

EY Tax Alert

SC rules NR taxpayer carried on business in India even in absence of contract or PE in India

Executive summary

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This Tax Alert summarizes a recent Supreme Court¹ (SC) (Two Judge Bench) decision in the case of *Pride Foramer S.A. v. CIT & Anr.*² (Taxpayer), where the key issue was whether business expenses and unabsorbed depreciation (arising from past business operations in India) claimed by a non-resident taxpayer under the Indian Tax Law³ (ITL) can be set off against interest on income tax refund, even in the absence of active business operations or physical presence in India.

The Taxpayer, a non-resident (NR) company, undertook a drilling contract for ONGC⁴ from 1983 to 1993. Subsequently, another drilling contract was awarded in October 1998. During the intervening period, the Taxpayer maintained continuous business correspondence with ONGC to offer manpower services for deep-water drilling and had even submitted a bid in 1996, which was unsuccessful.

The Taxpayer received interest on income tax refund during the intervening period and filed its return of income offering such interest as business income and claimed deductions for administrative and audit expenses including set off of unabsorbed depreciation brought forward from earlier years. While these claims for set off were disallowed by the Tax Authority, they were accepted by the Tribunal.

The Uttarakhand High Court (HC) reversed the Tribunal's decision and denied the deduction of business expenses including unabsorbed depreciation. On Taxpayer's further appeal, the SC held that a mere lull in business activity does not amount to cessation of business, particularly where the Taxpayer's conduct demonstrates a continuing intention to carry on business in India. Accordingly, the SC allowed deduction of expenses incurred including set off of unabsorbed depreciation. The SC observed that activities such as maintaining correspondence with ONGC for manpower supply contract and submitting bids were sufficient to establish the Taxpayer's continuing intent to conduct business.

¹ The Apex Court in India

² 2025 INSC 1247

³ Income-tax Act, 1961 r.w. Income tax Rules 1962

⁴ An Indian public sector company engaged in oil and gas business



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Background

- ▶ Under the ITL, an NR is taxable, *inter-alia*, on income that accrues or arises in India or is deemed to accrue or arise in India. The ITL further prescribes the circumstances under which income is deemed to accrue or arise in India, which, *inter alia*, includes income arising, directly or indirectly, from any business connection (BC) in India⁵. Once a business connection is established, the taxable income of the NR is restricted to the portion of income attributable to operations carried out in India.
- ▶ The scope of business connection in India has been the subject of extensive judicial debate in India. For instance, in one of the earliest SC rulings in case of CIT v. R.D. Aggarwal & Co.⁶, it was held that a business connection in India presupposes a real and intimate relationship between the business activities carried on in India and those conducted outside India. The concept inherently envisages a continuous business relationship.
- ▶ For NR taxpayers having a business connection in India, income is taxable either under a sector-specific presumptive taxation schemes⁷ or on a net income basis. If income is taxed on a net basis, the NR taxpayer is eligible to claim depreciation and carry forward and set-off of business losses/unabsorbed depreciation in accordance with the ITL. Unabsorbed depreciation can be set off against income under any head of income.

Facts of the case:

- ▶ The Taxpayer, an NR company incorporated in France, is engaged in oil drilling activities. It executed a 10-year drilling contract for ONGC in Mumbai from 1983 to 1993. Subsequently, another drilling contract was awarded by ONGC in October 1998 and formalized in January 1999.
- ▶ During the intervening period (1993 to 1999), when no drilling contract was awarded or in execution, the Taxpayer maintained continuous business correspondence with ONGC through its Dubai and France offices and even submitted a bid for oil exploration in 1996, which was unsuccessful. The Taxpayer, during such period, had incurred expenditure in nature of administrative charges, audit fees etc. with the intent of carrying out its business activities and for realization of income tax refunds. The Tribunal also noted that the Taxpayer had paid consultancy charges in relation to bid which was unsuccessful.
- ▶ For the intervening years, the Taxpayer did not earn any active business income in India but received interest on income tax refunds for past tax

years. The Taxpayer filed income tax returns declaring 'NIL' income, by setting off administrative charges, audit fees, etc., as also unabsorbed depreciation on furniture and fixtures brought forward from earlier years against the interest income by treating it as business income.

- ▶ The Tax Authority disallowed business expenditure as well as set-off of unabsorbed depreciation on the ground that the Taxpayer was not carrying on any business during the intervening years, and as per its own affidavit, it did not have a permanent establishment (PE) in India during the said years.
- ▶ On appeal by the Taxpayer, the Tribunal held that a temporary lull in business cannot be termed as cessation of business. It observed that the concept of a PE is relevant only for treaty purposes and absence of a PE does not necessarily lead to conclusion that the Taxpayer is not engaged in business. The Tribunal treated the interest income as taxable under "Income from Other Sources" and allowed the set-off of current year's business loss (represented by business expenditure) and unabsorbed depreciation in accordance with ITL.
- ▶ On further appeal by the Tax Authority, the Uttarakhand HC⁸ despite agreeing that a mere lull does not imply cessation of business, reversed the Tribunal's decision. The HC denied set off by holding that the Taxpayer cannot be said to be in business in India as it neither maintained a permanent office nor any office nor had any contract in execution during the period.
- ▶ Being aggrieved, the Taxpayer appealed further before the SC.

