

*CTC Seminar on TDS u/s 195 on Foreign
Remittances including Procedural Aspects*

**Foreign shipping and airline companies –
Recent tax developments and ongoing
controversies**

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**Presented by:
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Overview

- 01 ➤ Industry overview
- 02 ➤ Key provisions under IT Act & Tax Treaty
- 03 ➤ Controversial Issues
- 04 ➤ TDS Procedure
- 05 ➤ Foreign Logistics Companies
- 06 ➤ MLI Impact

Foreign shipping and airline companies – Recent developments and ongoing controversies



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Shipping industry in India¹

- 16th largest maritime country in the world with coastline of about 7,517 km
- 12 major ports and 205 notified minor / intermediate ports
- Approximately 95% of India's trade by volume and 70% by value of India's external trade is carried on through Maritime Transport
- Six new mega ports to be developed under National Perspective Plan for Sagarmala
 - Total Rs. 1056 cr sanctioned (out of which Rs. 570 cr released till FY 2018-19)
- 100% FDI allowed under automatic route for port development projects / shipping agency / crewing

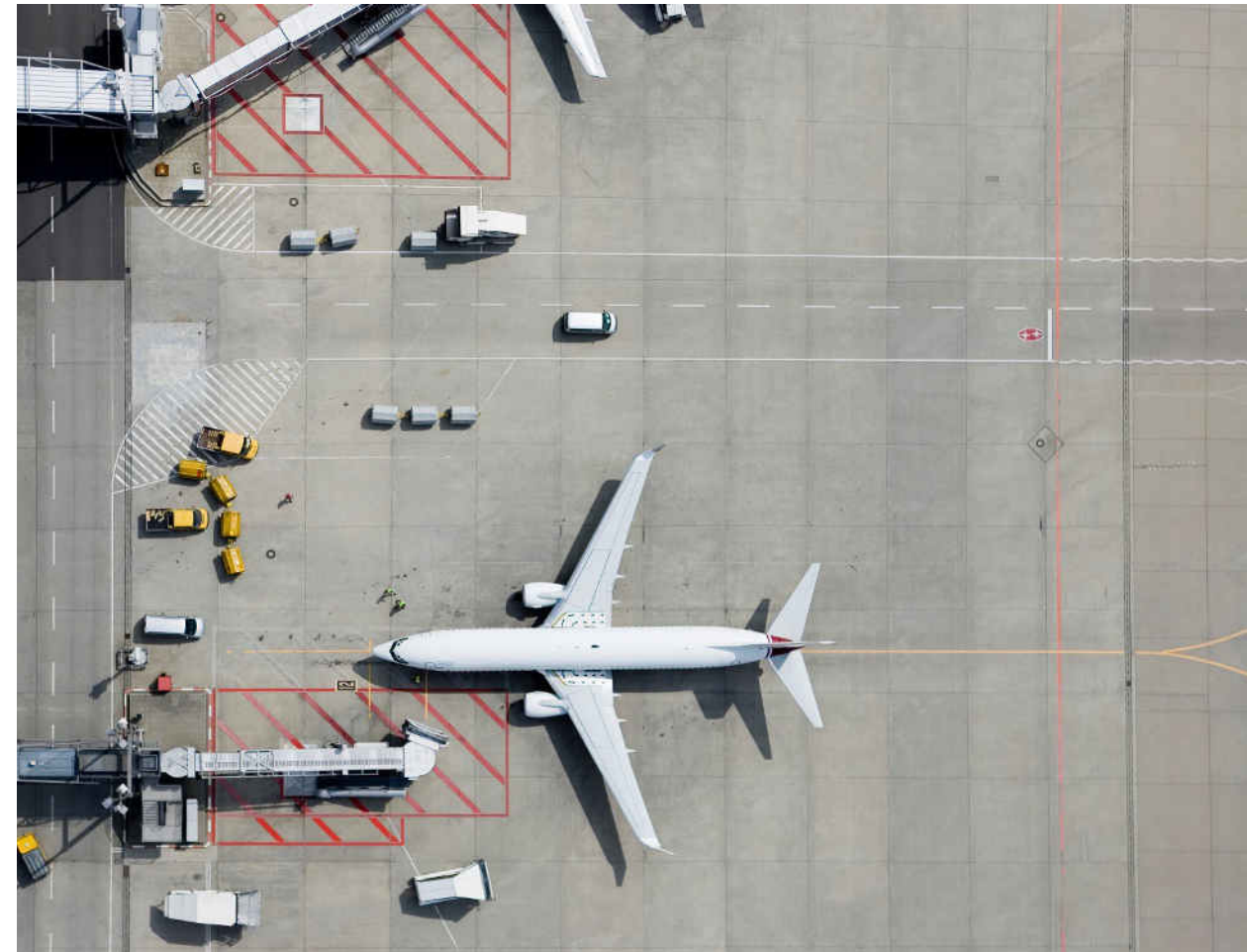
¹ www.IBEF.org and www.PIB.nic.in



Airline industry in India¹

- Projected to be 3rd largest aviation market by 2024 as per IATA
- Six new airports in Ahmedabad, Jaipur, Lucknow, Guwahati, Thiruvananthapuram and Mangaluru have received approval for leasing out under the PPP mode
- Investment to the tune of Rs. 42000 cr – 45000 cr are expected in India's airport infrastructure between FY 18-23
- Foreign Direct Investment (FDI) Policy
 - **Air transport services** – 100% FDI allowed (upto 49% allowed under automatic route) for scheduled air transport service / domestic scheduled passenger airline / regional air transport services and 100% FDI allowed under automatic route for non-scheduled air transport services and helicopter services, seaplane services which require DGCA
 - **Airports** - 100% FDI allowed under Automatic route for both greenfield as well as brownfield project
 - **Other services under the Civil Aviation Sector** - 100% FDI allowed under Automatic route

¹. www.makeinIndia.com and www.IBEF.org



Logistics industry in India¹

- As per world bank logistics performance index, India jumped to 35th rank in 2016 from 54th rank in 2014
- Warehousing automation expected to grow to us\$ 3.5 bn by 2020
- As per CRISIL, logistics industry stood at Rs. 6.4 tn in FY 2017 – expected to grow at CAGR 13% over next 3 years and will be at Rs. 9.2 tn by FY 20

