

Income from provision of cementing services and construction of mineral oil and gas wells is taxable under section 44BB of the Act

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In brief

In a recent decision,¹ the Jaipur Income Tax Appellate Tribunal (Tribunal) has ruled that cementing services which are inextricably linked with activities of prospecting for, extraction or production of mineral oil would not qualify as fees for technical services (FTS) as defined under Explanation 2 to section 9(1)(vii) of the Income Act, 1961 (the Act) and accordingly, the provisions of section 44BB of the Act would apply instead of the provisions of section 44DA of the Act.

In detail

Facts

- The taxpayer a foreign company entered into agreements with Oil & Gas companies in India (Indian Entities) for the provision of cementing services in respect of exploratory and development wells planned to be drilled through equipment, material and personnel during the contractual period in India.
- For the AY 2012-13, the taxpayer filed its return of income offering the income from cementing services under section 44BB of the Act.
- The Tax Officer (TO) passed an order pursuant to the

directions of Dispute Resolution Panel (DRP) and held that income from cementing service was liable to be taxed under section 44DA and not under section 44BB of the Act, considering the fact such income would qualify as FTS as defined under Explanation 2 to section 9(1)(vii) of the Act.

- Aggrieved by the order of the TO, the taxpayer filed an appeal before the Tribunal.

Taxpayer's contentions

- The taxpayer contended that the cementing services were not in the nature of technical services, as it fell under the exclusion clause

as provided under Explanation 2 to section 9(1)(vii) of the Act.²

- Further, the cementing services were part of construction of mineral oil and gas wells and were inextricably linked with prospecting for or extraction or production of mineral oil and accordingly revenue from such services would be taxable under section 44BB of the Act and not under the provisions of section 44DA of the Act. In addition, section 44BB of the Act, was more specific in the instant case, the provisions of section 44DA of the Act would not apply.³

¹ ITA No. 732/JP/2015 And I.T.A. No. 02/JP/2017

² Relying on decision of ONGC Ltd. v. CIT (2015) 59 taxmann.com 1 (SC)

³ Relying on decision of DIT v. OHM Ltd. (2012) 28 taxmann.com 120 (Delhi HC)

Revenue's contentions

The tax officer considered to tax income from services under section 44DA of the Act considering the services provided by the taxpayer were in the nature of FTS as defined under Explanation 2 to section 9(1)(vii).

Key Issue before Tribunal

- Whether the consideration for provision of comprehensive cementing services through equipment, material and personnel will qualify as FTS under Explanation 2 to section 9(1)(vii) of the Act.
- Whether the provisions of section 44BB of the Act being more specific are applicable and prevail over section 44DA of the Act.

Tribunal's ruling

- The contracts provides for provision of comprehensive cementing services, and relying on the ruling of Supreme Court (SC) in case of *ONGC v. CIT*,⁴ based on the test of pith and substance, Tribunal ruled that services as mentioned in the contracts are directly associated with drilling operations and inextricably connected with

prospecting, extraction or production of mineral oil.

- Tribunal further observed that the above decision of the SC holds good even in the instant case but for the fact that the said decision was rendered in the context of section 44D of the Act and the TO has failed to apply the principles of above ruling in the present case which is in the context of section 44DA of the Act.
- Further, as per CBDT Circular No. 1862 dated 22 October, 1990, which is still operative and has not been withdrawn by the CBDT, mining or like projects occurring in the exclusion part of Explanation 2 to section 9(1)(vii) covers rendering of services such as drilling operations for exploration of and extraction of oil and natural gas. As the cementing services are related to mining or like project, it will fall under the exclusion from FTS as defined under Explanation 2 to section 9(1)(vii) of the Act.
- The section 44DA of the Act presupposes the nature of income as FTS. As cementing services do not qualify as FTS,

the applicability of section 44DA is ruled out and income is rightly been offered to tax under section 44BB of the Act.

- Further, placing reliance on the decision of Hon'ble Delhi High Court in case of *DIT v. OHM* the Tribunal held that even if it is assumed that consideration received by taxpayer for such services rendered qualifies as FTS, the provisions of section 44BB being more specific shall prevail over general provisions contained in section 44DA.

The takeaways

This decision reaffirms the decision of SC in the case of *ONGC* that the income from activities which are inextricably linked with prospecting for or extraction or production of mineral oil are also to be excluded from the definition of FTS and accordingly such income would be taxed under the provisions of section 44BB of the Act.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

⁴ The SC held that services inextricably linked to prospecting, extraction or production of mineral oil falls under mining

or like project and qualifies for exclusion from fees for technical services, and thus, were covered under the presumptive

taxation regime under section 44BB of the Act.

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