आयकर अपीलीय अधिकरण "एच" न्यायपीठ मुंबई में।
IN THE INCOME TAX APPELLATE TRIBUNAL
"H" BENCH, MUMBAI

माननीय श्री अमरजीत सिंह, न्यायिक सदस्य एवं
माननीय श्री मनोज कुमार अग्रवाल ,लेखा सदस्य के समक्ष।

BEFORE HON'BLE SHRI AMARJIT SINGH, JM AND
HON'BLE SHRI MANOJ KUMAR AGGARWAL, AM

(Hearing through Video Conferencing Mode)

आयकरअपील सं./ I.T.A. No.2545/Mum/2019
(**निर्धारण वर्ष /** Assessment Year: 2007-08)

Hindustan Oil Exploration Co. Ltd. Khetwari Darbar Road Off-Linking Road, Khar (W) Mumbai-400 052	**बनाम**/ Vs.	**ACIT-12(2)(2)** Aaykar Bhavan, 145A, 1st Floor M.K. Road Mumbai-400 020
स्थायीलेखासं./जीआइआरसं./PAN/GIR No. **AAACH-1407-P**		
(अपीलार्थी/**Appellant**)	:	(प्रत्यर्थी / **Respondent**)

Assessee by	:	Shri Nishit Gandhi-Ld. AR
Revenue by	:	Shri Gurbinder Singh-Ld. DR

सुनवाई की तारीख/ **Date of Hearing**	:	15/07/2021
घोषणा की तारीख / **Date of Pronouncement**	:	26/07/2021

आदेश / O R D E R

Manoj Kumar Aggarwal (Accountant Member)

1. The assessee is in second round of appeal before us since the matter was earlier remanded back by co-ordinate bench of Tribunal (ITA No.61/Mum/2011 order dated 07/02/2014) to the file of Ld. Assessing Officer (AO) with following observations: -

> 25. The AO has disallowed the entire expenditure of Rs.7,57,80,104/-. As such, expense was first claimed in assessment year 1998-99, which was allowed by the Id. CIT(A) and the appeal before the ITAT, as filed by the department, which is still pending where the issue pertained to 'drilling' for prospecting.
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> 26. The AR submitted before us that as per the Production Sharing contract between Government of India and ONGC & GSPCL & HOECL prospecting

business, which includes Exploration Expenses and Drilling Expenses. The AR submitted that since the word drilling did not figure in section 42, the AO has restored to the disallowance and also that full contents of the Agreement dated 12.04.2000 may not have been referred to, therefore, the AO may look into the contents of the clauses of the Agreement signed by the assessee company with the Government of India and two other parties.

25. The DR submitted that only break up as appended at APB 128 & 129 was given without any further details. He, therefore, agreed with the AR that the issue be restored to the AO.

26. We have heard the arguments and referred to the detail and the agreement and its relevant clauses, i.e. clause 16.2.1, which read as:

> "16.2. Pursuant to the provisions of section 42 of the Income Tax Act, 1961. The allowances specified herein shall apply in computing income tax payable by a Company on its profits and gains from the business of Petroleum Operations in lieu of (and not in addition to) corresponding allowances provided for under the heading 'Profits and Gains of Business or Profession' in the Income Tax Act, 1961.
>
> 16.2.1 Subject to the provisions herein below, deductions at the rate of one hundred percent (100%) per annum shall be allowed for all expenditures incurred in respect of Exploration Operations and drilling operations. The expenditure incurred in respect of Development Operations, other than drilling operations, and Production Operations will be allowable as per the provisions of the following".

27. Though the AR has agreed to have the expenses and details along with relevant clauses of the agreement, verified by the AO, but we must observe as an obiter that in prospecting activity, where oil, natural gas, and/or other minerals or metal are to be extracted, how can drilling activity, has to be kept aside. The minerals are the down the earth's crust, unless heavy duty drilling machines are not used as the primary and basic equipment for going deep down in the earth, prospecting and any other exploration cannot be done. This, according to us, is a basic and important feature of expense.

28. As observed here above since the AR has agreed to have it verified by the AO, we are setting aside the order of the CIT (A) on this issue and restoring the same to the AO, who will take an appropriate decision after according to the assessee reasonable and adequate opportunity to present its case.

29. Ground no. 4 it is therefore, allow for statistical purposes.

Thus, it was the observation of the bench that drilling activity could not be separated from prospecting activity. The minerals are down to the earth's crust and without drilling, the operations of prospecting and exploration could not be carried out. In the above background, Ld.AO was directed to verify the expenses and various details after considering relevant clauses of the agreement.

