

OIL AND GAS INDUSTRY – ANNUAL DIRECT TAX AND REGULATORY UPDATE, 2009

This annual edition of Energy Buzz summarizes important court decisions and policy changes in the direct tax and regulatory environment during the year 2009, 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

Commercial production of natural gas amounts to production of 'mineral oil' for purpose of tax holiday under section 80IB(9) of the Income-tax Act, 1961; each well or a cluster of wells producing 'mineral oil' could be a separate undertaking eligible for tax holiday

The taxpayer, a company based in Canada, was engaged in the business of prospecting for, exploration and production of mineral oil in India. The taxpayer entered into a Production Sharing Contract (PSC) with the Government of India to develop oilfields. The taxpayer developed clusters of wells in phases – first cluster of wells H1, consisting of five wells started commercial production prior to April 1, 1997; second and third cluster of wells H2 (consisting of two wells) and H3, began commercial production after April 1, 1997. The taxpayer, by appending a note in the return of income, reserved the right for claiming the deduction in respect of wells which began commercial production after April 1, 1997. The exact amount of deduction, however, was not

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quantified, in view of the likelihood of getting the claim of deduction under section 42 of the Income-tax Act, 1961 ("Act"). On disallowance of deduction under section 42 of the Act on most of the expenditure, a tax holiday claim was made by the assessee under section 80IB of the Act. The Assessing Officer disallowed several claims made by the taxpayer including claim for tax holiday under section 80IB(9) of the Act for H2, *inter alia*, on the ground that the commercial production started before April 1, 1997. Claims of the assessee were partly allowed by the first appellate authority including the claim for tax holiday for H2 as a separate undertaking. On appeal, the following were some of the important conclusions of the Tribunal:

- The term 'mineral oil' is not defined under section 80IB. However, the term is defined to include 'natural gas' in other sections of the Act (sections 42, 44BB and 293A). Based on the principle of harmonious construction for interpretation of statutes, when the same word is used in different parts of the same section or statute, there is a presumption that the word is used in the same sense throughout. Accordingly, based on the meaning provided in other sections of the Act, as corroborated by the meaning of the term given in other statutes, production of natural gas amounts to production of mineral oil and is therefore, eligible for deduction under section 80IB(9) of the Act.
- Each well or a cluster of wells is a physically separate unit which can exist on its own and is capable of earning income independently. Since, in the instant case different clusters of wells (H1, H2, H3) produced measurable quantity of gas during the relevant financial year and separate books of accounts had been maintained by the assessee for each cluster, H1, H2 and H3 should be treated as three independent undertakings for the purpose of claiming tax holiday.
- The allowances claimed by the taxpayer were not of the nature specified in the PSC, nor did the PSCs provide any manner for computation of such deduction. In the absence of explicit mention of allowable deductions in the PSC and also of the manner in which such deduction were to be computed, drilling and exploration expenses could not be allowed as deduction under section 42 of the Act.
- A well is an apparatus used in the business of mineral oil production and hence 'plant' as per generic meaning. However, based on the meaning of 'building' as per the Income-tax Rules, 1962, oil wells would be treated as 'building' and thus shall be eligible to depreciation at the rate of 10 percent.

ACIT vs Niko Resources Ltd (123 TTJ 310) (Ahd)

For the Energy Buzz discussing the above ruling in detail and providing our comments and analysis in relation

Asia Awards

- [BMR named the leading Financial Advisor in the mid market segment in India and 10th in APAC](#)
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CONTACT

Gokul Chaudhri
T: +91 11 3081 5000
F: +91 11 3081 5001
gokul.chaudhri@bmradvisors.com

to the same, please [click here](#).

