

**IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION**

INCOME TAX APPEAL NO.184 OF 2017

Principal Commissioner of Income Tax, 12 Appellant

versus

Hindustan Oil Exploration Company Ltd. ... Respondent

.....

- Mr.Arvind Pinto, Advocate for Appellant.
- Mr.Nishit Gandhi, Advocate for Respondent.

**CORAM : AKIL KURESHI &
SARANG V. KOTWAL, JJ.**

DATE : 25th MARCH, 2019.

P.C. :

1. This is appeal filed by the revenue to challenge the judgment of Income Tax Appellate Tribunal. Following questions are presented for our consideration;

“1. Whether in law and on the facts of the instant case, was the Tribunal justified in holding that the Company was eligible for deduction u/s 42(1)(a) ignoring the fact that the Company had not surrendered its block; rather it had sought for an extension of time to fulfill its contract.

2. *Whether in law and on the facts of the instant case, was the Tribunal in error in its interpretation of Section 42(1)(a); that deals with the surrender of an area of exploration and not the relinquishment of the contract as concluded by the Tribunal.”*

2. Brief facts are as under;

Respondent-Assessee Hindustan Oil Exploration Company Ltd. is engaged in the business of exploration and extraction of oil. The issue pertains to the assessee's return of income for the year 2008-2009. The return filed by the assessee for the said assessment year declared NIL income. In the return, the assessee had claimed a deduction of a sum of Rs.99.96 Crores under section 42 of the Income Tax Act, 1961 (for short ‘the Act’).

3. The assessee company had entered into a Production Sharing Contract (PSC) with Government of India on 08/10/2001 for the purposes of oil exploration. As per the PSC, a consortium of three companies of which the assessee was a

part, was issued a license for carrying out exploration of oil in the Kaveri Basin by the Government of India. The initial period of contract was for three years. Entire oil exploration had to be completed in seven years in three phases. At the end of the said period, the company had asked for extension, which was denied by the Government of India. The deduction of Rs.99.96 crores was claimed by the company which was an expenditure in oil exploration on the ground that the block was surrendered on 15/03/2008. Reliance in this respect was made to section 42(1) (a) of the Act.

4. The Assessing Officer was of the opinion that this was not a case of surrender of right to carry on oil exploration since the assessee was interested in extension of time, which was denied by the Government of India. The issue eventually reached the tribunal. Tribunal by the impugned judgment rejected the revenue's appeal and held that looking to the specific purpose for which the section 42 of the Act was enacted, the purposive interpretation thereof was necessary and

resultantly the present case would be covered by the deduction provision contained in section 42 of the Act. The tribunal held and observed as under;

“We have heard the rival submissions and perused the material before us. We find that to encourage the oil exploration Government of India introduced a new policy and simultaneously made amendment in the Act, that the assessee had made an application in pursuance of PSC and was allotted area for exploration w.e.f. 16.03.2001, that it was allowed to explore the area for seven years in three phases, that it had informed the BSE that it could not oil in two of the wells, that in the year 2006 Government notified that extension could be granted to the earlier allottees, that vide its application, dated 16.1.2008, the assessee requested for an extension, that the DGHC rejected the application filed by it for extending the exploration period that the AO held that there was no voluntary surrender of the oil fields, that the assessee could not claim deduction u/s 42(1) of the Act. In our opinion, purposive interpretation of the provisions of the Act will be useful to decide the issue. Section 42 of the Act was brought on statute with a very specific purpose- to encourage oil exploration. Purpose to introduce it was to tide over the ever increasing import bill of petroleum products. PSC is the testimony of the

efforts and intention of the government to deal with the oil crisis. To encourage the oil exploration area incentive in form of introduction of section 42(1) was given to the assessee. As an exception capital expenditure and other expenditure are fully allowed, under section 42(1)(a) of the Act, even when the exploration of oil results in failure. Such expenditure is not being amortised or not is being allowed partially year after year-it has to be allowed in full. If the background of the legislation is considered it becomes clear that there was no scope for bringing in the concept of voluntarily surrender/forced surrender. The Act has not provided such terms in the section and therefore there was no justification in denying the assessee a legitimate benefit. As per Article 4 of PSC had distinguished relinquishment and termination of contracts. As per Article 4 of PSC (Pg. 19 of the PB) 'if the contractor exercises the option provided in paragraph (b) of Article 3.5 the contractor shall, after any development area has been designated, relinquished all of the contract area not included within the said development area'. Article-30 of PSC (pg. 1.84) deals with termination of contract. It provides 10 circumstances under which the government could terminate the contract. Clearly relinquishment and termination of agreement are two different concepts as per the PSC. In his letter, dated 28.03.2007, the DGHC has informed the assessee that its contract stood relinquished. We would like to reproduce the relevant portion of the letter and

same reads as under;

“Since Phase-III exploration period is expired on 16.3.2008 and the consortium has not fulfilled the terms laid down for extension as per policy for extension beyond exploration period, hence the block CY-OSN-97/1 stands relinquished as per Article 4.3 of PSC w.e.f the date of completion of phase-III i.e. 15.3.2008.”