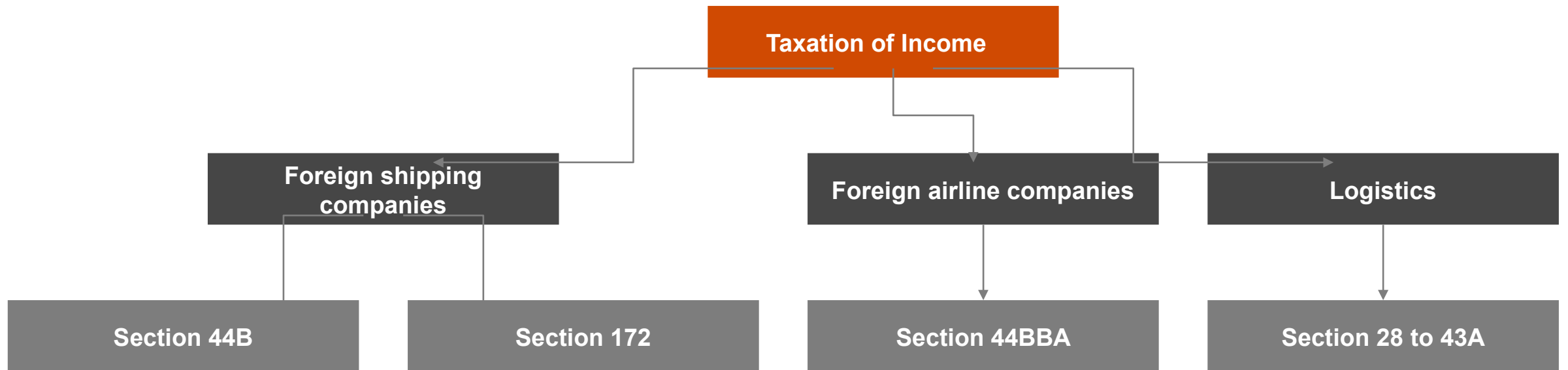
¹. www.IBEF.org



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Provisions under the IT Act – A snapshot



Deeming provisions – Section 44B and Section 172

Section 44B

- Inserted w.e.f April 1, 1976
 - Deals with 'Regular' shipping business
 - Starts with a non-obstante clause
 - Overrides sections 28 to 43A
-
- Income deemed at 7.5% of
 - Export freight (wherever received)
 - Import freight (received in India)
 - Freight to include demurrage, handling charges or any other charge of similar nature

No procedure prescribed for obtaining PCC, voyage returns, levy and collection of tax, etc – but practically followed

Section 172

- Inserted w.e.f April 1, 1962
 - Deals with 'Occasional' shipping business
 - Starts with a non-obstante clause
 - Overrides all other provisions of IT Act
 - Income deemed at 7.5% of
 - Export freight (wherever received)
 - Freight to include demurrage, handling charges or any other charge of similar nature
-
- Import freight taxable u/s 5(2) if received in India
 - Czechoslovak Ocean Shipping Int't Jt. Stock Co. v. ITO [81 ITR 162 (Cal)]

Procedure prescribed for obtaining PCC, filing of voyage returns, levy and collections of tax, etc – Refer **Annexure 1**