It is relevant to note that the Finance (No 2) Act, 2009 has made an amendment to section 80IB of the Act allowing the claim of tax holiday for the following:

- an undertaking engaged in commercial production of natural gas in blocks licensed under the VIII Round of bidding for award of exploration contracts under the New Exploration Licencing Policy which begins commercial production of natural gas on or after the 1st day of April, 2009;
- an undertaking engaged in commercial production of natural gas in blocks licensed under the IV Round of bidding for award of exploration contracts for Coal Bed Methane blocks which begins commercial production of natural gas on or after the 1st day of April, 2009.

Also, it has been provided that for the purposes of claiming deduction under section 80IB, all blocks licensed under a single contract, which has been awarded under the New Exploration Licencing Policy announced by the Government of India or has been awarded in pursuance of any law for the time being in force or has been awarded by Central or a State Government in any other manner, shall be treated as a single “undertaking”. This amendment would effectively nullify the “well by well” undertaking approach applied in the **Niko** decision.

Expenditure covered by the PSC cannot be subjected to disallowance under Section 44C

The taxpayer, a company incorporated in Cayman Islands, entered into a PSC with the Government of India for undertaking exploration and exploitation of mineral oil. In its return of income, the taxpayer had claimed deduction on the account of reimbursement of expenditure incurred by a third party. The Assessing Officer disallowed the claim of the taxpayer by invoking section 44C of the Act. Section 44C restricts the deduction of head office expenditure in the case of non-residents. On appeal, the first appellate authority allowed the taxpayer’s claim on the ground that section 44C is not applicable to a third party and further in the present case the taxpayer was entitled to concessional tax treatment provided in the PSC read with section 42(1) of the Act, hence section 44C is not applicable. On further appeal, Tribunal observed that section 44C speaks of expenditure in the nature of head office expenditure and not the expenditure incurred by the head office in relation to the operations of the taxpayer in India. Therefore, reimbursement of expenses to a third party is also caught within the mischief of head office expenses inadmissible under section 44C. However, following the decision of the Supreme Court in case of *CIT vs Enron Oil and Gas India Ltd (305 ITR 75) (SC)*, the Tribunal held that as the taxpayer is one of the parties to the PSC which represents an independent regime, such expenses are deductible under section 42 read with the PSC and section 44C is not applicable.

DDIT vs BG Exploration and Production India Ltd (29 SOT 79) (Delhi)

For computing book profits under section 115JA, deduction under section 42 of the Act is not available

The taxpayer, an oil and gas exploration company, was liable to pay tax on book profits computed under section 115JA of the Act. Section 115JA of the Act creates a legal fiction by deeming 30 percent of the book profits to be its total income on which tax is levied. The taxpayer claimed deduction under section 42 of the Act while computing the book profits. Section 42 is applicable in computing profit of the business of prospecting for or extraction or production of mineral oil and allows expenses by way of infructuous or abortive exploration etc. The tax officer disallowed the claim under section 42 of the Act on the ground that section 115JA of the Act did not provide for such a deduction. The taxpayer contended that since section 42 of the Act was a special provision for deduction in the case of business for prospecting or for extraction of mineral oil, the fiction created had to be given effect to and the fiction enacted under section 115JA of the Act would not operate on the basic principle that there could be no fiction on fiction. The Tribunal observed that there was no doubt that a legal fiction had been created in section 42 of the Act, but it was relevant only for the purpose of computation of income under the head "profits and gains from business or profession". If such fiction was extended into section 115JA of the Act, then the purpose of introducing Minimum Alternative Tax under section 115JA of the Act would be defeated. It held that the two fictions had to exist harmoniously and one should not destroy the other. With this, the Tribunal decided the issue against the taxpayer and held that section 42 of the Act cannot override section 115JA of the Act.

