

TAX FLASH NEWS

Since the taxpayer has bonafide business activities in the UAE, the benefit of the India-UAE tax treaty cannot be denied by applying the Limitation of Benefit clause

Background

Recently, the Rajkot Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of MUR Shipping DMC Co, UAE¹ (the taxpayer) held that the benefit of the India-UAE tax treaty (tax treaty) cannot be denied to the foreign shipping company by applying Limitation of Benefit (LOB) provisions, since such a company has bonafide business activities in the UAE. The Tribunal held that LOB provisions under the tax treaty would be applicable only when the main purpose or one of the main purposes of the creation of an entity was to obtain benefits of the tax treaty which would otherwise not be available.

Facts of the case

- During the year under consideration, the taxpayer claimed the tax treaty benefit for its freight income received on account of its shipping business. The taxpayer had registered its vessel with the UAE government to conduct its shipping business for three years. The vessel is owned by a company located in the Marshall Islands with which India does not have a tax treaty.
- The taxpayer's total five shares are held by two Switzerland based companies. The taxpayer also submitted a letter of commercial licence and tax residence certificate received from the UAE tax authorities.

- The Assessing Officer (AO) denied the tax treaty benefit on account of the fact that the taxpayer had registered in UAE to get the benefit of the tax treaty and it is neither paying any freight in India nor in UAE. The AO invoked the provisions of Article 29² of the tax treaty and declined the tax treaty benefits to the taxpayer.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that the true test for determining the location of control and management, lies is the location where the board meetings are held. The management of the company is in the hand of its board of directors who are responsible for the operations and growth of the company. The entire decision making though reviewed by the shareholders is done by the board of directors in board meetings, which were held in the UAE. Therefore, the taxpayer was eligible to claim the tax treaty benefit.

Tribunal's ruling

- Article 29 of the tax treaty was introduced by the virtue of a protocol³. Under the original tax treaty provisions, a resident of a contracting state was defined as 'any person who, under the laws of that state, is liable to tax therein by reason of his domicile, residence, place of management, place of incorporation or any other criterion of a similar nature' and there was considerable controversy on whether, under this provision, the actual taxability of income in the UAE was a condition precedent for availing the treaty benefits in India.

