



## Income of a foreign shipping company is not taxable in India as place of effective management is outside India

### Background

Recently, the Rajkot Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Pearl Logistics and EX-IM Corporation<sup>1</sup> (the taxpayer) held that as per Article 9 of the India-Denmark tax treaty (the tax treaty) income earned by a foreign company from operations of ships in international traffic is not taxable in India as Place of Effective Management (POEM) of such foreign company is outside India. The Tribunal observed that registration certificate, residence of shareholder and passport of owner show that the foreign company is a resident of Denmark. Director of the foreign company resides in Denmark and have been operating business wholly from Denmark. Further, all the important decisions are taken from Denmark in the form of meeting and therefore, the POEM and control is in Denmark.

### Facts of the case

- The taxpayer (agent) for two voyages during the Financial Year (FY) 2010-11 for being freight beneficiary of Faber Ship Brokers APS, Denmark (Faber Ship Brokers/foreign company) filed income-tax return without paying tax. The return was accompanied with certain details like indemnity bond, etc.
- The foreign company did not have regular business in the Port of Porbandhar and it is conducting only occasional business.
- On the prima facie verification of documents, it was noticed that certain details were required to

be called for. Accordingly, the tax department had issued a notice under Section 172(4) of the Income-tax Act, 1961 (the Act). In response to the said notice, the taxpayer had submitted details of filing return under Section 172(3) for obtaining port clearance under Section 172(6) of the Act.

- The AO observed that the taxpayer had not submitted complete details called for except the copy of vessels registration certificate.
- As per AO, the benefit under the tax treaty was claimed with incriminating and forged documents. The action of the local agent has itself proved the same beyond doubt. Under the circumstance, the tax treaty claimed is provisional. Accordingly, the final return under Section 172(3) of the Act is withdrawn and demand under Section 172(4) was raised.

### Tribunal's ruling

- According to Section 172 of the Act, income of owner or charter who receives freight is chargeable to tax. In this case, freight is received by Faber Ship Brokers and it has earned that freight. Therefore, the income of Faber Ship Brokers is chargeable to tax in India. Faber Ship Brokers is resident of Denmark having a tax residency certificate which was available on record.
- As per the decision of the Supreme Court in case of Azadi Bachao Andolan<sup>2</sup> the benefit of the tax treaty shall be available to the Faber Ship Brokers.

<sup>1</sup> Pearl Logistics and EX-IM Corporation v. ITO [2017-TII-57-ITAT-RAJKOT-INTL] – Taxindiainternational.com

<sup>2</sup> UOI v. Azadi Bachao Andolan [2003] 132 taxman 373 (SC)

- As per Article 9 of the tax treaty, profits derived from the operation of ships in international traffic shall be taxable only in the state where POEM of the enterprise is situated. In this case the POEM of the Denmark entity is situated in Denmark as - registration certificate, residence of shareholder, passport of owner show that Faber Ship Broker is a resident of Denmark and its POEM is in Denmark. Therefore, 'head and brain' of Faber Ship Broker is situated in Denmark. The Tribunal relied on various decisions<sup>3</sup>.
- The taxpayer has proved that the POEM is outside India by furnishing several documents including a declaration by the director of the company that it is 100 per cent owned by Mr. Jens Faber Anderson. A copy of owner's passport was submitted to prove his nationality.
- Director of Faber Ship Brokers resides in Denmark and has been operating the business wholly from Denmark, all the important decisions are taken from Denmark in the form of meeting and therefore, the POEM and control is in Denmark only. The Faber Ship Brokers is engaged in international traffic and its residence is in Denmark. Therefore, on the basis of Article 9 of the tax treaty, the income on account of operation of ship in international traffic shall be taxable in the state in which the POEM is situated i.e. in this case Denmark. Therefore, the income from ships shall not be taxed in India as per Article 9 of the tax treaty.

## Our comments

POEM is an internationally recognised test for determination of residential status of a company incorporated in a foreign jurisdiction. Most of the tax treaties entered into by India recognise the concept of POEM for determination of the residence of a company as a tie-breaker rule for the avoidance of double taxation.

In this decision the Rajkot Tribunal dealt with the specific POEM test in Article 9 of the India-Denmark tax treaty dealing with income from shipping. Based on the various documents, the Tribunal observed that the foreign company is a resident of Denmark. Director of the foreign company resides in Denmark

and has been operating the business wholly from Denmark. Further all the important decisions are taken from Denmark in the form of meeting and therefore, the POEM is in Denmark.

The Finance Act, 2015 amended the provisions of Section 6(3) of the Act to provide that a company is said to be resident in India in any previous year, if (i) it is an Indian company; or (ii) its POEM in that year is in India. These provisions have come into effect from 1 April 2017 and it applies from Assessment Year 2017-18 onwards. Recently, the Central Board of Direct Taxes<sup>4</sup> issued the final guiding principles for determination of POEM. The guidelines are primarily based on the fact as to whether or not the company is engaged in 'active business outside India'. For determination of 'active business outside India' factors such as passive income, total asset base, the number of employees, payroll expenses in India and outside, etc. are considered. The guidelines state that the concept of POEM is one of substance over form. It also deals with the impact of modern technology in POEM determination.



<sup>3</sup> Radha Rani Holdings Pvt. Ltd. v. ADIT [2007] 110 TTJ 920 (Del), Saraswati Holding Corp. Int. v. DDIT [2007] 16 SOT 535 (Del), De Beers Cons. Mines Ltd. (1906 AC 455), Arabian Express Line Ltd. v. UOI [1995] 212 ITR 31 (Guj)

<sup>4</sup> CBDT Circular No. 06/2017, dated 24 January 2017

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