Gujarat State Petroleum Corporation Ltd (308 ITR 248) (Ahm)

Expenditure with respect to business of prospecting, extraction or production of mineral oil is governed by special provision

The taxpayer, a non-resident company incorporated in Australia, engaged in prospecting and exploration of mineral oils in India, carried out its business activities under the Production Sharing Contract ("PSC"). The taxpayer reimbursed certain expenses incurred by the parent company as per terms of PSC and claims it as deduction under section 42 of the Act, which is a special provision for computing income from the business of prospecting, extraction or production of mineral oil. The tax officer disallowed the expense as tax was not withheld from the payment. It was argued by the taxpayer that the payment was a reimbursement without any element of profit for which withholding provisions are not applicable and nevertheless, the disallowance cannot be made under section 40(a)(i) of the Act, which stands overridden by section 42 of the Act. The Tribunal noted that payments were in the nature of reimbursement of expenses by taking on record the Auditor's certificate provided by the taxpayer from its parent and held that withholding tax provisions will not

apply to reimbursements. Also, it relied on the decision of the Supreme Court in case of *CIT v Enron Oil and Gas India Ltd 305 ITR 75 (SC)*, and held in favor of the taxpayer that section 40(a)(i) of the Act would not apply.

Cairn Energy India Pty Limited (2009 TIOL 220) (Chennai)

Assessment cannot be on the basis of combining provisions of Tax Treaty and domestic law in parts

The taxpayer, an Italian company, was engaged in drilling operations for extraction of mineral oils in India. It offered to tax its income applying the presumptive rate of tax of 10 per cent under section 44BB of the Act on the gross receipts less subcontractor payments and employee salary. The AO did not object to this but the Commissioner of Income Tax revised the order of the AO under section 263 of the Act and directed him to reassess the income without excluding the deductions claimed. On appeal before the Tribunal, the taxpayer defended its position by relying on Article 7 of the India - Italy DTAA which permits deduction of expenses in computing profits attributable to the Permanent Establishment. However, the Tribunal held that the taxpayer has to apply in full, either the provisions of the Act or the DTAA provisions, but it cannot apply a combination. The Tribunal held that if the provisions of the domestic law have been chosen, then the deductions as per the DTAA are not permissible. Accordingly, it upheld the revision by the Commissioner and decided against the taxpayer.

Saipem SPA vs CIT (27 SOT 531) (Delhi)

Technical services provided by a non-resident in connection with exploration and prospecting of mineral oil cannot be taxed as 'fees for technical services'

The taxpayer, engaged in the business of setting up offshore rigs for exploration and prospecting of mineral oil, hired the services of a non-resident for transportation and jacking up of rigs, reviewing design and issuing of suitability certificate to taxpayer's offshore rigs. As per section 44BB of the Act, ten percent of the amount paid to a non-resident for providing services or facilities in connection with prospecting and extraction of mineral oil was taxable in India as profits from the business. However, the Revenue assessed the sum as 'fees for technical services' under section 9(1)(vii) of the Act and held that 10 percent of the sum had to be withheld as tax. On appeal, the High Court took note of the finding of the Tribunal that services rendered by the non-resident were part and parcel of the exploration activities carried out offshore by the taxpayer and involved high level of technical expertise. Further, the Court noted that explanation 2 to section 9(1)(vii) of the Act excluded certain services from the scope of 'technical services'. These services are in the nature of construction, assembly, mining or like project undertaken by the recipient. The services provided in connection with prospecting, extraction or production of mineral oil were specifically covered under section 44BB of the Act. Accordingly, the Court held that the services can be taxed only under section 44BB of the Act

DIT vs Jindal Drilling and Industries Ltd (182 Taxman 59) (Delhi)

Income of a non-resident from services provided in relation to exploration of mineral oils is to be computed under section 44BB and not under section 44DA of the Act

