BEFORE THE AUTHORITY FOR ADVANCE RULINGS (INCOME-TAX)
NEW DELHI

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30th Day of September, 2009

P R E S E N T

Mr. Justice P.V. Reddi (Chairman)
Mr. J. Khosla (Member)

Application No. AAR/803/2009

Name & address of the applicant	:	Gearbulk AG C/0 Treforma AG Grabenstrasse 25 6340 Baar Switzerland
Commissioner concerned	:	Director of Income-tax (International Taxtion) Bangalore
Present for the applicant	:	Mr. Anurag Jain, Partner BMR & Associates Mr. Piyush Khanduja, Manager, -do- Ms. Akriti Katoch (Kundra & Bansal,C.A.)
Present for the Department	:	None

R U L I N G

[By Hon'ble Chairman]

1. The applicant - a non-resident shipping Company incorporated under the laws of Switzerland seeks advance ruling from this Authority on the following questions:

(1) Whether during the previous years relevant to assessment years 2008-09 and 2009-10, the applicant, in the stated facts and circumstances, had a Permanent Establishment in India under Article 5 of India-Switzerland Double Taxation Avoidance Agreement in relation to activity of charter of vessels for transporting cargoes from Indian ports to outside India ?

(2) If the answer to the first question is negative, whether income of the applicant from such charter of vessels is not liable to tax in India under the Treaty?

2. The following facts are stated in the application:

2.1. The applicant enters into medium and long term shipping contracts for the transportation of cargo worldwide. In the course of performance of such contracts, the applicant enters into further contracts with port agents, brokers and stevedores. The applicant only undertakes transportation of cargo.

2.2. During the financial years 2007-08 and 2008-09, the applicant entered into a shipping contract with USL, Shipping FZE ("Dubai Charterer) for transportation of cargo from Indian ports to China. The Dubai Charterer is an independent party engaged in the business of transportation/arranging transportation of cargoes. As per the Charter Agreement, the amount of freight for transportation of cargo from the Indian port to a port outside India is invoiced and received by the applicant. The Dubai Charterer receives a percentage of the freight amount as its commission. The applicant procures contracts utilizing brokering services from Gearbulk Shipping brokers/Kriship (UK) Ltd. which in turn hires the services of Globus Ltd., an independent brokering agent based in India. In consideration of its services, the said UK Company receives brokering commission.

2.3. The applicant, during the relevant years appointed JM Baxi & Co. as its port agent in India for handing the cargo. The activities of JM Baxi & Co., an independent shipping and logistics service provider consists of shipping agency services, charter brokering services and clearing and forwarding agent services. J.M.Baxi & Co. is working as port agent in India on behalf of several other shipping

companies. JM Baxi & Co. has, on behalf of the applicant, deposited income-tax under S.172 of the IT Act, on 7.5% of the freight charges received by the applicant.

2.4. During the financial years 2007-08 and 2008-09, the applicant filed the returns of income through JM Baxi & Co. under Section 172(3) of the IT Act. The details of income and the taxes paid are shown in the Chart (vide para 7 of application). An assessment order was passed by the Assistant Commissioner of IT, Circle-II, Margao on 23rd July, 2007 [under Section 172(4)] for the assessment year 2008-09.

2.5. The applicant has furnished copies of Charter Party Agreement, sample invoices, debit note raised by JM Baxi & Co., returns of income and assessment order under Section 172(4).

2.6. The applicant avers that it does not have any presence in India, whether in the form of an office or any other place of business and none of the employees of the applicant visited India during the relevant years.

3. The applicant submits that under the provisions of Section 172(7) of the Act, an option is available to a non-resident to claim that an assessment of its total income be made in accordance with the other provisions of the Act. Accordingly, the applicant 'elected' for assessment of its total income in accordance with the other provisions of the Act. In this context, the applicant relies on S.90 (2) of the Act with Art.7 and Art.22 of the Agreement for avoidance of

double taxation between India and Switzerland *(hereafter referred to as 'Treaty' or DTAA). As per Section 90(2) of the Act, the income of a non-resident is taxable in India in accordance with the provisions of the Act or the provisions of DTAA, whichever is more beneficial to the non-residents. That is why the applicant seeks to invoke Art.7 and 22 which according to the applicant are more beneficial to it. Broadly, it is the contention of the applicant that if those provisions of the Treaty are applied, the applicant's income derived from the shipping of cargo from the Indian ports cannot be subjected to tax at all having regard to the fact that the applicant has no permanent establishment in India.