Effective tax rate – 3%* (40% of 7.5) of prescribed freight collections

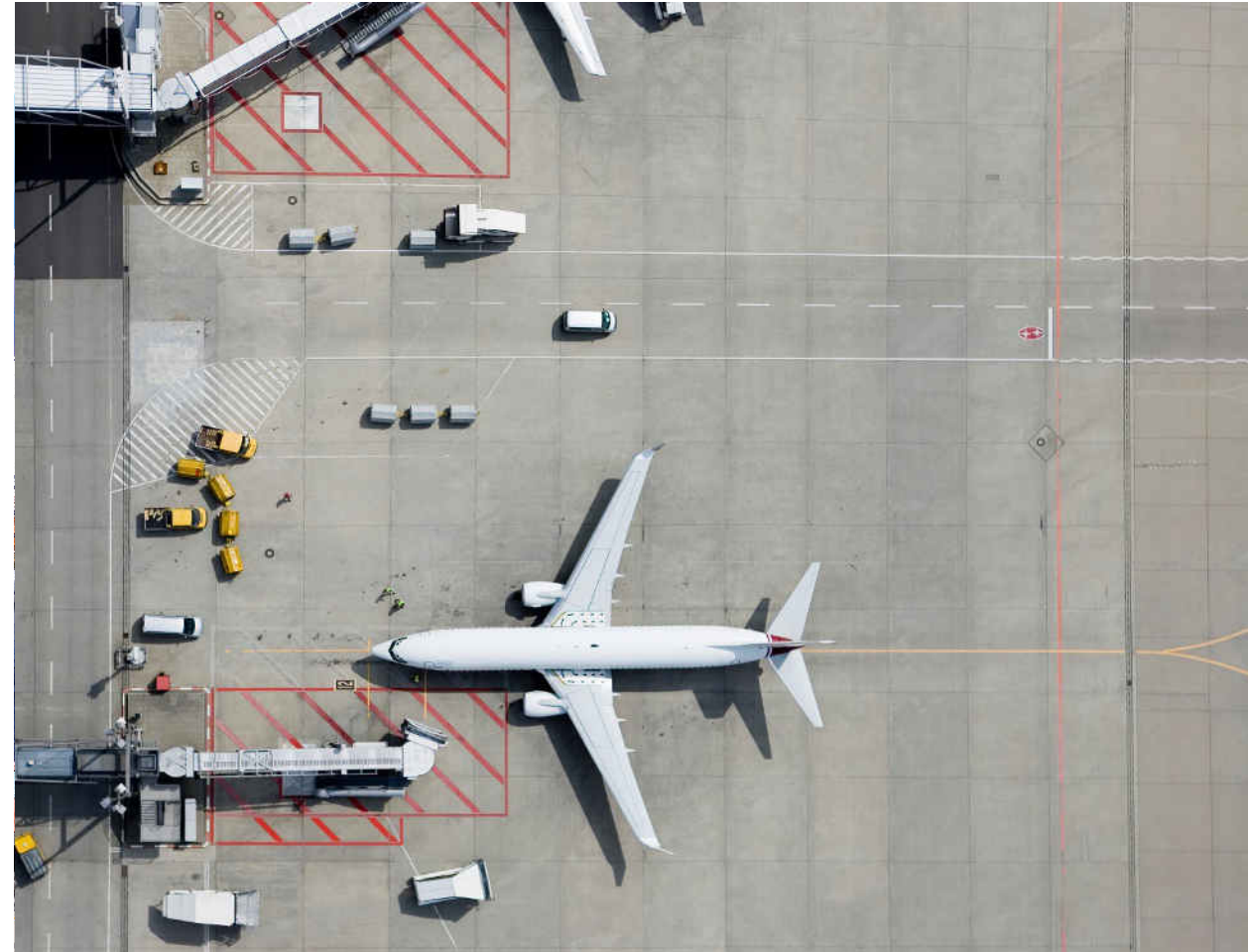
*Excluding surcharge and education cess

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Deeming provision – Section 44BBA

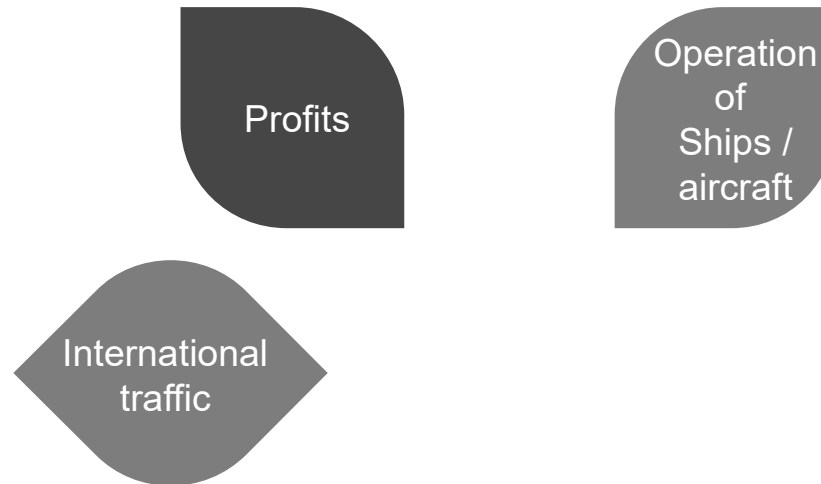
- Deals with taxation of non-residents engaged in the business of operation of aircraft
- Starts with a non-obstante clause
 - Overrides sections 28 to 43A
- Income deemed at 5% of the amounts for carriage of passengers, livestock, mail or goods :-
 - Export air fare - (wherever received)
 - Import air fare – (received in India)
- Other incidental / ancillary income not included

Applicable to domestic carriage as well –
Lloyd Helicopters [249 ITR 162 (AAR)]



Article 8 (1)

“Profits derived by an enterprise of a contracting state from the operation of ships or aircraft in international traffic shall be taxable only in that state¹”



Key conditions

Each of these conditions subject to judicial interpretation

Certain Indian Treaties gives right to tax to the source country @ half / two thirds the normal tax eg: Thailand, Ireland, Hongkong, Philippines, etc

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Article 8 (1)– Profits...

OECD Commentary

Profits - obtained from operation of ships / aircraft

- Profits from transportation of passengers or cargo by ships / aircraft (whether owned, leased or otherwise at the disposal of the enterprise) operating in international traffic
- Eg. freight charges and time charter / wet lease hire charges

Profits - directly connected with operation

- Transportation of passengers or cargo on ships / aircraft operated by other enterprises under code-sharing, slot-chartering arrangements or to take advantage of earlier sailing /fly schedule
 - US Model Convention - use, maintenance or rental of containers in international traffic also covered even if enterprise not engaged in operation of ships / aircraft
- Income from inland haulage charges

... Article 8 (1) – Profits

OECD Commentary

Profits - ancillary to operation

- Make minor contribution relative to operation and closely related to such operation
- Cannot be regarded as separate business or source of income
- Eg. Advertisement in magazines aboard ships

Profits - from pooling arrangements

- Profits from pool, joint business or international operating agency
 - Element of reciprocity essential ?

Article 8 – Pool participation

“The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency“

Terms ‘pool’, ‘joint business’ or ‘an international operating agency’ not defined

Generally covers all forms of cooperation like sharing of infrastructure, manpower, maintenance facilities, code sharing, joint operation of routes etc.

- Rendering and availing of services to/from other airlines amounts to participation in a pool – Income entitled to Article 8 benefit – Lufthansa German Airlines [83 TTJ 113 (ITAT, Delhi)]

Slot swap arrangements – Whether pooling?

Indirect pooling arrangements – Whether covered by Article 8(4)?

