarakhand)**
- Where assessee, engaged in business of rendering consultancy services for exploration of oil, had engaged non-resident consultants for rendering such

services, the assessee was justified in deducting tax at source in India at the rate of 4 percent (plus surcharge and cess) as only 10 per cent of receipt of such persons could be considered as income in their hands by virtue of section 44BB(1). – **DCIT vs Ajapa Integrated Project Management Consultants (P) Ltd (49 SOT 37) (ITAT Chennai)**

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- Service tax is to be included in consideration received for the service or facility provided under section 44BB while computing the tax liability under the section. – **Siem Offshore Inc, in re (337 ITR 207) (AAR)**

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PART II – Judicial decisions having relevance to the oil and gas industry

In case of non-resident companies, filing of return of income in India is mandatory even if income is not chargeable to tax in India by virtue of tax treaty provisions

The Applicant, VNU International BV, a subsidiary of the Nielsen Company, is a tax resident of Netherlands and held 100 percent shares of AC Nielsen ONG-MARG Private Limited (“AC Nielsen”), a company incorporated in India. ORG-IMS Research Private Limited (“ORG”), an Indian company, had entered into a scheme of arrangement with AC Nielsen in the year 2003, whereby the pharmaceutical industry retail research business of AC Nielsen got demerged. In the year 2004, the Applicant transferred 50,765 shares of ORG to IMS-AG, a company incorporated in Switzerland.

The questions before the AAR were, *inter alia*, whether any capital gain earned by the Applicant on transfer of shares of ORG to IMS-AG would be liable to tax in India as per the provisions of the Act and the India-Netherlands Double Taxation Avoidance Agreement (“DTAA”), and if the capital gain is not taxable in India, whether the Applicant is required to file any return of income under section 139 of the Act.

The AAR held that the capital gains arising to the Applicant would not be taxable in view of the India-Netherlands DTAA. The AAR noted that as per the third proviso of section 139(1), every company is required to file its return of income, whether it has an income or a loss. The AAR also noted that the income arising from the sale of shares is liable to be taxed in India by virtue of section 5(2) of the Act, although the right to tax the same is vested with Netherlands by virtue of the India-Netherlands DTAA. The AAR observed that if power to tax is granted it is difficult to appreciate the argument that when the resulting income is nil, there is no obligation to file return of income. The AAR accordingly ruled that the Applicant would be obliged to file a return of income under Section 139(1) of the Act even if its income is not chargeable to tax in India by virtue of the provisions of the India-Netherlands DTAA. It further stated that instead of causing inconvenience, the process of filing of return of income would facilitate the Applicant in all future interactions with the Income tax department.

VNU International BV, in re (334 ITR 56) (AAR)

For the special edition of Tax Edge (dated April 26, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click](#)

[here.](#)

Rulings of the Delhi HC in the case of two Rolls Royce entities on constitution of a Permanent Establishment (“PE”) and attribution of profits to a PE

(1) Rolls Royce Singapore Pte Limited

Rolls Royce Singapore Pte Limited (Appellant), incorporated in Singapore, was engaged in the business of supply of spare parts for oil field equipments, engines, turbines on offshore basis etc to various companies in India and rendering services in connection with repair and overhauling of such equipments. The Appellant engaged the services of an independent agent - M/s ANR (“ANR”) to provide support services in India on payment of commission. ANR was not related to the Appellant. The income from offshore supply of spares was not offered for tax (in India) by the Appellant on the basis that it did not have a PE in India.

The AO, amongst other issues, sought to tax income from such supplies holding that the Appellant had a business connection / PE in India and income from supplies was intricately related to such business connection / PE. The AO computed the profits from sale of spares in India by applying the global profitability percentage and attributed 75 to 100 percent of such profits to the PE in India. The CIT (A) upheld the contentions of the AO. However, it reduced the percentage of profits attributable to the business connection / PE of the Appellant to 10 / 25 percent for different years.

The ITAT held that ANR constituted a PE of the Appellant in India under the DTAA between India and Singapore because ANR was a dependent agent of the Appellant, as it was exclusively working for the Appellant and that the relationship between the Appellant and ANR was not on principal to principal basis. The overall services rendered by ANR under the agreement with the Appellant showed that ANR was instrumental in securing orders for the Appellant. ANR was also subject to specific restrictions under the agreement with the Appellant. The premises of ANR constituted a place of business from where the business of the Appellant was partly carried on in India and constituted a PE of the Appellant under Article 5(1) of the DTAA. The ITAT further held that the payment of commission to ANR was not at arm’s length and therefore, further profits would need to be attributed to such PE of the Appellant. Accordingly, the ITAT held that 10 percent of profits from the supply of spares should be attributed to the business connection / PE of the Appellant.

