



Benefit of tonnage tax scheme is available to slot charter arrangements – Supreme Court

Background

Recently, the Supreme Court in the case of Trans Asian Shipping Services (P) Ltd.¹ (the taxpayer) dealt with a case where the taxpayer owns a qualifying ship as well as fulfills all other conditions to make it a qualifying company under the Tonnage Tax Scheme (TTS). In addition to operating its qualifying ship, the taxpayer entered into 'slot charter' arrangements with other ships. The Supreme Court held that benefit of TTS is also available to the income from the slot charter arrangements. The requirement of producing a 'valid certificate' relating to qualifying ship would not apply when the entire ship is not chartered, and the arrangement pertains only to purchase of slots, slot charter, and sharing of the break-bulk vessel.

Facts of the case

- The taxpayer owns a qualifying ship and fulfills all other conditions as well to make it a qualifying company under Section 115VC of the Income-tax Act, 1961 (the Act). The income generated from the said qualifying ship is exigible to tax as per the special provisions contained in Chapter XII-G i.e. TTS, as the taxpayer has exercised the requisite option in this behalf.
- However, in addition to operating its qualifying ship, in the relevant Assessment Years (AYs) i.e. 2005-2006 and 2008-2009, it had also 'slot charter' arrangements in other ships.
- In the income tax returns filed by the taxpayer, the taxpayer also included the income earned from such slot charter arrangements for the purpose of computation under TTS.

- The Assessing Officer (AO) was of the view that the income earned under slot charter arrangement did not qualify for TTS as this income was neither generated by the taxpayer from its own ship nor from the entire ship chartered by the taxpayer. In order to avail the benefit of TTS, the taxpayer was supposed to show that the ship operated by it was qualifying ship and for this purpose, it was incumbent upon the taxpayer to produce a 'valid certificate indicating its net tonnage' as provided in Section 115VX(1)(b) of the Act.
- The taxpayer had submitted such valid certificate only in respect of its own ship and did not submit the same in respect of ship chartered by the taxpayer under the slot charter arrangement.
- The contention of the taxpayer was that the requirement of producing 'valid certificate' is to be insisted only for taxpayer's own ships and for the ships hired fully. As per the method of computation provided under Section 115VG of the Act read with Rule 11Q of the Income-tax Rules, 1961 (the Rules) income for full ship is to be computed on the basis of 'net tonnage' shown in the valid certificate, whereas income of part of the ship is computed as 'deemed tonnage'.
- The AO did not accept the contention of the taxpayer and passed the order. The Commissioner of Income-tax (Appeal) [CIT(A)] and Income-tax Appellate Tribunal upheld the order of the AO.
- However, the High Court allowed the income earned by the taxpayer under slot charter arrangement as it comes under the definition of 'deemed tonnage tax' as per explanation to Section 115VG(4) of the Act and, therefore, exclusion of this income while assessing the same under the special provisions was not appropriate.

¹ CIT v. Trans Asian Shipping Services (P) Ltd. [Civil Appeal No. 5870 of 2016] (SC) – Taxsutra.com

Supreme Court's ruling

- Section 115VB of the Act specifically provides that for the purpose of TTS, a company would be regarded as operating a ship if it operates any ship whether owned or chartered by it and includes a case where even a part of the ship has been chartered by it in an arrangement such as slot charter, space charter or joint charter. It is clear that slot charter is specifically included as an instance of a ship chartered by the company.
- Section 115VG(4) of the Act is in two parts insofar as computation of tonnage is concerned. When it comes to the tonnage of a ship, a certificate as mentioned in Section 115VX is to be produced. The second part of this provision talks about 'deemed tonnage' as compare to the 'actual tonnage' mentioned in the certificate.
- Thus, it is not only the actual tonnage that is mentioned in the certificate referred to in Section 115VX of the Act which this provision deals with. In addition, deemed tonnage is also to be included if there is such a deemed tonnage, and that is to be added to the actual tonnage which is indicated in the certificate.
- Explanation to Section 115VG(4) of the Act, inter alia, mentions that insofar as slot charter arrangements are concerned, purchase of such slot charter shall be treated as deemed tonnage. The Legislature has, thus, clearly visualized that insofar as deemed tonnage is concerned, there would not be any possibility of producing a certificate referred to in Section 115VX of the Act.
- When one read the provision in this manner, it becomes amply clear that Section 115VD of the Act which talks of a qualifying ship contemplates the situation in which entire ship is either owned or chartered.
- Similar is the position which inheres in Section 115VX of the Act as it refers to 'the tonnage of a ship'. Therefore, whenever the question of a tonnage of a ship crops up, and the said tonnage is to be determined, it has to be in accordance with the valid certificate indicating its tonnage and it is a compulsory obligation of the taxpayer to produce such a certificate.
- However, this requirement of producing a certificate would not apply when entire ship is not chartered, and the arrangement pertains only to purchase of slots, slot charter and an arrangement of sharing of the break-bulk vessel.
- The contention of the taxpayer is right that the legal fiction created by Section 115VG(4) is to be given its proper and sensible meaning.
- The Supreme Court in the case of Karimtharuvi Tea Estates Ltd.², while interpreting conflicting tax provisions held that the rules made under the Act, must be taken to be prescribed by the Act and the definitions contained therein must apply to other provisions. Further, if two provisions are in conflict, they must be interpreted in a harmonious manner.
- The calculation of income arising from the carriage of goods on slot basis has, in the wisdom of the Legislature, been disconnected from the capacity of a ship, on account of the impossibility of getting such information in relation to ships on which slot charter is undertaken. This aspect has due recognition in Note 3³ of the Form 66.
- Thus, the Act and the Rules for computation of tonnage tax specifically and categorically differentiate the requirement of the Certificate with regards to owned ship and slot charter. In law, the said Rule also recognises that identification of the vessel for slot charter cannot be done.
- It would also be pertinent to mention that Note 3 below Form No. 66, in terms of Rule 11D, recognizes the reason for prescribing a separate formula for slot charter. Further, the position is taken beyond any doubt with the Note in Form No. 66 that 'There is no need to mention the name of the ship, income from which is computed on deemed tonnage basis.'
- In terms of Section 115VI(2) of the Act, relevant shipping income of a Tonnage Tax Company means its profits from core activities and its profits from incidental activities. Core activities of a Tonnage Tax Company have been specified to include its activities from operating qualifying ships and other ship related activities including slot charter.

