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EY Tax Alert

AAR rules on availability of treaty benefits post shift of residence to treaty jurisdiction



Executive summary

This Tax Alert summarizes a recent ruling of the Authority for Advance Rulings (AAR) in the case of Siem Offshore Inc. (Taxpayer) [AAR No. 875 of 2010] on the issue of taxability of income from offshore activities connected with exploration of mineral oils under the Income Tax Laws (ITL) and under the India-Norway Double Taxation Avoidance Agreement (DTAA). The AAR ruled that the Taxpayer, which was incorporated in the Cayman Islands but had its control and management in Norway, was eligible to the benefits of the DTAA from the date the control and management was established in Norway. The AAR also ruled that the Taxpayer would be taxable in accordance with the special provisions of the ITL as well as that of the DTAA dealing with taxation of income from activities connected with mineral oil exploration.

Facts and contentions

- ▶ The Taxpayer is a company incorporated in the Cayman Islands. It is the owner and operator of support vessels and is engaged in providing services for extraction of oil and gas. The Taxpayer has an integrated operation with offices in Norway, Brazil and the Cayman Islands.
- ▶ In January 2010, the Taxpayer shifted its control and management to Norway with an intention to list in a stock exchange in Norway. It also obtained a tax residency certificate (TRC) from the Tax Authority in Norway.
- ▶ In 2009, the Taxpayer formed a consortium with three other members and entered into an agreement with Oil and Natural Gas Corporation Ltd. (ONGC), an Indian company, for provision of bundled services for a deep water rig for a period of four years (Agreement).
- ▶ Under the Agreement, ONGC was to make direct payments separately to each of the consortium members for the work done. The Taxpayer was required to provide sea logistics services which included:
 - ▶ Provision of marine logistics support for transportation of essential cargo, materials and personnel at the rig
 - ▶ Standby and rescue operations
 - ▶ Routine surveillance for safety and security
 - ▶ Any other field work as instructed by the operator, including statutory clearances from the government authorities
- ▶ Under the ITL, taxable income of a non-resident from certain activities connected with exploration and exploitation of mineral oil is deemed to be 10% of the gross receipts from such activities (presumptive taxation).
- ▶ The Taxpayer made an application to the Indian Tax Authority for ascertaining the rate of withholding on income received by it from ONGC. The Tax Authority gave an order by treating the Taxpayer's income as 'fees for technical services', requiring withholding at a rate of 10% on the gross amount, under the ITL.
- ▶ The Taxpayer was of the view that its income would fall under the presumptive taxation regime of the ITL and that it was eligible to the benefits of the DTAA after January 2010 when it became a tax resident of Norway. The DTAA also contains special provisions dealing with taxation of offshore activities relating to mineral oil and gas exploration. Under the DTAA, the taxable income from such activities carried on in India is deemed to be 7.5% of the sums receivable. Furthermore, the tax that may be levied is limited to 50% of the tax which may otherwise be imposed in India.
- ▶ The Taxpayer sought a ruling from the AAR on availability of DTAA benefits and on application of the special regime for taxation of oil and gas exploration activities under the ITL/DTAA.
- ▶ Before the AAR, the Taxpayer additionally contended:
 - ▶ Subsequent to the shares of the Taxpayer being listed in a stock exchange in Norway and managerial control being shifted to Norway, provisions of the DTAA would govern the taxability with effect from January 2010. Reliance was placed on the TRC obtained by the Taxpayer.
 - ▶ The gross receipts received by the Taxpayer from ONGC were inclusive of service tax. Under the terms of the Agreement and domestic laws in India, the obligation to pay service tax was on the service recipient i.e., ONGC. The Taxpayer received the service tax and paid it to the tax authorities on behalf of ONGC. Hence, the amount of service tax received on that behalf cannot be treated as income of the Taxpayer.
- ▶ The Tax Authority contended that the gross receipts of the Taxpayer were in the nature of 'fees for technical services' and such fees are specifically excluded from the presumptive taxation provisions of the ITL by a recent clarificatory amendment in the ITL.

- ▶ No specific comments were made by the Tax Authority on the applicability of the DTAA or the exclusion of service tax from the gross receipts from ONGC.

AAR ruling

- ▶ In terms of the Agreement, the services provided by the Taxpayer were in connection with extraction or production of oil and, hence, are covered by the presumptive taxation regime of the ITL. It is not 'fees for technical services' and, hence, the specific exclusion from presumptive taxation is not attracted.