On appeal, the HC observed that what has to be seen is whether the activities of ANR were devoted wholly or almost wholly on behalf of the Appellant. The HC further observed that while the ITAT was right in going into the facts regarding extent of control over ANR and whether the activities were devoted almost wholly to the Appellant, evidence regarding other incomes and customers of ANR was never requisitioned from the Appellant. It observed that the annual statements filed with the Registrar of Companies indicate that the income from the Appellant was not the only source of income of ANR. The HC came to the conclusion that this issue was not analysed by the RA and the ITAT, which had also proceeded on the wrong premise that the Appellant had consciously not furnished any evidence before the authorities.

On the basis of these observations, the HC remanded the matter back to the AO to examine whether ANR was providing services to other customers and to determine the applicability of criteria for independence set out under Article 5(9) of the DTAA. It was further held that in order to find out if the agent has been remunerated at arm's length, it is necessary to do an analysis of the Functions, Assets and Risks ("FAR") undertaken by the enterprise. The HC held that what are relevant are the FAR of the enterprise and not the FAR of the agent. If any function and risk of the enterprise has not been considered, profits could be attributed to that. The HC held that the ITAT was right in holding that 10 percent of the profits should be attributable to the business connection / PE of the Appellant in respect of supply of spares.

Rolls Royce Singapore (P) Ltd vs ADIT (202 Taxman 45) (Delhi)

(2) *Rolls Royce Plc*

Rolls Royce Plc (Appellant) is a foreign company incorporated under the laws of United Kingdom and is engaged in offshore supply of aircrafts engines and components to Indian customers. The Appellant's subsidiary in UK - Rolls Royce India Limited ("RRIL") had a Liaison Office ("LO") in India through which it provided liaison services in India to the Appellant and for such services, it was remunerated on a cost plus basis. The Appellant had not filed any income tax return (in India) in the absence of a PE in India.

Based on the documents collected during a survey, the AO alleged that the Appellant had a business connection / PE in India under Article 5 of the DTAA between India and UK in the form of RRIL, through which goods to Indian customers were being marketed and sold. The AO attributed 75 to 100 percent of the profits arising from offshore sale of goods to Indian customers. The CIT (A) upheld the order passed by the AO, but granted relief by lowering the attribution to 75 percent of profits for all the years.

On appeal to the ITAT, it upheld the order passed by the CIT (A) on the issue relating to PE. The ITAT did not deal in detail on the reasons for rejection of the arguments / rebuttal made by the Appellant in respect of the findings of the AO from the survey as regards the constitution of a PE. The ITAT held as follows regarding the attribution of profits:

- The manufacturing operations for the offshore equipments supplied by the Appellant to Indian customers were undertaken outside India and 50 percent of the profits should be attributed to the territory in which such operations were carried out (ie, in UK).
- 15 percent of the profits were attributable to research and development activities undertaken by the Appellant outside India.
- Balance 35 percent of the profits were attributable to marketing and selling activities undertaken by RRIL through its LO for the Appellant.

The HC, without offering any reasons, rejected the argument of the Appellant that the

objections and documents placed before the appellate authorities were not adequately considered by the ITAT. It, therefore, held that there was no reason to interfere with the order of the ITAT holding that the Appellant had a PE in India in the form of RRIL's LO. The HC did not adjudicate on the issue of payment of arm's length remuneration to RRIL resulting in extinguishment of attribution to the PE of the Appellant, an argument on which the Appellant placed primary reliance. The HC did not adjudicate on the reasonableness or otherwise of 35 percent profit attribution as it chose to not disturb the ITAT findings.

Rolls Royce Plc vs DIT (339 ITR 147) (Delhi)

For the special edition of Tax Edge (dated September 17, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

Payment for shrink wrapped software is royalty and would be subject to withholding tax

The assessee imported "shrink-wrapped" / "off-the-shelf" software from suppliers in foreign countries and made payment for the same without deducting tax at source under section 195. The AO and CIT (A) held that the payments were assessable to tax as "royalty" under section 9(1)(vi)/ Article 12 of the DTAA between India and USA and that the assessee was liable to pay the tax under section 201. On appeal, the ITAT relied on the judgement of the Supreme Court in *Tata Consultancy Services vs State of AP* (271 ITR 401), and held that the assessee had acquired a "copyrighted article" but not the "copyright" itself and so the amount paid was not assessable as "royalty".