The applicant, a Polish company, was engaged in conducting seismic surveys and providing seismic data to oil companies in connection with their oil exploration and drilling activities. Seismic data acquisition consisted of acquisition of data/information relating to earth structure in order to identify the existence of hydrocarbons underneath. Such services were aimed at increasing the exploration success of its customers and assisting them in maximizing the production from their existing reservoirs. The applicant applied for a ruling from Authority for Advance Rulings (“AAR”) on whether the income derived by the applicant was assessable under section 44BB or under section 9(1)(vii) read with section 44DA of the Act. Section 44BB of the Act provides for the computation of income of a non-resident taxpayer engaged in providing services in connection with extraction or production of mineral oil in India and section 44DA of the Act provides for the computation of income of a non-resident who receives royalties from an Indian concern. The Revenue contended that the term ‘services’ as mentioned in section 44BB of the Act should relate only to services other than technical / consultancy services covered by Explanation 2 to section 9(1)(vii) of the Act. However, the AAR held that the term ‘services’ under section 44BB should be understood in its plain and ordinary sense and could not be narrowed down to mean services other than technical, managerial or consultancy services. The AAR held that expression “in connection with” is important and has to be construed to have expansive meaning – the services provided by the applicant had a real, intimate and proximate nexus with the prospecting for or extraction of mineral oil, without which the activity of prospecting was impracticable and hence the same would be covered by section 44BB. The AAR also observed that section 44DA would not supersede section 44BB of the Act and that both the sections had to be read in harmony with each other. The AAR observed that the nature of business was an important factor which served as an indicator to choose either of the sections. If the business is of the specific nature envisaged by section 44BB, the same being a more specific provision, the computation provision therein would prevail over the computation provision in section 44DA. Accordingly, the AAR held that the profits derived by providing seismic data acquisition services were exclusively governed by section 44BB of the Act and would be taxed on deemed profits, being 10 percent of the gross receipts.

Geofizyka Torun SP ZO O (2009 TIOL 31) (AAR)

The above ruling has been followed by the AAR in the case of Seabird Exploration FZ LLC (2009 TIOL 33).

Income of a non-resident from letting out vessel on hire for the purpose of undertaking seismic survey

/ data acquisition operations would be covered by section 44BB of the Act

The applicant, a Norwegian company, was engaged in conducting seismic surveys and providing offshore seismic data to oil companies in connection with their oil exploration. The applicant was awarded a contract in India by ONGC for 3D seismic data acquisition and processing, pursuant to which the applicant entered into a contract with PF Thor, a Faroe Islands based company, for hire of vessel on time charter basis. The applicant applied for a ruling from AAR on whether the income derived by PF Thor would be construed as 'royalty' under section 9(1)(vi) or would be assessable under section 44BB of the Act. The Revenue contended that income derived by the vessel owner, if at all, falls within the second limb of section 44BB, ie supplying of plant and machinery on hire, however as PF Thor is a third party and has no privity of contract with ONGC, section 44BB does not come into play. The AA R observed that, vessel provided by PF Thor is inextricably linked to the prospecting operations. Once the deployment of the vessel in the prospecting operations is considered to be integral part of such operations, the second part of section 44BB(1) is triggered; it is immaterial whether the vessel is deployed in the prospecting activities pursuant to a direct contract with the oil producing company or pursuant to a contract with the seismic survey services provider. Accordingly, the AAR ruled that income derived by PF Thor would fall within the scope of provisions of section 44BB of the Act and as the amounts falling under section 44BB have been excluded from the purview of royalty definition, the income derived would not be characterized as royalty.

Wavefield Inseis ASA (2009 TIOL 32) (AAR)

Payment for acquiring a share in participating rights and licence in oil fields is a commercial right similar to license and entitled to depreciation under section 32 of the Act

The taxpayer, an oil and gas exploration company, acquired a participating interest in a certain oil field in Russia. The taxpayer was granted a license by the Russian State to carry out hydrocarbon operations in the block for a period of 20 years. The taxpayer claimed that the amount paid for participating interest and the license to carry out operations were in the nature of an intangible asset, falling under the term 'any other business or commercial rights', which were 'similar in nature' to 'know-how, patents, copyrights, trademarks, licences and franchises' as referred to under section 32 of the Act. Accordingly, depreciation was claimed in respect of the payment made for such participating rights and licence. Alternatively, the entire expenditure was claimed as deductible in the first year. Separately, the taxpayer also claimed certain expenditure incurred for purchase and evaluation of the seismic data of foreign blocks as revenue expenditure. The Revenue rejected the claims and held that depreciation on intangible assets was available only to intellectual property rights ("IPRs") as the nature of intangible assets referred to under section 32 of the Act indicated a connection to IPRs. The claim for deduction of such expenditure in full in the first year was also rejected holding it to be a capital expenditure. Expenditure on purchase and evaluation of the seismic data of foreign