Issue before SC: Whether the Taxpayer can be said to be carrying on business during the intervening period so as to avail deduction of business expenditure, and set off of unabsorbed depreciation under the ITL?

SC ruling:

The SC, based on the below reasonings, ruled that the Taxpayer was carrying on business in India during the interregnum period and hence, the deduction of expenses and set off of unabsorbed depreciation is allowable under the ITL:

- ▶ To avail the benefit of provisions of business deduction and set-off and carry forward of losses, the Taxpayer needs to demonstrate that it carried on business in India.
- ▶ Further, cessation of business must be determined from the Taxpayer's conduct. If the conduct, viewed from the standpoint of a prudent businessman,

⁵ The expanded scope of business connection by way of "Significant economic presence" (SEP) introduced in 2021 was not applicable for the concerned past tax years under consideration.

⁶ (1965) (56 ITR 20) (SC)

⁷ For instance, there is a specific presumptive tax scheme for taxpayer involved in oil and gas sector in India

⁸ CIT vs. Pride Foramer S.A. (2008) (214 CTR 77)

evinces an intention to continue to carry on business, mere failure to obtain a contract is not a determining factor to hold that the Taxpayer had ceased its business activities in India⁹.

- ▶ The SC noted that the term “business” has a wide import and requires some real, substantial and systematic or organized course of activity or activity with a set purpose¹⁰. The SC reaffirmed that the expression “for the purpose of business” is broader in scope than “for the purpose of earning profits” and encompasses the acts incidental to the carrying on of business, such as preservation and protection of assets¹¹.
- ▶ In facts of the case, the SC noted that continuous correspondence with ONGC and the submission of a bid in 1996 evidenced the Taxpayer’s intention and effort to continue business operations in India, even though it did not fructify into a contract.
- ▶ The SC observed that, under the ITL, for the purpose of carrying on business in India, it is not mandatory for the NR taxpayer to have any PE in India or business connection in India. The SC clarified that the concept of PE is relevant only for determining the availing beneficial provisions under the tax treaty, and not for deciding whether a business has ceased or not under the ITL. Accordingly, the SC held that the HC erred in holding that the Taxpayer was not carrying on business merely because there was no subsisting contract, no PE or office in India, and because its business correspondence with ONGC was conducted from its overseas office.
- ▶ Additionally, the HC’s restrictive interpretation that the Taxpayer effecting business communications from its foreign office cannot be construed as carrying on business in India was regarded as “wholly anachronistic” with the India’s goals “to Sustainable Development Goal relating to ease of doing business across national borders”.
- ▶ Accordingly, the SC revived the Tribunal’s order and directed the Tax Authority to pass fresh assessment orders. To recollect, the Tribunal treated interest on income tax refund as income from other source and not business income but allowed set-off of loss due to current year’s business expenditure and unabsorbed depreciation under the provisions of ITL.

Comments

It is a settled position that NRs establish taxable nexus with India through source rules of which “business connection” is one of the primary source rule for taxation of business income in India. Once the nexus is established, the computation of business income follows from the relevant computational provisions under the head “Profits and gains from business or profession”. The primary condition for applicability of this head is that the taxpayer should be carrying on business which is considered as fulfilled when the business is “set up”.

For residents liable to tax on global income, it is well settled that once business is set up, a temporary lull in business activity does not preclude the applicability of business chapter¹². For an NR who is taxable only to the extent of income attributable to “business connection” in India, requires business operations to be carried out in India. In such a situation, the application of above principle, in a scenario where NR admittedly carries on active business operations outside India but there is temporary lull in business activities in India, was an ambiguous issue.

The SC, in the present case, has adopted a broad and pragmatic interpretation for determining business operations carried out in India by an NR taxpayer. It lays down the principle that one may need to take a holistic view disregarding a temporary lull in business while establishing economic nexus with India.

The SC appears to have adopted a broader scope to hold that the Taxpayer carried on business in India even during the period where there was no active physical business activity in India. Furthermore, the SC seem to have considered the efforts for pitching/soliciting, during the interim period, with Indian entity through foreign office as sufficient tests to permit deduction of business expenditure and set off unabsorbed depreciation, which during relevant tax years were conditional upon continuation of the business. This principle may be helpful not only in cases like the present one where taxpayer earned interest on income tax refund assessable as other source income but also in cases where taxpayer realizes any bad debt or arbitration claims from Indian customers (which are admittedly in the nature of business income) even if there is no active business presence in India.

Taxpayers may need to carefully evaluate the implications of this binding SC ruling in light of their specific facts and business models.

¹² CIT v. Vikram Cotton Mills, (1988) 169 ITR 597 (SC), Hindustan Chemical Works Ltd. vs. CIT (124 ITR 561) (Bom.HC)

⁹ CIT v. Vikram Cotton Mills, (1988) 169 ITR 597 (SC)

¹⁰ Narain Swadeshi Weaving Mills v. Commissioner of excess Profits Tax (1954) 2 SCC 546

¹¹ CIT v. Malayalam Plantations Ltd (1964) 53 ITR 140 (SC)

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