On appeal by the department, the Karnataka HC, reversing the decision of the ITAT, held that under section 9(1)(vi) of the Act and Article 12 of the DTAA, "payments of any kind in consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work" is deemed to be "royalty". Under the Copyright Act, 1957, a software programme constitutes a "copyright". A right to make a copy of the software and use it for internal business by making copy of the same and storing it on the hard disk amounts to a use of the copyright under section 14(1) of that Act because in the absence of such a licence, there would have been an infringement of the copyright. Accordingly, the argument that there is no transfer of any part of the copyright and the transaction involves only a sale of a copyrighted article was not accepted. The HC further held that the amount paid to the supplier for supply of the "shrink-wrapped" software is not the price of the CD alone nor software alone nor the price of licence granted. It is a combination of all. In substance, unless a licence was granted permitting the end user to copy and download the software, the CD would not be helpful to the end user.

Accordingly, it was held that the payments made for the software imports are for certain rights in the copyright, along with the media on which it is purchased as well as the software. Hence, it meets the definition of 'royalty' as per the DTAA as well as under the Act. Consequently, the payments would be chargeable to tax in India and withholding tax provisions under section 195 are applicable.

CIT vs Samsung Electronics Co Ltd (2011 TII 43) (Karnataka)

For the special edition of *Tax Edge* (dated December 2, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

The Karnataka High Court has subsequently followed the aforesaid decision in ***CIT vs Wipro Ltd (203 Taxman 621) (Karnataka)*** to hold that payment for accessing electronic database is also taxable as royalty.

AAR holds that gains arising from offshore transfer of shares are chargeable to tax in India

Groupe Industrial Marcel Dassault (“GIMD”) and Marieux Alliance (“MA”) (collectively referred to as “the Applicants”) were tax residents of France holding a Tax Residency Certificate (“TRC”). MA formed a wholly owned subsidiary (“WOS”) in France, ‘ShanH’ and entered into a share purchase agreement for acquiring up to 80 percent equity shares of an Indian company, Shantha Biotechnics Ltd (“Shantha”). Though the consideration and stamp duty were paid for by MA, the shares were acquired in the name of ShanH. Thereafter, GIMD purchased 20 percent of the shares of ShanH from MA and subsequently, an individual purchased part of the shares of ShanH from MA and GIMD. Finally, the Applicants sold their shares in ShanH to another French company, Sanofi Pasteur Holding (“Sanofi”). The Applicants applied to the AAR seeking a ruling on the Indian tax implications arising from the sale of shares of ShanH to Sanofi.

The issues before the AAR, *inter alia*, involved whether capital gains arising from sale of shares of ShanH to Sanofi would be chargeable to tax in India or France under the provisions of the DTAA between India and France and whether the controlling interest in a company could be treated as a separate asset, and whether gain from transferring such controlling interest could be taxed only in France as per Article 14(6) of the DTAA between India and France.

The AAR made a departure from the Supreme Court decision in case of *Union of India vs Azadi Bachao Andolan* (263 ITR 706) by holding that if the purpose of a transaction was to create a legal smoke screen to avoid the payment of tax, which would legitimately arise, the legal effect of the transaction has to be considered in the context of the taxing statute. The incidence of capital gains in India related to transfer of shares of Shantha could be perpetually avoided by transferring the shares of ShanH. The AAR held that the series of transactions starting from the formation of ShanH to transfer of shares in ShanH appears to be preordained to avoid dealing with the shares of Shantha, which would have created an incidence of tax in India. The word ‘alienation’ used in the Article 14.5 of the DTAA between India and France is of wide import and it includes within its ambit, transfer of the right of participation in an Indian company and therefore, the transfer of shares of ShanH should be regarded as taxable in India as per Article 14 of the DTAA. The transfer of shares of ShanH involves alienation of assets and controlling interest of an Indian company and consequently, the transactions should be regarded as part of scheme for avoidance of

tax, which has to be ignored. Even then, it is not alienation of shares of an Indian company on a literal interpretation of Article 14(5) of the DTAA, but on a purposive interpretation of the Article and the gain arising from the transaction should be treated as chargeable to tax in India.

Groupe Industrial Marcel Dassault and Merieux Alliance, in re (340 ITR 353) (AAR)

For the special edition of Tax Edge (dated December 4, 2011) discussing the above ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

PART III – Important tax and regulatory policy amendments / announcements

Finance Act, 2011

The Finance Act, 2011 was passed by the Parliament to, *inter alia*, amend the provisions of the Act. Some of the key amendments in the Act brought in by the Finance Act, 2011, relevant for the oil and gas industry, are:

- Sunset introduced for income tax holiday for certain undertakings engaged in commercial production of mineral oil. Income derived from blocks licensed under a contract awarded after March 31, 2011 shall not be eligible for the 7 year income tax holiday.
- The rate of MAT increased from 18 percent to 18.5 percent of book profits.
- Alternate minimum tax for Limited Liability Partnerships introduced (similar to the concept of MAT for companies).
- Surcharge on corporate tax reduced from 7.5 to 5 percent for domestic companies and from 2.5 to 2 percent for foreign companies.