blocks was also disallowed on the ground that it is a capital expenditure. On appeal, the Commissioner (Appeals) held that the expenditure was deductible over the 20 year period of licence as deferred revenue expenditure. On appeal, the Tribunal held that the share in participating rights and licence, acquired by the taxpayer, was a commercial right similar to 'licence', which is specified as an intangible asset under section 32 of the Act. Accordingly, it held that payment was entitled to depreciation under section 32 of the Act. It further held that the payment could not be treated as a deferred expenditure as the concept was alien to the Act. As regards the expenditure incurred on purchase and evaluation of the seismic data of foreign blocks, the court held that the same is for the furtherance of activities undertaken by the taxpayer in the normal course of its business and hence the same was allowable as revenue expenditure.

ONGC Videsh Ltd vs DCIT (2009 TIOL 748) (Delhi)

Computation of gross receipts under section 44BB

Whether or not a particular item of receipt in the nature of reimbursement would be included in the gross receipts for the purpose of computing deemed profits of the business under section 44BB of the Act, is often a contentious issue. During the year 2009, courts examined certain receipts in the nature of reimbursements for this purpose and held as follows:

- **Mobilization / Demobilization charges**
Reimbursement of mobilization / demobilization charges for transporting rigs are not deductible from the gross receipts, as the mobilization fee paid to the taxpayer is not the actual reimbursement and has no nexus with the actual amount incurred by the taxpayer. ***CIT vs Sundowner Offshore International (Bermuda) Ltd (183 Taxman 365) (Uttarakhand HC); CIT vs R&B Falcon Drilling Co (181 Taxman 62) (Uttarakhand HC)***
- **Service tax**
Section 44BB of the Act is a complete code in itself and since the section provides for applying the rate on gross receipts, service tax collected should be included. The contention of the taxpayer that service tax is a statutory levy and hence should be excluded was rejected by the Tribunal. ***DDIT vs Technip Offshore Contracting BV (29 SOT 33) (ITAT Delhi)***
- **Customs duty**
Reimbursement of custom duty, being statutory in nature, shall be excluded for computing deemed profits under section 44BB of the Act. ***DIT vs Schlumberger Asia Services Limited (317 ITR 156) (Uttarakhand HC)***

- **Reimbursement towards catering services / loss of equipment / fuel**
Section 44BB is a special provision which includes within its ambit all the receipts which form part of 'services and facilities' in connection with the extraction or production of mineral oil. Catering services / loss of equipment / fuel form part of such services and facilities and accordingly are includible for computing tax under section 44BB of the Act.
CIT vs Ensco Maritime Ltd (317 ITR 14) (Uttarakhand HC); RBF Rig Corporation (313 ITR 369) (Uttarakhand HC)
- **Capital receipts**
The taxpayer had received reimbursements towards cost of tools lost in the operation. Held, section 44BB of the Act envisaged taxing only revenue receipts and reimbursements for loss of tools, being a capital receipt, was not includible for computing profits under section 44BB of the Act.
ACIT vs Halliburton Offshore Services Inc (2009 TIOL 399) (ITAT Delhi)

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

Supreme Court dismisses Vodafone plea

The Bombay High Court had earlier held in Vodafone's case that the Indian Revenue was well within its jurisdiction to issue show cause notice to examine the taxability of offshore transactions that enabled Vodafone to acquire control in an Indian telecom business. Vodafone thereafter moved the Supreme Court against the Bombay High Court decision. The Supreme Court has dismissed Vodafone's petition, holding that the petition merely entails reply to Revenue Department's show cause notice and that it did not warrant intervention by the Apex Court. The court also observed that Vodafone should have filed agreements in relation to the transactions before the Bombay High Court. The court directed the Revenue to look into the jurisdictional issue on the basis of its ruling in *Express Newspaper's* case. The court held that Vodafone would be at liberty to move the Bombay High Court in the event the Revenue answers the jurisdictional questions in the negative and that the High Court should admit such a petition as it entails a question of law.