² Karimtharuvi Tea Estates Ltd. v. State of Kerala and Ors [1968] 48 ITR 28 (SC)

³In addition to loading containers on their own container vessels, shipping companies also hire slots on container ships (not owned by them) plying on various routes. These slots could be hired for a sector voyage or on long term basis, all round the year, in various vessels and in varying numbers and thus cannot be converted to net tonnage identifying the particular vessel on which the slot is hired. Thus, a formula has been worked out to convert the slots hired into net tonnage.

- In view of stiff competition faced by the Indian shipping companies vis-a-vis foreign shipping lines, and in order to ensure an easily accessible, fixed rate, low tax regime for shipping companies, the Rakesh Mohan Committee in its report (of January, 2002) recommended the introduction of the TTS in India, which was similar to, and adopted some of the best global practices prevalent. The whole purpose of introduction of the Scheme was to make the Indian shipping industry more competitive in the global space by rationalising its tax cost.
- For the reason that it is impossible to cater to all shipping routes on owned ships, it is an accepted and widely prevalent practice globally and in India that shipping companies engage in slot charter operations. If such slot charter arrangements are not entered into, then Indian shipping companies will not be able to take up the contract of affreightments and these contracts would have fallen to only foreign shipping lines thereby making Indian shipping industry uncompetitive.
- Such slot charter arrangements being with a shipping company but not in relation to or for a particular ship, it is impossible for the Indian shipping company to identify the cargo ship, which carried the goods. This peculiarity has been duly recognized at Note 3 of Form 66. Similarly, for space charter also, this business aspect has been recognized at Note 4(b) to Form 66.
- Accordingly, it was held that there is no requirement of the certificate under the TTS in relation to the vessel on which slot charter operations are carried out.
- The Supreme Court referred to Circular No. 05/2005⁴ explaining the need and essence of the introduction of TTS related provisions which was issued contemporaneously by the Central Board of Direct Taxes (CBDT). The circular clarifies that the TTS is a 'preferential regime of taxation'. Circulars of CBDT explaining the Scheme of the Act have been held to be binding on the tax department repeatedly by the Supreme Court in a series of decisions including *Azadi Bachao Andolan*⁵, *Navnit Lal Jhaveri*⁶, and *UCO Bank*⁷. Accordingly, the Supreme Court agreed with the decision of the High Court.

Our comments

In the present case, the issue before the Supreme Court was with respect to the applicability of tonnage tax scheme to income from slot charter agreement.

The tax department in this case was of the view that even slot charter arrangement has to be in respect of a qualifying ship, and the taxpayer was required to produce a 'valid certificate indicating its net tonnage'. In an absence of such certificate, the benefit of tonnage tax scheme is not available to slot charter arrangements. On the other hand, the taxpayer was of the view that the requirement of producing 'valid certificate' is to be insisted only for taxpayer's own ships and for the ships hired fully and not in the cases of slot charter arrangements.

The Supreme Court observed that whenever there is a question of a tonnage of a ship and the said tonnage is to be determined, it has to be in accordance with the valid certificate indicating its tonnage and it is a compulsory obligation of the taxpayer to produce such a certificate. However, this requirement of producing a certificate would not apply when the entire ship is not chartered, and the arrangement pertains only to purchase of slots, slot charter, and sharing of the break-bulk vessel. Accordingly, the Supreme Court allowed the benefit of tonnage tax scheme to the taxpayer.

The Supreme Court decision may help the shipping companies to claim the benefit of tonnage tax scheme for slot charter arrangements.

⁴ CBDT Circular No. 05/2005, dated 15 July 2005

⁵ Union of India v Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

⁶ Navnit Lal C. Javeri v. K. K. Sen [1965] 56 ITR 198 (SC)

⁷ UCO Bank v. CIT [1991] 237 ITR 889 (SC)

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