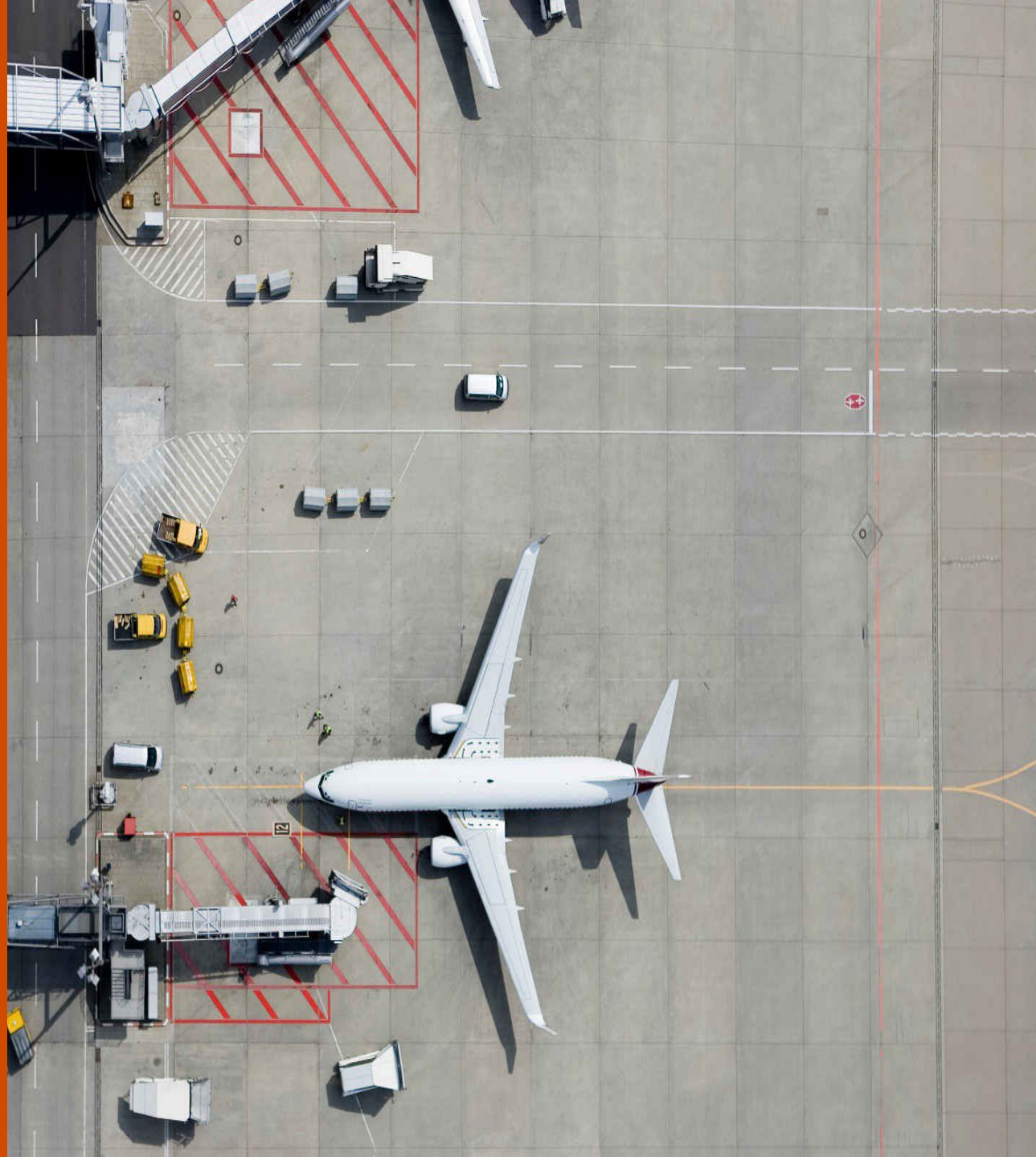
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3A



Key players – Shipping industry



Main Line Operators (MLO)

- Own / Charter vessels which carry cargo from origin-port to destination-port
- Issue B/L to shippers / NVOCC for entire voyage
- Earn freight income from shippers / NVOCC

Feeder Vessel Operators (FVO)

- Serve MLO whose vessels do not call origin / destination ports
- Own / charter vessels which carry cargo between origin / destination ports and hub ports i.e. “Relay” Cargo
- Issue Service B/L to MLO for voyage between origin / destination ports and hub ports
- Earn freight from MLO

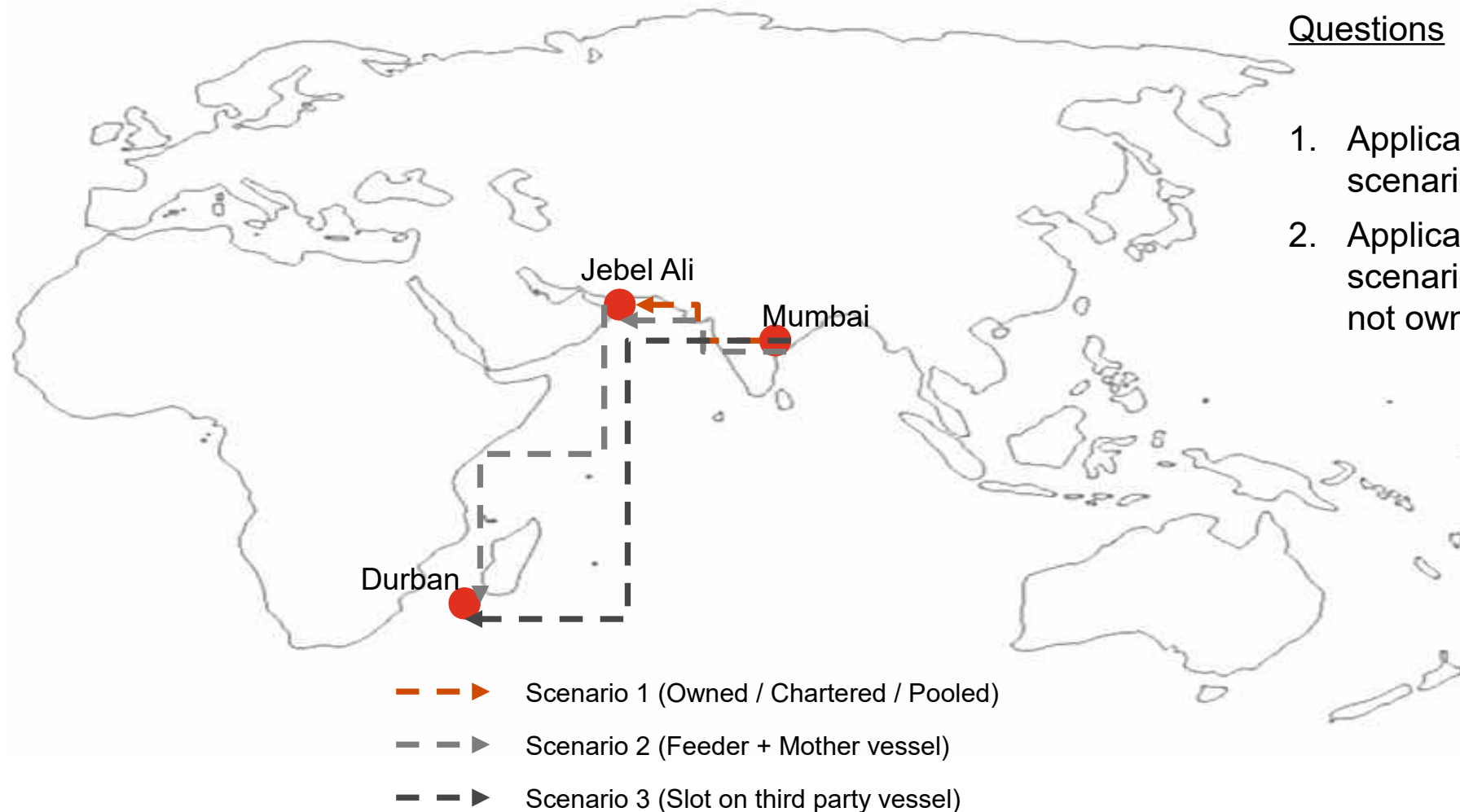
Non vessel operating / owning common carrier