Applicability of the DTAA

- ▶ In the absence of any dispute from the Tax Authority on the shift of managerial control of the Taxpayer to Norway, its subsequent listing on the stock exchange and validity of the TRC of Norway, the provisions of the DTAA would be considered.
- ▶ In view of the specific provisions in the DTAA relating to taxation of offshore activities, income arising from such activities would be taxable in India. The taxable income would be determined at a rate of 7.5% of the sums receivable and the tax would be limited to 50% of the tax otherwise imposed in India.

Service tax

- ▶ Under the Agreement, the obligation of the service rests on ONGC. However, the domestic laws governing service tax clarify that it is the liability of the service provider (i.e., the Taxpayer, in the present case) to pay service tax. The provisions relied by the Taxpayer are with regard to deposit of tax and the same cannot dilute the obligation of the service provider.
- ▶ Under the ITL, presumptive taxation is on a fixed percentage i.e., 10% of amount paid for the services rendered in connection with exploration of mineral oils. The provision does not speak of any deductions from such amount. The very object of introducing the above fiction is to avoid all complications in determining the liability of a taxpayer coming under those specific provisions.
- ▶ Thus, service tax was held to be part of the consideration payable by ONGC to the Taxpayer.

A ruling by the AAR is binding only on the Applicant, in respect of transaction in relation to which the ruling is sought and on the Tax Authority, in respect of the Applicant and the said transaction. However, it does have persuasive value and the Courts in India, the Tax Authority and the appellate authorities do recognize the principles and ratio laid down by the AAR, in deciding comparable cases.

Comments

This ruling confirms the applicability of a DTAA to an entity that is incorporated in one country but has its control and management in another, as long as the country in which the control and management is based accepts that entity as its tax resident. The ruling also recognizes that, for the computation of tax liability under a presumptive tax regime, the consideration agreed in the contract between the parties should form the basis and no deduction or adjustments are permitted from the same.

Our offices

Ahmedabad

2nd floor, Shivalik Ishaan
Near CN Vidhyalaya Ambawadi
Ahmedabad - 380 015
Tel: + 91 79 6608 3800
Fax: + 91 79 6608 3900

Bengaluru

"UB City", Canberra Block
12th & 13th floor
No.24 Vittal Mallya Road
Bengaluru - 560 001
Tel: + 91 80 4027 5000
+ 91 80 6727 5000
Fax: + 91 80 2210 6000 (12th floor)
+ 91 80 2224 0695 (13th floor)

Chennai

TPL House, 2nd floor
No. 3 Cenotaph Road Teynampet
Chennai - 600 018
Tel: + 91 44 6632 8400
Fax: + 91 44 2431 1450

Hyderabad

205, 2nd floor
Ashoka Bhoopal Chambers
Sardar Patel Road
Secunderabad - 500 003
Tel: + 91 40 6627 4000
Fax: + 91 40 2789 8851

Oval Office, 18, iLabs Centre
HITECH City, Madhapur
Hyderabad - 500081
Tel: + 91 40 6736 2000
Fax: + 91 40 6736 2200

Kochi

9th Floor, Abad Nucleus
NH-49, Maradu PO
Kochi -682304
Tel: +91 484 3044000
Fax: +91 484 2705393

Kolkata

22 Camac Street
Block 'C', 3rd floor
Kolkata - 700 016
Tel: + 91 33 6615 3400
Fax: + 91 33 2281 7750

Mumbai

14th floor, The Ruby,
Dadar, Mumbai - 400 028.
Tel: + 91 22 6192 0000
Fax: + 91 22 6192 1000

6th Floor, Express Towers,
Nariman Point,
Mumbai - 400 021
Tel: + 91 22 6657 9200
Fax: + 91 22 2287 6401

Block B-2, 5th Floor
Nirlon Knowledge Park
Off. Western Express Highway
Goregaon (E), Mumbai - 400 063.
Tel: + 91 22 6749 8000
Fax: + 91 22 6749 8200

NCR

Golf View Corporate Tower B
Near DLF Golf Course Sector 42
Gurgaon - 122002
Tel: + 91 124 464 4000
Fax: + 91 124 464 4050

6th floor, HT House
18-20 Kasturba Gandhi Marg
New Delhi - 110 001
Tel: + 91 11 4363 3000
Fax: + 91 11 4363 3200

4th & 5th Floor, Plot No 2B, Tower 2,
Sector 126, NOIDA 201 304
Gautam Budh Nagar, U.P. India
Tel: + 91 120 671 7000
Fax: + 91 120 671 7171

Pune

C-401, 4th floor Panchshil Tech Park
Yerwada (Near Don Bosco School)
Pune - 411 006
Tel: + 91 20 6603 6000
Fax: + 91 20 6601 5900

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