For the special edition of Tax Edge providing the highlights of the Budget 2011, please [click here](#)

Indian Limited Liability Partnerships opened for receiving Foreign Direct Investment

The Government of India issued a press release, followed by Press Note 1 (2011 series), approving the proposal to allow foreign direct investment (“FDI”) in limited liability partnerships (“LLPs”). The FDI in LLPs will be implemented in a calibrated manner. In the first stage, FDI will be allowed only in the ‘open’ sectors where monitoring of the foreign investment is not required, subject to the following conditions:

- FDI will be allowed only in those sectors where 100 percent FDI is permissible under the automatic route and where no FDI-linked conditions are prescribed (‘LLP permissible sectors’). FDI is not allowed in LLPs engaged in agricultural /

plantation activity, print media or real estate business.

- All FDI in LLPs would be allowed only through the Government route and thereby require a prior approval from the Foreign Investment Promotion Board ('FIPB').
- Foreign capital contribution in the capital structure of a LLP would be allowed only by way of cash consideration received by inward remittance through normal banking channels. This is unlike the norms applicable to Indian companies, which are permitted to convert specified payables into equity shares.
- Foreign Institutional Investors and Foreign Venture Capital Investors are not eligible to invest in LLPs.
- LLPs with FDI are not permitted to make any downstream investments.
- Further, Indian companies having FDI are permitted to invest in LLPs only if both, ie, the investing Indian company and the LLP, are engaged in LLP permissible sectors.
- LLPs are not allowed to avail external commercial borrowings ("ECB") such as loans from non-residents, etc.
- Under the LLP Act, one of the designated partners necessarily needs to be a resident of India. The Press Note requires that such residential status of the designated partner is in accordance with the meaning of 'person resident in India' as defined under FEMA.
- In addition, it is also provided that in case of a LLP with FDI, if the designated partner is a body corporate, it should be a company registered under the Companies Act, 1956.

For the special edition of Tax Edge (dated May 11, 2011) providing the highlights of the said press release, please [click here](#).

Foreign Direct Investment – Circular 1 of 2011 and Circular 2 of 2011

The Department of Industrial Policy and Promotion ('the Department'), in line with semi-annual consolidation of the FDI policy framework, issued Circular 1 of 2011 and Circular 2 of 2011 to notify the updated FDI policy. The new Circulars introduce certain important changes in the extant FDI policy framework and integrate Press Notes / Press Releases / Clarifications / Circulars issued by the Department since the previously notified consolidated FDI policy (ie after April 1, 2011). The important changes brought about by the new Circulars are as follows:

Salient features / key changes brought about by Circular 1 of 2011

- Instead of specifying the price of convertible instruments upfront, companies would have the option to specify the conversion formula.

- Issue of shares for non-cash consideration permitted in certain situations under the Government approval route, subject to specified conditions.
- Abolition of the need for prior approval in case of existing joint venture / technical collaboration in the same field.
- Categorisation of companies having FDI into operating, investing and operating-cum-investing companies has been done away with.
- Liberalisation of FDI in the development and production of seeds and planting material under controlled conditions.

For the special edition of Tax Edge discussing the revised policy framework, along with our analysis and comments on the new guidelines, please [click here](#).

Salient features / key changes brought about by Circular 2 of 2011

- FDI in Single Brand product trading – The new policy document provides for an additional condition that the foreign investor should be the owner of the brand.
- The new consolidated policy document, in line with the extant ECB guidelines, contains provisions permitting pledging of shares of an Indian borrowing company (or its associated resident company) by the promoter for the purpose of securing the ECB raised by the borrowing company. Pledging of shares shall be permitted subject to a no-objection certificate from the Authorised Dealer.
- Press Note 1 of 2011 dated May 20, 2011 permitting and outlining conditions for FDI in LLPs has been incorporated in the new consolidated policy document.
- FDI in 'Industrial parks' is extended for R&D activities in specified sectors.
- FDI in FM Radio is increased to 26 percent, from the extant limit of 20 percent.
- FDI in construction development activities in the education sector and old age homes have been granted exemption from conditionalities applicable to FDI in this sector including, *inter alia*, minimum area and built up area requirement, minimum capitalisation requirement and lock in period requirement.

For the special edition of Tax Edge (dated October 9, 2011) discussing the revised policy framework, along with our analysis and comments on the new guidelines, please [click here](#).

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BMR Advisors | 22nd Floor | Building No. 5 | Tower A | DLF Cyber City | DLF Phase III | Gurgaon 122 002

Tel: +91 124 339 5000 | Fax: +91 124 339 5001

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