Assessment Proceedings

2.1 Pursuant to these directions, an assessment order has been passed by Ld.AO u/s 143(3) r.w.s. 254 on 31/03/2016. It transpired that the assessee had claimed an expenditure of Rs.757.80 Lacs u/s 42 of the Act. During set-aside proceedings, the assessee referred to its letter dated 16/03/2015 wherein the party-wise details of exploration and development expenses were furnished. The assessee submitted that the expenses were as per Petroleum Sharing Contract (PSC) entered into by the assessee, ONGC and GSPCL with Government of India for block CB-ON7 dated 12/03/2000. The relevant extract from the agreement were also attached. As per the relevant Article 16, the assessee was to be allowed deduction u/s 42 for exploration expenses. As per para 16.2.1, full deduction was to be allowed for all expenditure incurred on exploration operation and drilling operation. The same para envisages deduction of expenditure incurred for development other than expenditure incurred on drilling and exploration as general expenditure relating to business.

2.2 The assessee submitted that the exploration cost would include the cost incurred for drilling of exploratory wells for finding out the petroleum and the appraisal thereon. Since PSC provide for 100% deduction of exploration expenses, the expenses detailed in the exploration activities in addition to drilling need to be considered for deduction under the Income Tax Act which should be in addition to the expenditure allowable u/s 42.

2.3 The Ld. AO concurred that as per PSC, exploration cost includes direct or indirect expenses incurred in search of petroleum area which inter-alia include aerial, geophysical, geochemical, geological types of

survey and core hole drilling and water well drilling. Similarly, the development cost includes all direct and indirect expenditure incurred in respect to development of development area including expenditure incurred for drilling development wells. The development cost also includes completion of exploration well by way of installation of casting or equipment or otherwise or for the purpose of bringing a well into use as a producing well for the injection of water or gas to enhance recovery of petroleum and re-entry completion of working over the existing well.

As per PSC, drilling expenses could be incurred for exploration as well as development activities. Though the assessee has filed details of expenses incurred as per PSC, however, it has failed to establish that expenditure was incurred for exploration or development as the commercial production of wells had already started and the above expenses incurred were after the starting of commercial production. Therefore, the expenditure would not qualify for deduction u/s. 42 since production from wells had already started and expenditure was for enhancement of productivity. Therefore, the amounts would not qualify as expenditure incurred for exploration activity rather it would be development expenditure.

2.4 In the opinion of Ld. AO, Sec. 42 is a special provision which provides for deduction of expenditure incurred on prospecting, extracting or production of mineral oil. As against this, the assessee had incurred expenditure on the existing well which has already started commercial production. Similar view was taken in AY 2006-07 which was confirmed by learned first appellate authority. Therefore, the deduction of the expenditure was finally denied to the assessee.

Appellate Proceedings

3.1 During appellate proceedings, the assessee pleaded that deduction in respect of expenses incurred for exploration and drilling is allowable even after commencement of commercial production. The Ld. AR also submitted that pursuant to the directions of Tribunal for AY 2009-10, Ld. AO allowed similar claim u/s. 42(1)(b). The assessee also submitted that it incurred various expenses for exploration and development before the blocks were put on commercial production. The expenses incurred by the Company were as per the PSC. The details of the expenditure were as follows: -

Particulars of the claim	**Block**	**Amount (Rs.)**	**Percentage of share in JV**
Drilling & Exploration	Palej	6,70,62,762	50% (E), 35%(D)
Drilling	North Balol	(69,629)	25%
Drilling	PY-3	87,86,971	21%
Total		7,57,80,104	

It was submitted that the expenses were related to drilling, exploration activities and certain services necessary to continue ongoing activities in accordance with the PSC. As per the terms of PSC, the assessee is allowed to claim deduction u/s 42 in respect of all the block expenses. The assessee submitted that the provisions of Sec. 42(1)(b) provide for deduction of expenditure incurred for exploration, development, production and related services in the block whether incurred before or after the commencement of commercial production.

3.2 The Ld. CIT(A) noted that the deduction was denied due to the fact that the expenditure was incurred after start of commercial

production and further due to the fact that the assessee failed to file the details of the same. The assessee made conflicting statements during original assessment proceedings as well as during set-aside proceedings and therefore, the claim was not allowable. Alternatively, the assessee failed to establish that the entire expenses were incurred for exploration and drilling operations and therefore, the reliance on the order for AY 2009-10 was misplaced. Finally, the action of Ld. AO was confirmed. Aggrieved, the assessee is in further appeal before us with following grounds of appeal: -