3.1. Before proceeding further, we may clarify one factual aspect regarding the option under Section 172(7). Though the applicant stated in the application that it elected for assessment under the regular provisions of the Act as per Section 172(7), it is seen from the clarification furnished by the applicant on 22nd September (in reply to our query) that such option was exercised for one year i.e. 2008-09 in the return filed on 30th March, 2009 pursuant to which the assessing authority issued a notice under section 143(2) of the I.T. Act on 7.8.2009. It needs to be stated here that the application before AAR was filed on 2nd April, 2009 and an order was passed on 17th June, 2009 admitting the application. For the next year i.e., 2009-10, the time for exercising the option is still there and so far, the applicant has not formally made its claim/option under section 172(7).

4. The relevant provisions of the Income Tax Act, 1961 and the DTAA may now be noticed.

4.1. Section 172 is a special provision in relation to taxation of income derived from the shipment of goods at a port in India in a ship belonging to or chartered by a non-resident. Section 172(1) starts with a non-obstante provision. The tax is levied and collected on a presumptive basis at a fixed rate. The relevant sub-sections of S.172 are extracted below:

> **172. Shipping business of non-residents.- (1)**The provisions of this section shall, notwithstanding anything contained in the other provisions of this Act, apply for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped at a port in India.
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> **(2)** Where such a ship carries passengers, livestock, mail or goods shipped at a port in India, seven and a half per cent of the amount paid or payable on account of such carriage to the owner or the charterer or to any person on his behalf, whether that amount is paid or payable in or out of India, shall be deemed to be income accruing in India to the owner or charterer on account of such carriage.
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> **(3)** Before the departure from any port in India of any such ship, the master of the ship shall prepare and furnish to the Assessing Officer a return of the full amount paid or payable to the owner or charterer or any person on his behalf, on account of the carriage of all passengers, livestock, mail or goods shipped at that port since the last arrival of the ship thereto:
>
> Provided xx xx xx xx xx
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> **(4)** On receipt of the return, the Assessing officer shall assess the income referred to in sub-section (2) and determine the sum payable as tax thereon at the rate or rates in force applicable to the total income of a company which has not made the arrangements referred to in section 194 and such sum shall be payable by the master of the ship.
>
> **(5) & (6)** xx xx xx xx xx
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> **(7)** Nothing in this section shall be deemed to prevent the owner or charterer of a ship from claiming before the expiry of the

assessment year relevant to the previous year in which the date of departure of the ship from the Indian port falls, that an assessment be made of his total income of the previous year and the tax payable on the basis thereof be determined in accordance with the other provisions of this Act, and if he so claims, any payment made under this section in respect of the passengers, livestock, mail or goods shipped at Indian ports during that previous year shall be treated as a payment in advance of the tax leviable for that assessment year, and the difference between the sum so paid and the amount of tax found payable by him on such assessment shall be paid by him or refunded to him, as the case may be.

4.2. In *Union of India vs. Gosalia Shipping P.Ltd*[^], the Supreme Court analyzed and discussed the scope and object of Section 172 in the following words :

> "Section 172 occurs in Chapter XV which is entitled "Liability in special cases" and the sub-heading of the section is "Profits of non-residents from occasional shipping business." It creates a tax liability in respect of occasional shipping by making a special provision for the levy and recovery of tax in the case of a ship belonging to or chartered by a non-resident which carries passengers, livestock, mail or goods shipped at a port in India. The object of the section is to ensure the levy and recovery of tax in the case of ships belonging to or chartered by non-residents. The section brings to tax the profits made by them from occasional shipping, by means of a summary assessment in which one-sixth of the gross amount received by them is deemed to be the assessable profit. Before the departure of the ship, the master of the ship has to furnish to the Income-tax Officer a return of the full amount paid or payable to the owner or charterer on account of the carriage of passengers, goods etc., shipped at the port in India since the last arrival of the ship at the port. In the event that, to the satisfaction of the Income-tax Officer, the master is unable so to do, he has to make satisfactory arrangements for the filling of the return and payment of the tax by any other person on his behalf. A port clearance cannot be granted to the ship until the tax assessable under the section is duly paid or satisfactory arrangements have been made for the payment thereof."

5. We shall now turn our attention to the relevant provisions in the "Agreement between the Republic of India and the Swiss Confederation for the Avoidance of Double Taxation with respect to taxes on income" (hereafter referred to as DTAA

[^] 113 ITR 307

or Treaty). The Agreement was entered into on 29th December, 1994 and it was notified under Section 90 of the Income Tax Act on 21st April, 1995. The DTAA was amended in 2001 and after amendment, another notification was issued by the Central Govt. under Section 90 on 7th February, 2001. As in many other Treaties, Art.7 deals with business profits. The relevant portion of Art.7 is extracted hereunder:

> "(1) The business profits of an enterprise of a Contracting State, other than the profits from the operation of ships in international traffic, shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is directly or indirectly attributable to that permanent establishment. [emphasis supplied]
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> (6) Where profits include items of income which are dealt with separately in other Articles of this Agreement, then the provisions of those Articles shall not be affected by the provisions of this Article."

