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Tax Flash News

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Charges for bareboat chartering is not taxable as royalty under the India-Belgium tax treaty

Executive summary

The taxation of cross-border equipment leasing remains a contentious issue, with tax implications varying based on the relevant treaty provisions and the type of lease, such as a time-charter or bareboat arrangement.

In the case of *Baggerwerken Decloedt*[1], the Chennai Bench of the Tribunal ruled that payments for the bareboat chartering of a dredger are not taxable as royalties under the India-Belgium tax treaty, as the treaty's definition of 'royalties' does not include payments for the use or right to use industrial, commercial or scientific equipment.

The Tribunal also noted that the term 'plant' in the treaty definition was a typographical error meant to be 'plan.'

[1] *Baggerwerken Decloedt En Zoon* v. *DCIT* (IT(TP) No. 69/Chny/2019)

Facts of the case

The taxpayer, a tax resident of Belgium, was engaged in the construction and development of ports, harbours, artificial islands, etc.

It leased a dredger to its Indian group company for projects in India on a bareboat charter basis, meaning the taxpayer did not provide crew members.

The tax officer alleged that the hire charges received by the taxpayer were taxable in India as royalty income. Alternatively, it was taxable as business income as the Indian company constituted the taxpayer's dependent agent permanent establishment (DAPE) in India and 20 per cent of the hire charges received by the taxpayer was attributable to that PE.

Relevant provisions

Business income of a non-resident is taxable in India if the non-resident has a business connection in India as per the Income-tax Act, 1961 (the Act) and a permanent establishment (PE) in India as per the applicable treaty (in the instant case, the India-Belgium tax treaty (the treaty)).

Royalty paid by an Indian resident to a non-resident is taxable in India. In this regard, the Act defines royalty to *inter alia* mean consideration for the use or right to use any industrial, commercial or scientific equipment (ICS equipment). The treaty defines the term 'royalties' to *inter alia* mean consideration for the use of, or the right to use plant.

Revenue's contentions

The hire charges were taxable as royalty under the Act as well as the treaty, relying on the decision in the case of *Poompuhar Shipping*[2] where a time-charter arrangement was held taxable as royalty.

Under the treaty, the term 'royalties' included consideration for the use of, or the right to use plant which was defined in the Act to include ships and thus, dredgers qualified as plant.

The taxpayer had a business connection in India, given the close operational link between the Indian company and the taxpayer's group. The weekly reporting structure demonstrated continuous involvement.

[2] *Poompuhar Shipping Corporation Ltd*. v. *ITO* [2014] 360 ITR 257 (Mad)

The taxpayer had artificially split the components of the work by letting out the dredger on bareboat basis and separately deputing the crew members from various group entities. The entire coordination and control were with the taxpayer.

The Indian company acted as a DAPE of the taxpayer as its work was crucial to the taxpayer's business.

Taxpayer's contention

Royalty

The bareboat hire charges for the dredger did not qualify as royalties under the treaty, relying on the decision in the cases of *Van Oord ACZ* and *Nederlandsche Overzee*.[3]

The decision in the case of *Poompuhar Shipping* was distinguishable on two grounds:

(a) The *Poompuhar* decision was rendered in the context of time-charter arrangement, whereas the instant case involved bareboat charter.

(b) In the *Poompuhar* decision, the treaty definition of royalties included payment for use or right to use ICS equipment which was not included in the definition under the India-Belgium treaty.

The word 'plant' in the treaty was a typographical error intended to be 'plan.' This was supported by the notification[4] amending the treaty definition of royalties in 2001, which used the term 'plan' instead of 'plant.'

Business income

The taxpayer had no business connection in India as per the Act.[5] It was engaged in construction of ports etc. and the activity of leasing equipment was not connected with the taxpayer's primary business operations; nor was there any continuity between the two activities.

The hire charges are taxable under the Act as royalty income.[6] Once the income is taxable under the specific clause of royalty[7], it cannot be considered under the general clause of business income[8], as supported by the Gujarat High Court decision in the case of *Meteor Satellite*.[9]

The taxpayer also denied having a PE in India arguing that merely leasing a dredger on a bareboat basis did not constitute a Fixed Place PE or a Construction PE. The Indian company was not a DAPE because

[3] *CIT* v.*Van Oord ACZ Equipment* BV [2015] 373 ITR 133 (Mad) and *DDIT v. Nederlandsche Overzee Baggermaatsehappiji BV* [2010] 39 SOT 556 (Mumbai)

[4] Notification S.O. 54 [NO. 20 (F. NO. 505/2/89-FTD)] dated 19 January 2001

[5] Section 9(1)(i) of the Act

[6] The taxpayer had argued that the hire charges were not taxable by virtue of the treaty (though taxable under the Act).

[7] Section 9(1)(vi)

[8] Section 9(1)(i)

[9] *Meteor Satellite Ltd* v. *ITO* [1980] 121 ITR 311 (Guj.)

it did not act on behalf of the taxpayer or conclude contracts for it. The dredging projects were conducted in the name of the Indian company.

The taxpayer leased dredgers to the Indian company on a bareboat basis, and the Indian company hired independent manpower agencies to recruit crew members for each project. These crew members were not employees of the taxpayer. The tax officer mistakenly confused seconded employees with dredger crew members.

Seconding employees between companies was a common practice in the dredging industry, driven by project manpower needs and the availability of skilled staff within group companies. In fact, the Indian company also seconded some of its employees to other group entities.

The secondment agreement clearly stated that the seconded employees would work under the control and supervision of the Indian company.

Providing status updates to the parent company was a standard business practice for multinational corporations, aimed at ensuring the efficient and effective use of the group's resources. The taxpayer was not involved in the planning or supervision of the Indian company's projects.

Once the transfer pricing officer accepted the arm's length price, no further attribution of profits to the alleged PE was necessary.[10]

Tribunal's Decision

The Tribunal ruled in favour of the taxpayer.

Relying on the decision in the cases of *Van Oord ACZ* and *Nederlandsche Overzee*, the Tribunal held that the charges for a bareboat charter did not constitute royalties as the treaty definition did not include payment for use or right to use ICS equipment.

The term 'plant' in the treaty definition was a typographical error meant to be 'plan.'

The taxpayer did not have a business connection or a PE in India.

Our comments

The Tribunal's decision underscores the importance of correctly interpreting tax treaties and distinguishing between bareboat and time-charter arrangements.

It reaffirms that an isolated lease arrangement without continuity is insufficient to establish a taxable presence in India.

[10] *DIT* v. *Morgan Stanley & Co.* [2007] 292 ITR 416 (SC)

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