¹ ITO v. MUR Shipping DMC Co, UAE (I.T.A. No. 405/RJT/2013) – Taxsutra.com

² LOB provisions

³ Notification No. 282 of 2007, dated 26 March 2007

- This issue was particularly relevant as not all the residents, whether individual or corporate, were necessarily taxable entities under the UAE law. The UAE, as a tax jurisdiction, had the right to tax these residents but the rights were not exercised by introducing a law to tax them.
- While dealing with the issue as to whether or not the UAE tax residents will be eligible for tax treaty protection in respect of their income sourced in India, the Mumbai Tribunal, in the case of Green Emirate Travels⁴ observed that being 'liable to tax' in the contracting state does not necessarily imply that the person should actually be liable to tax in that contracting state by virtue of an existing legal provision but would also cover the cases where that other contracting state has the right to tax such persons irrespective of whether or not such a right is exercised by the contracting state.
- Vide protocol dated 26 March 2007, the definition of the expression 'resident' was revised and the requirement of an actual liability to tax for the residents of UAE was consciously removed from the definition of the 'resident of a contracting state'. The Delhi High Court, in the case of Emirates Shipping Line FZE⁵ in the context of this amended definition of the 'resident of a contracting state' so far as a UAE tax resident is concerned, held that under the amended article, the requirement of liability to tax has been done away with. Therefore, it is not open to the AO to decline the tax treaty protection to a UAE tax resident in respect of India sourced income, on the ground that the UAE tax resident has not actually been taxed in respect of his income in the UAE.
- The amendment of the tax treaty definition for a 'resident in a contracting state', however, did come with a built-in check to ensure that this provision is not abused by incorporating Special Purpose Vehicles (SPVs) in the UAE only to seek undue benefits in India.
- On a plain reading of Article 29 of the tax treaty, it indicates that this article seeks to decline the tax treaty benefits in a case in which the main purpose or one of the main purposes of the creation of an entity is to obtain the benefits of this agreement which would otherwise not be available.
- Even this LOB clause is subject to the rider that the cases of legal entities not having bonafide business activities shall be covered by this article. As long as such entities have bonafide business activities, the provisions of Article 29 of the tax treaty cannot be pressed into service at all by a tax jurisdiction.
- Even though the merchant vessel is owned by the Marshall Islands based entity, the vessel is given to the taxpayer under a long-term charter arrangement and under Article 8 the ownership of the vessel is not a *sine qua non* for availing of treaty protection of shipping income.
- Essentially profits from the operation of ships in international traffic will also cover the situations in which the profits are earned from operating the ships, irrespective of whether or not such ships are owned by the enterprise claiming the treaty protection.
- The present case is of post the amendment vide protocol⁶ which gives residuary taxation rights to the residence jurisdiction. While it is indeed correct that Article 8 of Indo-Switzerland tax treaty does not cover income from operation of ships in international traffic and restricts itself to income operation of aircrafts in international traffic. Article 22(1) of the India-Switzerland tax treaty, inserted with effect from 1 April 2001, provides that 'items of income of a resident of a contracting state, wherever arising, not dealt with in the foregoing Articles of this tax treaty shall be taxable only in that state'.
- There is no dispute that income from operation of ships in international traffic is not specifically dealt with in the India-Switzerland tax treaty. While on this aspect of the matter, a useful reference may also be made to the decision of the Tribunal in the case of Mediterranean Shipping Co SA⁷. Therefore, whether a Swiss tax resident earns India sourced income from operations of ships in international traffic in India or whether a UAE tax resident earns Indian sourced income from operations of ships in international traffic, the income is not taxable in India; in the former case, because of the provisions of Article 22(1) of the India-Switzerland tax treaty, and in the latter case, because of the provisions of Article 8 of the India-UAE tax treaty.
- In this case, the condition precedent for invoking Article 29 of the India-UAE tax treaty has not been fulfilled. When tax treaty protection in respect of income of such a nature was anyway available, though, under a different kind of provision of the India-Switzerland tax treaty, the taxpayer cannot be said to have been created for the purposes of availing the India-UAE tax treaty benefits. The action of the AO in invoking the provisions of Article 29 is vitiated in the law. Accordingly, the AO was in error in invoking the provisions of Article 29 of the tax treaty.

⁴ ADIT v. Green Emirate Travels [2006] 100 ITD 203 (Mum)

⁵ Emirates Shipping Line FZE v. ADIT [2012] 349 ITR 493 (Del)

⁶ Notification no. 35 of 2001, dated 7 February 2001

⁷ ADIT v. Mediterranean Shipping Co SA [2013] 56 SOT 278 (Mum)

- As regards to the stand of the AO that the directors of the taxpayer are not UAE nationals is wholly irrelevant as the directors are residents of UAE and the nationality of the directors, de hors their place of residence.
- Further, the shareholder meetings have taken place in the UAE. It has been observed that the taxpayer is not merely a paper company and has actually carried out material business operations from the UAE.
- As regards the issue raised by the AO on the shortcomings in the tax residency certificate, it is wholly devoid of any legally sustainable merits so far as eligibility for treaty benefits are concerned. The issue of a limited three year period of a commercial licence issued by the Government of UAE raised by the AO is devoid of any merits. Whether the taxpayer is given a perpetual licence to carry on business in the UAE or whether the licence is renewed every year, does not affect the fact that the taxpayer was carrying on business in the relevant previous year.
- Once there is reasonable evidence to suggest that the affairs of the company are conducted from UAE, and there is no material to controvert the same or to establish that the company is controlled or managed from outside the UAE, the CIT(A) was indeed justified in reversing the action of the AO and consequently granting the benefits of the India-UAE tax treaty.



Our comments

In the instant case, the Rajkot Tribunal held that the benefit of the India-UAE tax treaty cannot be denied to the foreign shipping company by applying the LOB provisions since such a company has bonafide business activities in the UAE. The Tribunal held that the LOB provisions under the tax treaty would be applicable only when the main purpose or one of the main purposes of the creation of an entity was to obtain the benefits of the tax treaty which would otherwise not be available.

It would be interesting to see how such transactions will be viewed when General Anti-Avoidance Rules come into effect⁸.

⁸ With effect from 1 April 2017

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