5.1. The underlined words in Art.7.1 are significant. The profits arising from the operation of ships in international traffic stands excluded from the Article dealing with business profits. The next Article i.e. Article 8 makes a special provision in respect of the profits derived from the operation of aircraft in international traffic. Such profits shall be taxable only in the State to which the enterprise belongs. That means the State of residence can alone tax such profits and the existence or otherwise of a permanent establishment which is an ingredient of Art.7 is not material under Art.8.

5.2 Then, the Treaty proceeds to deal with various other items of income such as dividends, interest, royalties and fees for technical services, independent and dependent personal services, director's fees, income derived by entertainers, pension and annuities, Government remuneration and pensions and payments received by students, teachers and researchers (vide Art.10 to 21). Then comes Art.22 which is in the nature of a residuary article bearing the caption 'other income'. Art.22 was not there in the original DTAA. It was introduced in the year 2001. The two relevant paragraphs of Art.22 are extracted hereunder :

> **"Art.22-Other income - 1.** Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Agreement shall be taxable only in that State**.**
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> **2.** The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such case the provisions of Article 7 or Article 14, as the case may be, shall apply.**"**

6. It is the contention of the applicant that the profits from the operation of ships in international traffic which stand excluded by Art.7 should be brought within the purview of Art.22 and in view of the fact that the applicant does not have a permanent establishment in India as contemplated by para 2 of Art.22, only the State of residence can levy tax in terms of the first para of Art.22. On the other hand, the Revenue contends that the item excluded by Art.7, namely the profits from international shipping business have been consciously

kept outside the ambit of the Treaty and it cannot be brought within the fold of Art.22.

7. On a deep consideration, we are inclined to uphold the contention of the Revenue that the profits arising in India by the carriage of goods from Indian ports to foreign ports will be governed by the domestic law enforced in India i.e. the Income Tax Act, 1961. There are unmistakable indications in the Treaty provisions to show that shipping business income earned by a non-resident is not intended to be covered by the Treaty. The language and scheme of the provisions, the possible incongruities that would otherwise arise and a comparative study of other Treaties would lead us to the inevitable conclusion that shipping income derived from international operations is outside the purview of the Treaty and it is left to be taxed under the domestic law. We shall proceed to spell out the reasons which weighed with us in reaching such conclusion.

8. Art. 22 – a residuary article concerning 'other incomes' was introduced, as noted earlier, in 2001. Till then, there is no dispute and it cannot be disputed that the profits derived from the operation of ships in international traffic are left untouched by the Treaty because of the specific exclusion clause in Art.7. The obvious implication of exclusion is that such income can be subjected to domestic law discipline. Therefore, such income was liable to be taxed in accordance with and in the manner laid down in Section 172 of the IT Act. If this legal position was intended to be changed by the amendments made to the Treaty in 2001, a specific reference to this

'item' of income and specific language to bring it within the ambit of the Treaty should have been there. Neither a separate article is devoted to it nor is there explicit language in Art.22 to bring it within the coverage of that Article. When a particular species of income excluded from the ambit of the Treaty is sought to be brought within the scope of the Treaty for the first time, we would expect clear and specific language to express the intendment rather than leaving it to be taken care of by Art.22 by implication. At this juncture, it may be seen that a separate Article namely, Art.8 is devoted to the profits derived from the operation of aircraft in international traffic. For this, the explanation of the learned counsel for the applicant is that the profits derived from international air traffic are made taxable only in the State of residence and that is why a separate provision has been made, but as far as profits from shipping business are concerned, they are intended to be taxed by the source State in case there is a permanent establishment in that State. There is a fallacy in this argument. It raises an immediate question as to why the exclusion clause has been allowed to remain in Art.7 and why the shipping profits have been relegated to the residuary article i.e. Article 22, as contended by the applicant. It must be noted that both under Art.7 and Art.22, the right of taxation is conferred on the State of residence subject to the qualification that if the business is carried on through a permanent establishment, the source State will have the right of taxation. Thus, the same qualification or exception is carved out based on PE both in Art. 7 and Art. 22. That being the case, we do

not see any intelligible basis for retaining the exclusion clause in Art.7 while at the same time, shifting the shipping profits to Art.22. The substance and basis of taxation, as observed earlier, remains the same both in Art.7 and Art.22, wherever the PE exists. If that be so, excluding the international shipping profits from Art.7 and taking them to the fold of newly framed Art.22 would be a meaningless exercise. We do not think that the signatories to the Treaty would have thought of giving effect to their supposed intention in that manner. It is reasonable to think that when the Treaty was revisited in 2001, both the countries apparently desired to continue the *status quo* as regards the profits derived by non-residents from international shipping operations. At any rate, there would not have been a consensus to alter the existing position. That is why the exclusionary words in Art.7 have been retained.