> 1.1. On the facts and circumstances of the case and in law, the Hon'ble Commissioner of Income tax Appeals-20 ('the Hon'ble CIT(A)') erred in upholding the disallowance of expenditure incurred by the Appellant in respect of exploration and drilling activities and related services of Rs.7,57,80,104 u/s 42(1)(b) of the Act, considering the same as expenditure incurred for the relevant blocks after the commencement of commercial production.
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> 1.2. On the facts and circumstances of the case and in law, the Hon'ble CIT(A) erred in not considering the facts that the expenditure u/s 42(1)(b) of the Act were accounted under the head "development" expenditure and without appreciating the facts that all expenditure were incurred in respect of drilling activities and related services, which were allowable as per the Act and the Production Sharing Contract (PSC).
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> 1.3. On the facts and circumstances of the case and in law, the Hon'ble CIT(A) erred in not considering the facts that the Appellant had filed all the relevant details during course of hearing before the leaned AO in respect of expenses claimed as exploration expenses u/s 42(1)(b) of the Act.
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> 1.4. On the facts and circumstances of the case and in law, the Hon'ble CIT(A) erred in not appreciating the language used in section 42(1)(b) of the Act that after the beginning of the Commercial Production, any expenditure incurred, whether before or after starting of the commercial production, in respect of drilling or exploration activities is to be allowed u/s 42(1)(b) of the Act.
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> 1.5. Without prejudice to the above, on the facts and circumstances of the case and in law, the Hon'ble CIT(A) erred in disallowing the appellant's claim u/s 42(1)(b) of the Act without bringing any adverse evidence on records of such disallowance made in the hands of any Joint Venture Party, as the Appellant was one of the parties to the Joint Venture.
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> 1.6. Without prejudice to the above, on the facts and circumstances of the case and in law, the Hon'ble CIT(A) erred in disallowing the Appellant's claim u/s 42(1)(b) of the Act without considering the facts that in preceding year AY 2006-07 and subsequent year AY 2009-10, the similar nature of expenses was allowed as deduction while passing OGE to ITAT Order as per the directions given by Hon'ble ITAT in these respective years.

Our findings & Adjudication

4. Upon perusal of assessment order, we find that the main reason to deny the deduction of expenditure is the conclusion of Ld. AO that expenses incurred for exploration or development were after the start of commercial production and therefore, the expenditure would not qualify for deduction u/s 42. The expenditure was for enhancement of productivity. Similar view was stated to be taken in AY 2006-07.

5. We find that the provisions of Sec.42 are special provisions for deduction in case of prospecting etc. of mineral oil. These provisions provide that for the purpose of computing the profits or gains of any business consisting of the prospecting for or extraction or production of mineral oils etc. as per the agreement, the assessee shall be allowed allowances as specified in the agreement. Such allowances, as per clause (b) of sub-section (1) of Sec.42, would be after the beginning of commercial production and with respect to expenditure incurred by the assessee, whether before or after such commercial production, of expenditure relating to drilling and exploration activities or services etc. It could be seen that the expenditure has been incurred by the assessee on existing wells after the commencement of commercial production and hence, the same is allowable as per the provisions of the Act.

6. We find that similar issue arose in assessee's case for AY 2009-10 before this Tribunal vide ITA No.6118, 6424/Mum/2014 order dated 15/02/2017 wherein the matter was remitted back to the file of Ld. AO for re-adjudication. In the set aside proceeding, order was passed by Ld. AO on 10/11/2017 wherein deduction of expenditure was allowed to the assessee as per the provisions of Sec.42(1)(b).

Similar was the position in AY 2006-07 wherein in the set-aside proceedings, Ld. AO allowed similar deduction vide order dated 17/11/2017.

7. Proceeding further, it could be seen that during assessment proceedings, the assessee had filed party-wise details of exploration and development expenses. These expenses were in accordance with Petroleum Sharing Contract (PSC) entered into by the assessee with Government of India for block CB-ON7. As per para-16.2.1 of PSC, the assessee was to be allowed deduction for all expenditure in respect of exploration and drilling operations. The expenses incurred on development other than drilling and exploration were to be allowed as general deduction. Therefore, there could be no occasion to disallow assessee's claim.

8. In view of the foregoing, we direct Ld. AO to allow the deduction of impugned expenditure.

9. The appeal stands allowed in terms of our above order.

Order pronounced on 26th July 2021

Sd/-	**Sd/-**
(Amarjit Singh)	**(Manoj Kumar Aggarwal)**
न्यायिक सदस्य **/ Judicial Member**	लेखा सदस्य **/ Accountant Member**

मुंबई Mumbai; दिनांक Dated : 26/07/2021
Sr.PS, Dhananjay

<u>आदेशकीप्रतिलिपिअग्रेषित/Copy of the Order forwarded to</u> :

1. अपीलार्थी/ The Appellant
2. प्रत्यर्थी/ The Respondent
3. आयकरआयुक्त(अपील) / The CIT(A)
4. आयकरआयुक्त/ CIT– concerned
5. विभागीयप्रतिनिधि, आयकरअपीलीयअधिकरण, मुंबई/ DR, ITAT, Mumbai
6. गार्डफाईल / Guard File

आदेशानुसार/ BY ORDER,

उप/सहायक पंजीकार (Dy./Asstt.Registrar)
आयकरअपीलीयअधिकरण, मुंबई **/ ITAT, Mumbai.**