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

For the special edition of Taxedge discussing the Bombay High Court ruling in detail and providing our comments and analysis in relation to the same, please [click here](#).

For applicability of withholding tax provisions of section 195 of the Act, determination of final tax liability of the non-resident is not required – Any payment to the non-resident prima facie bearing the character of income is liable to tax withholding

Taxpayer imported 'shrink-wrapped' computer software from vendor based in US for use in its business. No tax was withheld in respect of such payments on the ground that it is not taxable as 'royalty' or as 'business income', in absence of permanent establishment of the non-resident software supplier in India. The department argued that such payments were in the nature of royalty and accordingly liable to deduction of tax at source under the Act. The first appellate authority ruled in favour of the department, but the Tribunal reversed the order in favour of the taxpayer holding that transaction was akin to import of goods and hence did not warrant any tax withholding. Appeal was filed by the department before the High Court. The High Court held that

for the purposes of withholding under section 195 of the Act, determination of final tax liability of the recipient is not required. The withholding under section 195 is only a tentative deduction and the rights of the recipient are not adversely affected. Therefore, if the payment by the resident payer *prima facie* bears the character of income, the obligation of withholding under section 195(1) of the Act arises. The court held that even under section 195(2) and 195(3) of the Act, when an application is made by the resident payer to the revenue authorities seeking concessions from the withholding liability, the scope of the revenue authorities is limited to what quantum or percentage of the payment will have to suffer withholding and it is not actually either an exercise for the assessment of the income of the non-resident or the actual tax determination of the non-resident. Accordingly, the court held that in the absence of an order from the tax authority for determination of appropriate withholding tax rate, the taxpayer is liable to withhold tax on the entire income paid to the non-resident.

CIT vs Samsung Electronics Co Ltd (2009 TIOL 629) (Karnataka HC)

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

It is relevant to note that the taxpayer has filed an appeal against the above decision with the Supreme Court. The Supreme Court has passed an interim order granting stay of recovery of tax until further orders.

Mere combined effort and overall responsibility in a project do not constitute an AOP

The applicant, a Korean Company, entered into a contract with Power Grid Corporation ("Power Grid") to execute a turnkey contract which consisted of offshore supply of equipments and onshore supply of equipment and services in India. The applicant was entitled to assign the onshore portion of its contract to any

other company and on such assignment Power Grid would enter into a separate agreement with the assignee company. The applicant assigned the onshore portion to Larsen & Toubro (“L&T”) and Power Grid awarded a letter of award to L&T for the onshore portion of the contract. Under the contract, the applicant was entrusted with the overall responsibility and management of the project and to provide performance guarantee for the entire project. For the offshore supply of equipment, the title to the goods passed to Power Grid outside India although the applicant was to remain responsible for all risks of loss or damage to the equipment and materials until acceptance of the goods in India. The applicant sought a ruling from Authority for AAR on whether its association with L&T would be construed as an Association of Persons (“AOP”) and whether the consideration received for the offshore supply of equipment would be taxable in India. The AAR held that mere combined effort and assuming overall responsibility of performing the contract, are not sufficient to constitute an AOP. There must be requisite cohesion, unity of action and common objective of sharing the profit. The AAR observed that Power Grid entered into separate contracts with the applicant and L&T, each party performs independent portion of the contract and their respective consideration was also independent of each other. Since requisite cohesion, unity of action and common objective of sharing profit were not present in the case of the applicant, the AAR held that association between the applicant and L&T cannot be construed as AOP. As regards the offshore supply of equipment, the AAR held that the fact that the applicant would be responsible for loss or damage to the goods until their final acceptance was not inconsistent with Power Grid becoming the owner of the goods outside India and does not postpone the transfer of title. The AAR also held that risk in the goods need not pass simultaneously with the title in the goods. Accordingly, applying the Supreme Court ruling in *Ishikawajima Harima Heavy Industries Limited vs DIT* (288 ITR 408), it was held that since the title to the equipment passed outside India, consideration received for the same would not be taxable in India.