9. Then, we shall pointedly turn our attention to the language of Art. 22 and test the argument of the applicant. The question is whether the profits from the shipping operations in international traffic can be said to be “an item of income” “not dealt with” in the previous Articles of DTAA? We do not think so. Among the various items of income in the foregoing Articles, business profits into which the shipping income falls has been dealt with under Art. 7. Profits from the international operation of ships are only a species of business profits just as the profits from international air transport. The latter is dealt with separately in Art.8 for the reason that it does not fall in line with the scheme of taxation of business profits under Art.7. Exclusive

right is given to the State in which the enterprise resides. Permanent Establishment test is irrelevant under Art.8. Hence, a separate Article. As far as the profits from international operation of ships are concerned, it is an integral part of business profits; at the same time, they are excluded from the business profits-Article for the obvious reason that it is not intended to be covered by the Treaty. That income has been left to the care of domestic law under which the burden of taxation on such income has been minimized (vide Section 172 of IT Act). We are of the considered view that a particular species of income which is specifically referred to in Art.7 and deliberately left out of its genus, namely business profits, cannot be said to be an item of income not dealt with under Article 7. The expression 'deal with' is a comprehensive expression having different shades of meaning. In the New Chambers Thesaurus, the meanings of 'deal with' are given thus:

> "*1. deal with a situation, attend to, concern, see to, manage, handle, tackle, cope with, get to grips with, take care of, look after, sort out, process."*

In Collins Cobuild English Language Dictionary, it is stated thus:

> "*If a book, speech, film etc.* deals with *a particular thing, it has that thing as its subject or is concerned with it*".

In Shorter Oxford Dictionary (Thumb Index Edn.) one of the meanings given is:

> *"be concerned with (a thing) in any way; busy or occupied oneself with, esp. with a view to discuss or refutation"*.

The following meaning given in the New Oxford American Dictionary may also be noted:

"take measures concerning (someone or something)……. take or have as a subject; discuss".

Bearing these meanings in view, we shall consider whether Art.7 'deals with' the profits from international shipping operations. Whether the exclusion of that particular species of business profits from Art.7 would amount to dealing with those profits is the question that should engage our attention. When the Article concerning business profits specifically refers to "*profits from the operation of ships in international traffic*" which are an integral part of business profits and then it ordains that such profits should go out of the ambit and reach of that Article, it can very well be said that the shipping profits have been dealt with in a particular manner in Article 7. The exclusion clause in Art.7 clearly reflects the conscious decision of the authors of the Treaty not to treat the shipping profits at par with the business profits for the purpose of allocating the taxing jurisdiction to the States concerned. In that way, the subject of shipping profits have been dealt with under Article 7. It is not an uncovered or untreated item. We are therefore of the view that for the purposes of Art.22, profits arising from the operation of ships in international traffic cannot be treated as a distinct item of income not dealt with in the preceding Articles of the Treaty.

9.1 The applicant's counsel submitted that an item of income can be said to have been dealt with in an Article of the Treaty only if it defines its scope as well as allocates the right to tax such income

between the two contracting States. Mere exclusion of shipping business profits from Article 7 does not amount to dealing with that item of income. We find it difficult to accept this contention. Allocation of taxing right to the source State can well be done by such a process of exclusion. There is no particular manner or methodology of achieving that result. The expression 'dealt with' does not necessarily mean that there should be a detailed or elaborate treatment of the subject.

9.2 Another argument projected by the learned counsel for the applicant was with reference to the language used in the DTAAs of some other countries viz. Australia, Malaysia, Singapore where the expression used is "not expressly mentioned". According to the learned counsel, such language employed in Article 22/23 of those treaties might be suggestive of the interpretation sought to be placed by the Revenue; but, the expression "not dealt with" has a different dimension. We do not find merit in this contention. We have explained how the expression "dealt with" should be construed in the context of Art.7 and we reached the conclusion that the profits arising from international shipping operations have in fact been dealt with by that Article in the manner intended by the sovereign States which are signatories to the Treaty.