- May not own, charter or operate any vessel
- Undertake transport of goods using container slots on vessels of other operators
- Break bulk cargo / small packets / cargo of various shippers into one or two containers ie. consolidators
- May own or hire containers
- Issue B/L to shippers

Freight forwarder i.e.
Logistics sector

MLO and FVO generally regarded as operator of ships

Operation of ships / aircraft



Questions

1. Applicability of Article 8 in each scenario?
2. Applicability of Article 8 in scenario 3 if the Company does not own / charter any ships

Case laws

Nature of income	Case laws
Slot charter / Space charter	<ul style="list-style-type: none">• Balaji Shipping (UK) Ltd. [253 CTR 460 (Bom)]• CMA CGM SA France [ITA No. 2175 of 2009 (Bom HC)]• Hapag Lloyd [146 TTJ 279 (Mum Tribunal)]• APL Co. Pte. Ltd. [142 ITD 498 (Mum Tribunal)]• MISC Berhad vs. ADIT [150 ITD 213(Mum Tribunal)]• Delta Air lines [(2015) 69 SOT 45 (Mum Tribunal)] (against the taxpayer)
Rental income	<ul style="list-style-type: none">• KLM Royal Dutch Airlines [178 Taxman 291 Del HC]
Lease of containers and short term storage of containers	<ul style="list-style-type: none">• Hoyer Odfjell BV [2011-TII-ITAT-MUM-INTL] – Only if incidental

Case laws

Nature of income	Case laws
Other incidental / ancillary charges <ul style="list-style-type: none">• CFS rebate• Container cleaning charges• Container damages / maintenance charges• Repairs• Port storage• Empty containers repositioning charges• Documentation / bill of lading charges	<ul style="list-style-type: none">• Whether covered under Article 8 ?
<ul style="list-style-type: none">• Interest on Income-tax refund	<ul style="list-style-type: none">• Hapag Lloyd Container Line GmbH vs. ADIT [136 ITD 122 (Mum Tribunal)]• Delta Air Lines [Income Tax Appeal No. 1795/1796 of 2007 (Mum Trib)] – Appeal filed by the taxpayer has been admitted by the HC• [(2013) 57 SOT 267 (Mum Trib)]

3B



Type of charters

Bareboat Charter / Dry lease

- 'Bare' ship / aircraft is given on hire (ie. without crew, supporting equipment, ground staff, maintenance, etc.)
- Payment nomenclated as – 'use and hire' of ship / aircraft

Bareboat Charter cum Demise

- Bareboat charter where ownership is intended to be transferred to the charterer after a specified period

Time Charter / Wet lease

- Fully equipped ship / aircraft along with operating crews is provided
- Agreement for a definite period
- Payment nomenclated as – 'use and hire' of ship / aircraft

Voyage / spot Charter

- Fully equipped ship along with crew is generally provided
- Agreement for a particular voyage
- Payment nomenclated as – 'freight' on account of carriage

Taxability of bareboat and time charter hire income...



Bareboat Charter Hire (Dry lease)

- Payment to owner for hire of bare vessel / aircraft
- Not considered as 'operation of ship / aircraft' by lessor* (crew of lessee operating the ship / aircraft)
- Considered as 'Royalty' for use of equipment
 - West Asia Maritime Ltd. v. ITO (109 TTJ 617)(ITAT, Chennai)
 - Poompuhar Shipping Corporation Ltd vs. ITO [360 ITR 257 (Madras High Court)]
 - Payment was for 'use and hire of vessel', not for services

Unless lease / charter hire income is incidental to profits from operation of ships referred under Article 8 / Article 9 (India – Netherlands DTAA, India – Korea DTAA, India-Singapore, etc

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Time charter Hire (Wet lease)

- Payment to owner for hire of vessel / aircraft with crew and equipment – viz. provision of services
- Considered as 'operation of ship / aircraft' by lessor – Article 8 benefit available to lessor
- OECD and Klaus Vogel recognise time charter as operation of ships / aircrafts by lessor
- Certain treaties include profits derived from the rental of ships or aircraft on a full time (time or voyage) or bareboat basis e.g.: India – Cyprus DTAA
- Payment to shipping company for Time Charter Charges – Not Royalty
 - **Mathewsons Exports & Imports (50 taxmann.com 378) (Poompuhar's case distinguished as that decision was in the context of coastal voyages and not international)**
 - **Sical Logistics (53 SOT 313) – Permissive Right – not royalty**

...Taxability of bareboat and time charter hire income

Freight on account of 'carriage' of passengers, livestock, etc.

