



If the POEM of an enterprise is not situated in one of the contracting states but is situated in the third state, the benefit of the shipping and air transport article of the India-Mauritius tax treaty cannot be granted

Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Bay Lines (Mauritius)¹ (the taxpayer) held that if the Place of Effective Management (POEM) of an enterprise is not situated in one of the contracting states but is situated in the third state, benefit of Article 8 (Shipping and air transport) of the India-Mauritius tax treaty cannot be granted to the taxpayer. The argument of the taxpayer that the effective management can only be in-between two contracting states cannot be accepted. Since the major policy decisions were taken in UAE, the effective management of the taxpayer is neither in Mauritius nor in India, and it is situated in UAE.

The Tribunal also held that the taxpayer's agent in India is an independent agent who acts in the ordinary course of its business and whose activities are not devoted exclusively or almost exclusively on behalf of the taxpayer. Therefore, the taxpayer does not have an Agency Permanent Establishment (PE) in India. Even if the taxpayer's case is not covered by Article 8, business profits would not be chargeable to tax in the absence of PE in India.

Facts of the case

- The taxpayer is a shipping company incorporated in Mauritius. The taxpayer has an exclusive agent in the form of Freight Connection India Pvt. Ltd (FCIPL) and agreement for the same was entered into by the taxpayer and the address shown at Dubai, UAE.
- During the year under consideration, the taxpayer filed its return of income claiming tax treaty benefit. The copy of Tax Residency Certificate (TRC) issued by the tax authorities of Mauritius indicates that taxpayer is a resident of Mauritius.
- The Assessing Officer (AO) held that that the effective management of the taxpayer is situated at a place which is other than India and Mauritius and thus denied the benefit of Article 8 of the tax treaty and held that the taxpayer's income is chargeable to tax in India. The AO also held that the agent of the taxpayer i.e. FCIPL is doing the agency work in all the Indian Ports which is habitually concluding the contracts on behalf of the taxpayer and performing duties such as clearances from the government departments, deciding the brokers, contacting with the parties, loading of cargo, dealing with labourers for loading, collecting the freight on behalf of the taxpayer and also maintaining the bank account on behalf of the taxpayer, etc. Thus, the AO held that the taxpayer has PE in India in the form of the agent.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that the effective management of the taxpayer is neither in Mauritius nor in India but in a third country. Accordingly, the taxpayer is not entitled for the benefit of Article 8 of the tax treaty. The CIT(A) held that the taxpayer is not having PE in India and hence it is not taxable under Article 7 of the tax treaty.

¹ ADIT v. Bay Lines (Mauritius) [ITA No. 1181/Mum/2012] – Taxsutra.com

Tribunal's decision

Place of Effective Management

- The Tribunal held that the findings of the CIT(A) are judicious and are well reasoned. Accordingly, the Tribunal upheld the same. The CIT(A) is held as follows:
 - The taxpayer contended that Article 4(3)² of the tax treaty provides a formula where there is a tie-breaker rule, i.e., if the person is resident in both the contracting state his status-of his residence in a particular contracting state is to be decided as per Article 4(3) of the tax treaty. Article 4(3) of the tax treaty does not define the effective management.
 - The taxpayer is resident of Mauritius. However, the shareholders are UAE residents. The other directors are only on company's board only to satisfy the conditions of Mauritius government. The main agent in India was appointed as an agent on a letter head showing its address in Dubai. A letter from the taxpayer addressed to the AO also originated from Dubai. All these indicate that though the company was registered in Mauritius, but the major policy decisions were taken at UAE (Dubai).
 - Thus, the POEM is the place where the key and commercial decision that is necessary for the business is taken or in substance the POEM will originally be a place where the most senior person or a group of person make its decisions. Therefore, the effective management of the taxpayer is neither in Mauritius nor in India.
 - Klaus Vogel in his book on International Taxation has stated that if the effective management of the enterprise is not in one of the contracting states, but is situated in the third state, the benefit of the article cannot be extended. Thus, the argument of the taxpayer that the effective management can be only in between two contracting state is not correct. Accordingly, it has been held that the effective management of the taxpayer is neither in Mauritius nor in India but in a third country.
 - Accordingly, the taxpayer is not entitled to the benefit of Article 8 of the tax treaty.