9.3 The counsel for the applicant then drew our attention to the Commentary on the United Nations Model Convention which explains the rationale of the provision reserving the right of taxation to the

Country of residence in respect of aircraft and shipping operations. The following passage in UNMC Commentary has been referred to:

> "*The exemption from tax in the source country of foreign enterprises engaged in international shipping traffic is predicated largely on the premise that the income of these enterprises is earned on the high seas, that exposure to the tax laws of numerous countries is likely to result in double taxation or at best in difficult allocation problems, and that exemption in places other than the home country ensures that the enterprises will not be taxed in foreign countries if their overall operations turn out to be unprofitable."*

9.4 He has also referred to the comments of Prof. Klaus Vogel to the same effect:

> *"By laying down this rule, the MCs take account of the ways in which the international shipping and air transport industries typically manifest themselves. Their operations spread out over a multitude of States in which PEs are frequently set up to handle the business. Because a single flight or voyage will often involve stops in one foreign State after another, taxation under PE principle would result in difficulty of how to attribute to each of the PE its proper share in the profits made by the enterprise from transportation activities."*

9.5 No doubt, there appears to be a good reason for vesting the exclusive power of taxation on the country of residence of the business enterprise concerned in the case of both international shipping and air transport. However, in the absence of clear words in the India-Swiss Treaty, the shipping profits arising from international operations cannot be placed at par with the profits from the business of international air transport. Whether or not to accord the same treatment to the international shipping business is a matter of policy and it is left to the wisdom and volition of the sovereign representatives at the negotiating table. We have interpreted the Treaty as its stands without being unduly carried away by the

adoption of a different criterion in the Model Conventions. In fact, even the applicant does not go to the extent of saying that only the Country of residence can tax the shipping profits. The applicant agrees that the shipping profits can be taxed by the State of source if the enterprise concerned has a PE in that state. Thus, the applicant cannot derive much of assistance from the Commentaries referred to above.

10. A comparative study of the Treaties which India has entered into with various countries viz. USA, U.K., Australia including the land-locked countries (Switzerland being one such) like Uganda, Kazakstan and Mongolia would reveal that the item shipping profits was dealt with separately or in conjunction with air transport. Further in the treaties that Switzerland had entered into with certain other countries, towit, USA, Australia and Italy, a separate Article with respect to taxation of profits from the operation of ships and aircrafts, is found. A perusal of limited DTAAs which India had entered into with Oman and Russian Federation reveals that the profits from operation of ships and aircraft are both dealt with together and the power of taxation is given to the country of residence. In the limited DTAAs with Pakistan and UAE, such exclusive power has been conferred on the State of residence only in regard to air transport. We, therefore, see considerable force in the contention of the Revenue that whenever it was intended to cover the shipping income under the provisions of DTAA, a separate provision has been made therefor. The need for separate Article was all the more demanding

in Indo-Swiss Treaty, for the reason that such income stood specifically excluded from Article 7.

Ist Question:

11. Strictly speaking, the question whether the applicant can be said to have permanent establishment in India need not be answered in view of the conclusion we have reached that the shipping profits are not covered by the DTAA and they have to be taxed under the domestic Law. However, we would like to observe that on the facts stated by the applicant in regard to the modalities of its business operations in India, it does not appear that there is a permanent establishment in India. The ruling on the first question is given accordingly.

2nd Question:

12. The second question is answered against the applicant by holding that the freight income received by the applicant on account of carrying the cargo from the Indian ports to the foreign ports by deploying chartered vessels is liable to be taxed in India under the provisions of the Income-tax Act, 1961 and such income is not covered by the DTAA (Treaty) between India and Swiss Confederation.

12.1. The applicant has exercised its option as per Section 172(7) of the IT Act for the year 2008-09 just two days before presenting this application. Obviously, such option was exercised in anticipation of ruling of this Authority and by way of abundant caution so as to avoid

the time running out. The assessment proceedings have not gone beyond the stage of issuance of notice under Section 143(2) of the IT Act. It is now open to the applicant, in view of the ruling of this Authority, to retract from the said option and agree for assessment under Section 172 of the IT Act.

Accordingly, the ruling is given and pronounced on this 30th day of September, 2009.

Sd/-	Sd/-
(J.Khosla)	**(P.V.Reddi)**
Member	**Chairman**

F.No. AAR/803/2009 **dated …….**

This copy is certified to be a true copy of the Ruling and is sent to:

1. The applicant
2. The Director of Income-tax (International Taxation), Bangalore.

(Batsala Jha Yadav)
Addl. Commissioner of Income-tax, AAR