The termination condition of the PSC deals with totally different situations. We find that the letter dt.28.3.2007 talks of Article-\$ and not of the PSC. Clearly, the case of the assessee does not fall in the category of termination. Considering the above, we are of the opinion that the order of the FAA does not suffer from any legal or factual information. So, confirming his order, we decide effective ground of appeal against the AO.”

5. The facts as noted are not seriously in dispute. The assessee having been awarded a contract for oil exploration in Kaveri Basin for a total period of 7 years could not complete, the project within such time¹. The assessee therefore had to

1. The contract envisaged oil exploration in three phrases; initial phase would be completed within three years and thereafter there would be two

surrender the block to the Government of India. Admittedly, commercial production of oil had not commenced. In view of such facts, the question is, whether the tribunal was correct in holding that the assessee's claim of deduction under section 42 of the Act was justified.

6. Section 42 of the Act pertains to special provision for deduction in case of business for prospecting etc. for mineral oil. We are concerned with sub-section (1) of the section 42 which reads as under;

Special provision for deductions in the case of business for prospecting, etc., for mineral oil.

[(1)] For the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils in relation to which the Central Government has entered into an agreement with any person for the association or participation [of the Central Government or any person authorised by it in such business] (which agreement has been laid on the Table of each House of Parliament), there shall be

phases of 2 years each. Thus, the total period of contract was for 7 years. At the end of the period of 7 years, the assessee asked for extension of time which the Government of India denied.

made in lieu of, or in addition to, the allowances admissible under this Act, such allowances as are specified in the agreement in relation—

- (a) to expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of commercial production by the assessee;
- (b) after the beginning of commercial production, to expenditure incurred by the assessee, whether before or after such commercial production, in respect of drilling or exploration activities or services or in respect of physical assets used in that connection, except assets on which allowance for depreciation is admissible under section 32:

[Provided that in relation to any agreement entered into after the 31st day of March, 1981, this clause shall have effect subject to the modification that the words and figures “except assets on which allowance for depreciation is admissible under section 32” had been omitted; and]

- (c) to the depletion of mineral oil in the mining area in respect of the assessment year relevant to the previous year in which commercial production is begun and for such succeeding year or years as may be specified in the agreement;

and such allowances shall be computed and made in the manner specified in the agreement, the other provisions of this Act being deemed for this purpose to have been modified to the extent necessary to give effect to the terms of the agreement.

7. In terms of sub-section (1) of section 42, for the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils in relation to which the agreement has been entered into with the Central Government in lieu of or in addition to, the allowances admissible under the Act such allowances as are specified in agreement in relation to inter alia, in terms of clause (a) of any expenditure by way of infructuous or abortive exploration expenses in respect of any area surrendered prior to the beginning of the commercial production by the assessee would be admissible. For the applicability of clause (a) of sub-section (1), the elements vital are that the expenditure should be infructuous or abortive exploration expenses and that the area should be surrendered prior to beginning of the commercial production by the assessee. In other words, as long as these two

requirements are satisfied, the expenditure in question would be recognized as a deduction. The emphasis of this provision is of infructuous or abortive exploration expenses and that there is surrender prior to the beginning of the commercial production. The term 'surrender' in this clause, therefore, has to be appreciated in light of these essential requirements of the deduction clause. The revenue in our opinion has put unnecessary stress on the term 'surrender' while the main focus of the clause is on infructuous or abortive exploration expenditure in respect of area surrendered prior to the beginning of the commercial production. As long as the commercial production has not begun and the expenditure is abortive or infructuous exploration expenditure, the deduction would be allowed. The term 'surrender' itself is flexible one and does not always connote the meaning of voluntarily surrender. As in the present case, the surrender can also take place under compulsion. The assessee had no choice but to surrender the oil blocks, because the Government of India refused to extend the validity period of the contract. Nevertheless, the act of the

assessee to hand over the oil blocks before the commencement of commercial production would as well be covered within the expression; “any area surrendered prior to the beginning of commercial production by the assessee.” The revenue does not dispute that the expenditure was infructuous or abortive exploration expenditure.

8. In the result we do not find that the tribunal has committed any error.
9. Section 42 of the Act recognizes the risks of the business of oil exploration which activity is capital intensive and high in risk of entire expenditure not yielding any fruitful result. Entire purpose or enactment would be destroyed if the rigid interpretation of the revenue is accepted.
10. In the result Income Tax Appeal is dismissed.

(SARANG V. KOTWAL, J.)

(AKIL KURESHI, J.)