Hyosung Corporation (2009 TIOL 14) (AAR)

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

Offshore salary paid to non-resident employees for services rendered in India liable to tax withholding in India

Expatriates were seconded to the Indian joint venture / branch office (“JV/BO”) by the foreign enterprise. The JV/BO deducted tax at source on the salary payable in India in accordance with section 192 of the Act, but did not deduct tax on the home salary paid to expatriates. The department took a position that as per section 192 of the Act, tax should have been deducted by the JV/BO on the home salary as well. Accordingly, penalty proceedings were initiated by the department for non-deduction of tax at source. On appeal, both the Tribunal and the High Court ruled in favour of the JV/BO, post which the department appealed to the Supreme Court.

The key question before the Supreme Court was whether the JV/BO is liable to deduct tax on home salary and whether provisions dealing with the deduction of tax at source are independent of the charging provisions, which determine chargeability of income under the head "salaries" in the hands of the expatriates. The Court observed that where home salary paid to the expatriates has any connection or nexus with his rendition of service in India, then such payment would constitute income which is deemed to accrue or arise to the expatriate in India in terms of section 9(1)(ii) of the Act. It was held that the TDS provisions have extra territorial operation in respect of subject matters permissible under Article 245 of the Constitution and the provisions are enforceable within the area where the Act extends through the machinery provided under it. It was held that if the services of employment are rendered in India, the place of receipt or actual accrual of salary is immaterial and that Section 192(1) of the Act has to be read with section 9(1)(ii) of the Act. As regards levy of penalty, the Court held that the non-deduction of tax at source occurred on account of a controversial addition and the JV/BO were under the *bona fide* belief that it was not under any obligation to deduct tax at source from home salary and the expatriates had also paid the advance tax / self assessment tax and therefore penalty should not be levied.

CIT vs Eli Lilly and Company (India) Pvt Ltd (312 ITR 225) (SC)

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

Taxability under EPC contracts

The taxpayer, an Italian company, entered into a turnkey contract with Neyveli Lignite Corporation for set-up of thermal power plants in India. The taxpayer bid for the contract as a single bidder, but post award, the contract was split into four separate contracts on specific request of the taxpayer. The contracts for offshore supplies and supervisory activities were entered into with the taxpayer while the contracts for onshore supplies and services, which were loss making contracts, were executed with the Indian subsidiary of the taxpayer. The taxpayer claimed exemption for income attributable to offshore supplies. Based on the review of the contracts and other bid documents, the Assessing Officer and the first appellate authority disallowed the claim on the ground that such contracts essentially represented a composite contract, which was split only for the convenience of the non-resident taxpayer. Accordingly, certain portion of income attributable to the activities relating to the offshore supply contract in India was taxable. On appeal before the Tribunal, the Tribunal concluded that the Indian subsidiary did not have any expertise or resources for execution of the contract and its presence was only a façade created for the purpose of taxation. The various clauses of the contracts and inter-dependence between the contracts proved that the entire scope of work was in the nature of a single consolidated contract with the foreign company. The High Court affirmed most of the findings of the Tribunal and held that all the contracts were inextricably linked and there existed a composite contract

which was split at a later stage with the Indian subsidiary for tax purposes. The court also noted that there was price imbalance among the contracts, with price being unreasonably skewed in favor of the offshore supply contract. The taxpayer formed a PE in India in respect of the execution of the entire contract and mere passing of the title outside India in respect of the offshore portion of the composite contract would not exempt the offshore supply from tax in India. The court remitted the matter back to the Tribunal to assess the appropriate percentage of the activities relating to offshore supplies attributable to India which would be taxable in India.