² Article 4(3) of the India-Mauritius tax treaty provides that the term 'resident of a contracting state' means any person who, under the laws of that state, is liable to taxation therein by reason of his domicile, residence, place of management or any other criterion of similar nature. Where a person other than an individual is a resident of both the contracting states, then it shall be deemed to be a resident of the contracting state in which its place of effective management is situated.

- The argument of the taxpayer that the effective management can be only in between two contracting state is not correct and hence, the Tribunal is of the considered view that the effective management of the taxpayer is neither in Mauritius nor in India.
- The Tribunal agreed with the views of Klaus Vogel, who is an eminent authority of International Taxation, that if the effective management of an enterprise is not in one of the contracting state, but is situated in the third state, the benefit of Article 8, cannot be extended.

Permanent establishment

- On reference to Article 5(5) of the tax treaty, it has been observed that FCIPL is an agent of independent status and acts for the taxpayer in the ordinary course of its business. Its activities are not devoted exclusively or almost exclusively on behalf of the taxpayer in view of the following:
 - Oxford dictionary defines exclusively to mean 'so as to exclude all except some particular object, subject, etc.; solely.'
 - Oxford dictionary defines solely to mean
 - as a single person (or thing); without any other as an associate, partner, sharer, etc.; alone; occas. without aid or assistance'
 - apart from or unaccompanied by others; solitarily
 - Only, merely, exclusively; also (contextually), entirely, altogether. The dictionary meanings were handed over separately in the course of the hearing.
 - The dictionary meanings of the term 'exclusively' suggest that the agent should earn 100 per cent or something near to 100 per cent from this principal so as to be dubbed as a dependent agent which is not the fact in the present case.
 - The Mumbai Tribunal in the case of Shardul Securities Ltd.³ has extracted the definition of 'exclusively' and has held that the term 'exclusively or almost exclusively' means 100 per cent or something nearer to 100 per cent.

³ Shardul Securities Ltd v. JCIT [2008] 115 ITD 345 (Mum)

- The activities of FCIPL are not devoted exclusively or almost exclusively on behalf of the taxpayer as it also does work on behalf of other principals and earns a substantial part of its income.
- The Tribunal observed that on a plain reading of Article 5(5) of the tax treaty, it is clear that for determining the independence, one should look at the agent and as to whether the agent has only one principal for whom the agent works exclusively. The fact that the principal has only one agent in India who undertakes all the activities for the principal is not relevant.
- The Mumbai Tribunal in the case of B4U International Holdings Ltd.⁴ while departing from the ratio laid down in the decision of DHL Operations BV Netherlands⁵ held that one has to look at the activities of the agent, and its 'devotion' to the non-resident principal and not the other way round, i.e., the perspective should be from the angle of the agent and not that of the non-resident principal. Therefore, if an agent exclusively works for one principal he may be said to be dependent agent resulting in Agency PE but where the principal has a sole agent who also undertakes work and undertakes such work extensively for other principals, the agent cannot be said to be 'dependent', and there can be no question of creation of an Agency PE. Subsequently, the Bombay High Court has affirmed the Mumbai Tribunal's decision in B4U International Holdings.
- It has been held that FCIPL is an independent agent who acts in its ordinary course of its business and whose activities are not devoted exclusively or almost exclusively on behalf of the taxpayer. Therefore, the taxpayer does not have an Agency PE in India. Accordingly, it has been held that even if the taxpayer's case is not covered by Article 8, the business profits would not be chargeable to tax as it does not carry on business in India through an agency PE as per Articles 7 and 5 of the tax treaty.

Our comments

In various tax treaties, income of shipping company is taxable in the contracting state where POEM of such company is situated. The Mumbai Tribunal in the present case held that if the POEM of an enterprise is not situated in one of the contracting states, but is situated in the third state, the benefit of Article 8 of the tax treaty, cannot be granted to the taxpayer. The Tribunal observed that the POEM is a place where the key management and commercial decision that is necessary for the business is taken or in substance

⁴ DDIT(IT) v. B4U International Holdings Ltd. [2012] 137 ITD 346 (Mum)

⁵ ACIT v. DHL Operations BV Netherlands [2000] 142 Taxman 1 (Mum)

the POEM is originally be a place where the most senior person or a group of person make its decisions. Since the major policy decisions were taken in UAE, the effective management of the taxpayer is neither in Mauritius nor in India and it is situated in UAE.