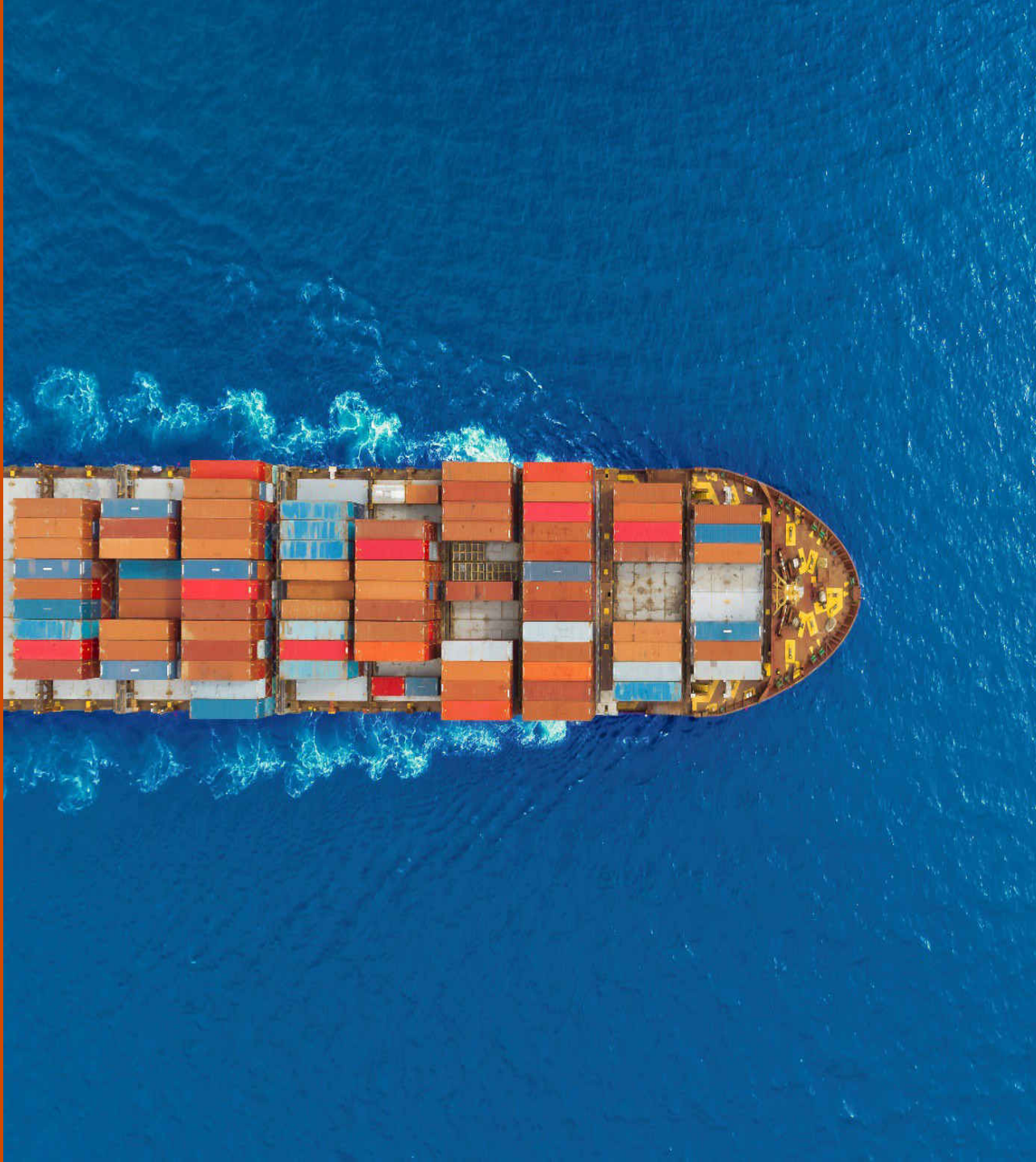
Payment for 'use and hire of ship' i.e. charter hire income

- **UOI v. Gosalia Shipping P. Ltd. [113 ITR 307 (SC)] – Not shipping profits**
 - Whether taxable as Royalty u/s 9(i)(vi)?
- **DCIT v. Reliance Industries Ltd. [81 TTJ 787 (Mumbai Tbl)]**
 - Pre-amendment to definition of 'Royalty'

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3C



International Traffic & Coastal Traffic

Defined under Tax Treaty – Article 3(e)

- Transport by ship operated by enterprise which has its POEM in a Contracting State, except
 - Coastal traffic – operation solely between places in other Contracting State
- **Coastal traffic (forming part of longer voyage in international traffic) regarded as international traffic**

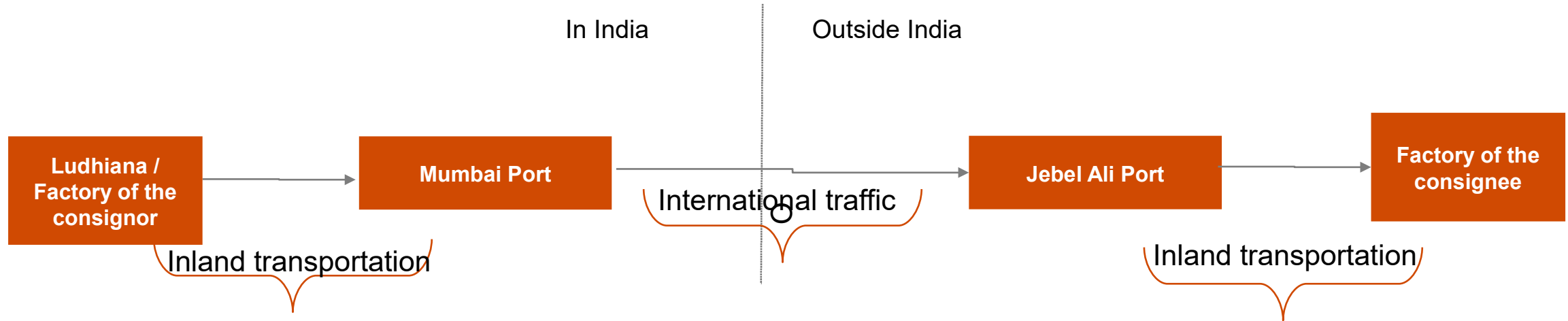
International traffic

- Ships / aircraft plying:
 - Essar Oil Ltd. [SOT 669 (ITAT, Mumbai)]
 - Tristar Logistics India Pvt Ltd [ITA No. 352/Rjt/2011]
 - Colombo (Sri Lanka) – Chennai (India)
 - Colombo (Sri Lanka) – Chennai (India) – Mumbai (India)
 - Colombo (Sri Lanka) – Chennai (India) – Dubai (UAE)
 - Singapore – Chennai (India) – Surat (Gujarat) - Dubai (UAE)

Not international traffic / Coastal traffic / domestic voyages

- Ships / aircraft plying:
 - Chennai (India) – Colombo (Sri Lanka) (not stopping) – Mumbai (India)
 - Chennai (India) – Mumbai (India)

Inland Haulage



- Cargo is transported from Ludhiana to Mumbai by Road/Railway
- From Mumbai, Cargo is loaded on vessel for export outside India
- Separate charges levied for movement of cargo from Ludhiana to Mumbai under a single invoice
- One consolidated bill of lading, airway bill issued by shipping / airline company to the consignor

Questions

1. Whether Article 8 applicable to IHC?
2. Would mode of inland transportation (land / railway / inland waterways) make a difference?
3. Would difference in Treaty language make a difference?