Ansaldo Energia SPA vs ITAT (310 ITR 237) (Chennai High Court)

For the special edition of Taxedge 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

Release of the Direct Tax Code Bill, 2009

The Finance Minister of India unveiled the Direct Taxes Code Bill, 2009 (Code) on August 12, 2009. The Code proposes to align the Indian tax laws with internationally accepted taxation principles and best practices. The Finance Minister has indicated that the Code is drafted from scratch and does not attempt to modify the existing tax law. Amongst the key features of the new Code are its lucidity and brevity. A concerted effort has been made to increase the tax base and to improve the vertical and horizontal equity of the tax system. The Code is expected to eventually pave the way for a unified taxpayer reporting system in India. The Code is open for public comments and is expected to be tabled in the Budget session of the Parliament in 2010. The Code is expected to be implemented from April 1, 2011.

For the special edition of Taxedge providing the highlights of the Code, please [click here](#).

Guidelines for the calculation of total foreign investment (direct and indirect), transfer of ownership or control of Indian companies, downstream investment and liberalization of royalty payments

The Department of Industrial Policy and Promotion (DIPP), part of the Ministry of Commerce & Industry and the policy wing of the Foreign Investment Promotion Board (FIPB), issued the following important Press Notes –

- Press Note 2 (2009 series), laying down the guidelines for calculation of total foreign investment, ie

direct and indirect, in Indian companies

- Press Note 3 (2009 series), laying down the guidelines for transfer of ownership or control of Indian companies in sectors with caps from resident Indian citizens to non-resident entities.

For the special edition of Taxedge discussing the existing and the new policy framework and providing our analysis and comments on the new guidelines, please [click here](#)

- Press Note 4 (2009 series), laying down the guidelines for downstream investments by Indian companies.

For the special edition of Taxedge discussing the existing and the new policy framework and providing our analysis and comments on the new guidelines, please [click here](#)

- Press Note 8 (2009 series) permitting all payments for royalty, lumpsum fee for transfer of technology and payments for use of trademark / brand name under the automatic route without any restrictions.

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

Withdrawal of instruction on taxability of turnkey contracts

The Central Board of Direct Taxes (CBDT) issued Instruction No 5/2009 on July 20, 2009 to withdraw its historic Instruction No 1829 dated September 21, 1989, which provided specific guidance on taxability for a consortium of companies executing defined scopes of work for engineering, procurement and construction of hydro electric power plants in India. For example, it provided that the consortium of companies involved in executing individual scopes of work will not constitute an Association of Persons for tax purposes and that profits from sale of equipments, on FOB basis, will not be deemed to accrue or arise in India as the title of the goods will pass outside India. It clarified certain other issues in this regard.

For the Energy Buzz discussing the key aspects of Instruction No 1829 and impact of withdrawal, please [click here](#).

Withdrawal of clarification on taxability of certain incomes of non-residents in India

CBDT issued Circular No 7 dated October 22, 2009 withdrawing its Circular No 23 dated July 23, 1969 [and two related circulars (Circular No 163 dated May 29, 1975 and Circular No 786 dated February 7, 2000) which were based on Circular No 23]. Circular No 23 laid out instances when income does not accrue or arise to non-residents in India under section 9 of the Act. For example, it provided where the goods are sold using the services of an agent in India, the income from the transaction could be taxed only to the extent of profits attributable to the agent's services. If the agent is fully compensated at arm's length for its services, no further income would be attributable to the transaction. It also clarified certain aspects relating to taxability of a non-resident in case of export of goods to India and various other issues relevant to section 9 of the Act.

For the special edition of Taxedge discussing the key aspects of Circular No 23 and the impact of its withdrawal, please [click here](#)

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