The Rajkot Tribunal in the case of Pearl Logistics and EX-IM Corporation⁶ held that as per Article 9 of the India-Denmark tax treaty, income earned by a foreign company from operation of ship in international traffic is not taxable in India as 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.

The Finance Act, 2016 amended⁷ 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. The CBDT⁸ also issued the guiding principles for determination of POEM. The guiding principles provides that in cases of companies other than those that are engaged in active business outside India, the determination of POEM would be a two-stage process, i.e. (i) first stage would be identification or ascertaining the person or persons who actually make the key management and commercial decision for conduct of the company's business as a whole. (ii) the second stage would be a determination of place where these decisions are in fact being made.

With respect to dependent agent PE, various Courts/Tribunal⁹ held that the activities of the Indian subsidiary were not devoted wholly or almost wholly for the foreign company. The Indian company was a service provider to the foreign company and it does not have any authority to conclude any contracts on behalf of the foreign company. Therefore, the taxpayer was not having agency PE in India.

⁶ Pearl Logistics and EX-IM Corporation v. ITO [2017-TII-57-ITAT-RAJKOT-INTL]

⁷ These provisions have come into effect from 1 April 2017 and it applies from Assessment Year 2017-18 onwards.

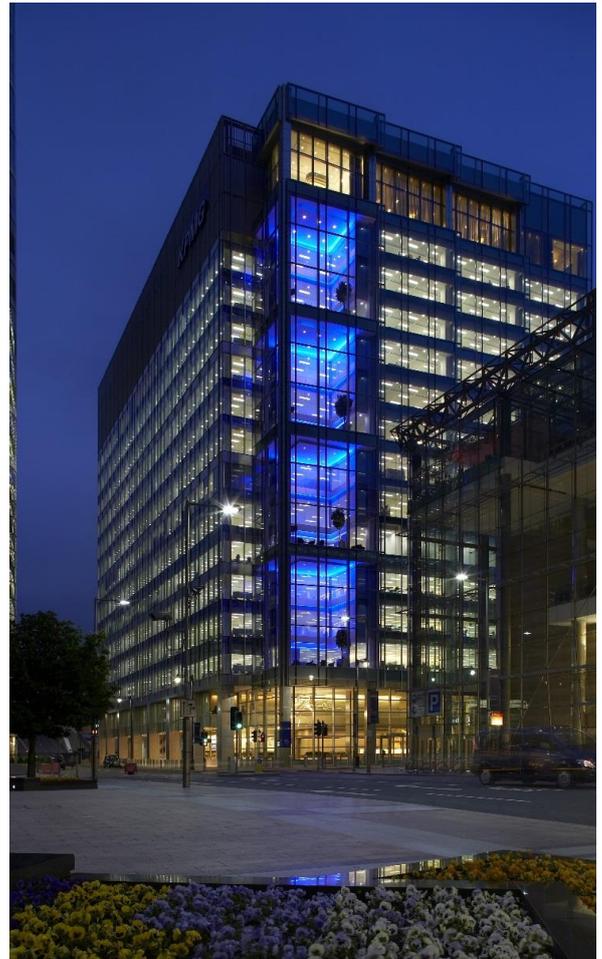
⁸ CBDT Circular No. 06/2017, dated 24 January 2017

⁹ NetApp BV v. DDIT [2017] 78 taxmann.com 97 (Del), DDIT v. Western Union Financial Services Inc [2012] 50 SOT 109 (Del), National Petroleum Construction Company v. DIT [2016] 383 ITR 648 (Del), SPE Networks India Inc v. DCIT (ITA No. 652/Mum/2014)

The Tribunal in the present case held that the agent is an independent agent who acts in its ordinary course of its business and whose activities are not devoted exclusively or almost exclusively on behalf of the taxpayer. Therefore, the taxpayer does not have an agency PE in India.

The Organisation for Economic Co-operation and Development under a Base Erosion and Profit Shifting (BEPS) project issued 15 action plans. As per Action Plan 7 dealing with PE, the scope of DAPE was widened to include an agent habitually playing the principal role leading to the conclusion of contracts that are routinely concluded without material modification. The objective is to tackle the situation where a contract is substantially negotiated in a country but is not formally concluded there as it is finalised or approved outside.

The Finance Bill, 2018 proposed an amendment to the definition of 'Business Connection' to align it with BEPS Action Plan 7 to include any business activity carried out through a person who, acting on behalf of the non-resident has and habitually exercises in India, an authority to conclude contracts or habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident.



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