Case laws

Inland Haulage Charges – Whether shipping income?

- **ITO v. Freight Systems (India) P. Ltd. [6 SOT 473 (Del Tbl)]**
 - Tax Department's appeal dismissed by Delhi High Court vide order dated May 15, 2007
 - Reliance placed on earlier decision in Continental Carriers P. Ltd's case [163 Taxman 479 (Delhi HC)]
 - Special Leave Petition filed by Tax Department in Continental Carriers case dismissed by Supreme Court in July 2007
- **Safmarine Container Lines, NV [(Bombay High Court) in its order dated 17 January 2013) (ITA No. 952 of 2011 with ITA No. 147 of 2009)] – SLP filed by Revenue admitted by SC**
- **Federal Express Corp. [130 TTJ 526 (Mum Trib)]**
- **[(2018) 90 taxmann.com 326 (Mum Trib)]**



3D



Presumptive basis vs. Net-income

Whether section 44B /44BBA/172 is mandatory and applicable even in case of losses ?

- **Royal Jordanian Airlines [(2016) 383 ITR 465 (Delhi HC)]**
 - Section 44BBA is not a charging section but a machinery provision for computation of income

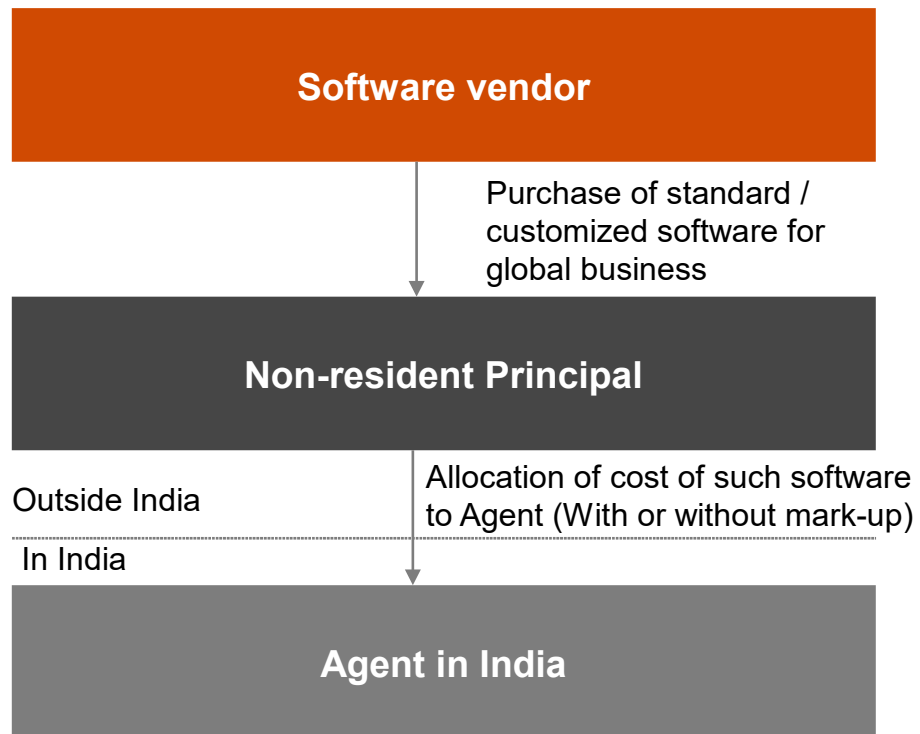


Computation of deemed income - Statutory levies to be considered?

- **China Shipping Container [38 taxmann.com 2] 2013**
 - Service tax should form part of total receipts for the purpose of determining presumptive income
- **Islamic Republic of Iran Shipping Lines [46 SOT 101] 2011**
- **Orient Overseas Container Line [35 taxmann.com 342] 2013**
 - Service tax, a statutory liability, would not involve any element of profit and a service provider collects same from its customers on behalf of Government and, therefore, same cannot be included in total receipt for determining presumptive income
- **DIT vs. M/s Schlumberger Asia Service Ltd. (317 ITR 156) (Uttarakhand HC)**
 - Rendered in the context of section 44BB
 - Indirect-taxes not to be included for gross collections



Taxability of reimbursements



- Under a Global Framework Arrangements, Principal acquires software for its global business
- Cost of software is allocated to agents globally (including Indian agent)
- Agent reimburses cost to the Principal

Questions

1. Taxability of underlying payment to be seen?
2. Nature of software (standard or customized) would make a difference?
3. Whether Article 8 applicable to such recovery of software cost / charges?

Case law

- [(2015) 374 ITR 497 (Bom HC)] – Upheld by Supreme Court in (2017) 392 ITR 186

POEM located in third country – whether Article 8 benefit available?

· Article 7 will, instead, apply

- **Essar Oil Ltd. [5 SOT 669]**
- **Delmas France [2011-TII-17-ITAT-MUM-INTL]**
- **Bay Lines Mauritius [(2018) 91 taxmann.com 11 (Mum Trib)]**

Tax residence certificate sufficient to determine POEM?

- **USAC / CSL Ltd. [12 SOT 588 (ITAT, Mum)] – Yes, based on ratio of UOI v. Azadi Bachao Andolan [263 ITR 706 (SC)]**



Presence in India & constitution of PE

Liaison Office

- To act solely as communication link
- Cannot undertake commercial activity
- Approval from AD Category-I Bank required

Branch

- Virtual projection in India
- Approval from AD Category-I Bank required
- PE under Tax Treaty

Agents

- WOS, Joint Venture or third party
- Commission payable for services rendered
- May or may not constitute a PE

- **Income earned from coastal voyages (i.e. voyages between two Indian ports) – PE constituted ?**
- **Whether Ship / aircraft constitutes a fixed place PE ? – 237 ITR 798 (AAR)**
- **Whether moving ship constitutes fixed place PE where the ship is docked ? – Poompohar Shipping Corporation (Madras HC)**

Others

- Denial of beneficial provisions of DTAA to Singaporean based companies (DTAA)
- Issuance of draft order u/s 144C for orders passed under section 172(4)



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TDS implications

- Circular No. 723 (dated 19 September 1995)
 - Withholding tax on freight charges paid to FSC / Indian shipping agents
 - Section 172 overrides all other provisions of IT Act
 - Overrides sections 195 and 194C – No tax to be deducted at source
- Circular No. 732 (dated 20 December 1995) – Issuance of Annual No Objection Certificate (NOC)
- Circular No. 30 (dated 26 August 2016) – Requirement of obtaining vessel wise NOC done away with where Annual DIT is obtained
- Annual DIT Relief Certificate – akin to a Certificate under section 197
 - Most foreign shipping / airline Companies obtain an Annual DIT Relief Certificate as per which income from operation of ships / air of specified vessels / aircrafts taxable only in Country of Residence / POEM (and not in India) as per Article 8 / 9 of the Tax Treaty
 - Not a blanket certificate – Mentions name of vessels, and pooling partners
 - No withholding tax required by the payer

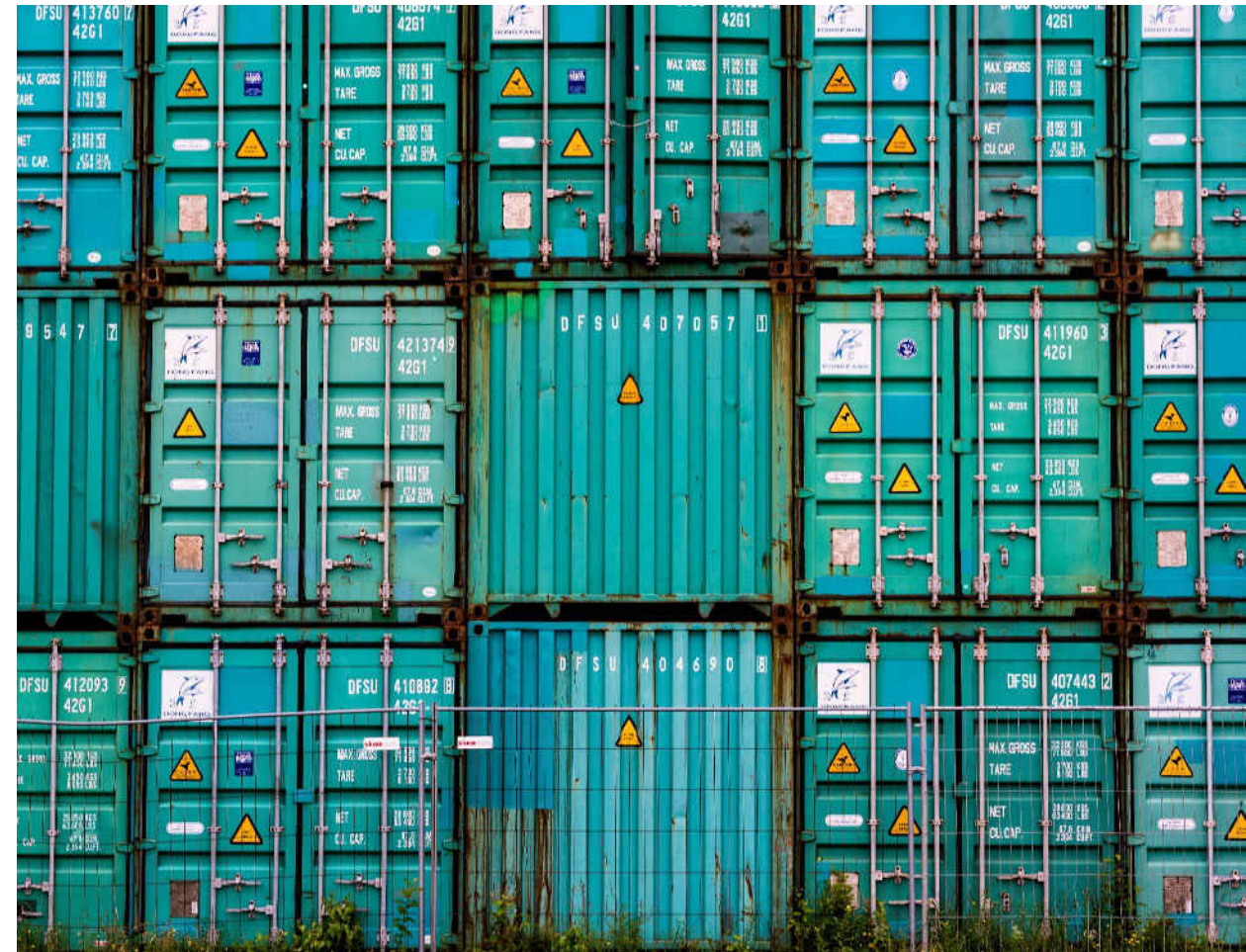


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Taxability of foreign logistics companies

- Taxability of network fee
- Taxability of freight and logistics services such as transport, procurement, custom clearance, sorting, delivery, warehousing and pick-up services rendered by Foreign Companies
- Constitution of Permanent Establishment (PE) – Fixed Place PE / Service PE / Agency PE / Group PE
- AOP exposure



6

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MLI Impact on Shipping, Aircraft & Logistics Sector

Article 6 – Purpose of Tax Treaty

- Preamble to tax treaty to include
 - Intending to eliminate double taxation with respect to the taxes covered without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs for the indirect benefit of residents of third jurisdictions)

Article 7 – Prevention of Treaty Abuse

- Tax Treaty Benefit to be denied if
 - It is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit,
 - unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Tax Treaty

Entities based from non Treaty countries carrying operations from Treaty jurisdictions / favourable Treaty jurisdictions – Whether Treaty Shopping ?

Article 12 - Artificial Avoidance of PE Status

- Agent will be deemed to be PE of principal, if such agent
 - Habitually concludes contracts or
 - Plays principal role leading to conclusion of contracts that are routinely concluded without modification

Logistics business through network model – Role of Indian group companies ?

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