IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'L ' BENCH
MUMBAI BENCHES, MUMBAI

BEFORE SHRI J SUDHAKAR REDDY, AM & SHRI VIJAY PAL RAO, JM

ITA No. 8854/Mum/2010
(Asst Year 2007-08)

Hapag-Lloyod Container Line GMBH Diamond Square 2nd Floor, CST Road, Kalina, Santacruz (E) Mumbai 98	Vs	The Addl Director of Income Tax ((International Taxation) Mumbai
(Appellant)		**(Respondent)**

PAN No.	**AAACH0979G**
Assessee by	Sh Rajan Vora
Revenue by	Sh Mahesh Kumar
Dt.of hearing	23.1.2012
Dt of pronouncement	7th, Mar 2012

ORDER

PER VIJAY PAL RAO, JM

This appeal by the assessee is directed against the assessment order passed u/s 144C(1) r.w.s 143(3) of the I T Act in pursuance to the directions of DRP u/s 144C(5) of the I T Act dt 28.9.2010 for the Assessment Year 2007-08.

2 The assessee has raised the following grounds in this appeal:

On the facts and in the circumstances of the case and in law, the Assessing Officer based on directions of DRP:

1. erred in assessing the total taxable income of Rs 125,815,348 against Rs Nil returned by the Appellant;

Benefit of Article 8 of India and Germany Double Taxation Avoidance Agreement
('DTAA'

2. erred in holding that appellant is not entitled to the benefits of the Article 8 of the DTAA between India and Germany ('DTAA') on the freight income of Rs 1,67,75,37,979/- earned by the Appellant;

3. erred in holding that 'pooling arrangements' entered into by the appellant are in the nature of 'slot arrangements' and denying the benefit of Article 8 of the DTAA;

4. erred in holding that the linkage needs to be established between the cargo transported on feeder vessels with the mother vessels without appreciating the fact that the arrangements entered into by the appellant are in the nature of pooling arrangements only;

5. Without prejudice to the above, has taxed the appellant's income under section 44B of the Act which applies to companies engaged in operation of ships and erred in applying the same rationale under Article 8 of the DTAA. Levy of interest under section 234B of the Act

6. erred in levying interest under section 234B of the Act; Initiation of Penalty proceedings under section 271(11(c) of the Act

7. erred in initiating penalty proceedings under section 271(1)(c) of the Act;

3 From the grounds 1 to 5, the only issue arises for our consideration and adjudication is whether in the facts and circumstances of the case, the assessee is entitled to the benefit of Article 8 of the DTAA between India & German on the freight income of Rs. 1,67,75,37,979/- earned on account of transportation of cargo by feeder vessels under pooling/slot arrangements.

4 Brief facts leading to the controversy are as under:

The assessee is a non resident company engaged in the operation of ships in international traffic. The assessee is a tax resident of Germany. The assessee filed its return of income on 23.10.2007 declaring total income of Rs. nil. The Assessing Officer noticed that the assessee was transporting goods by means of feeder vessels which has neither owned nor chartered by the assessee company. On being asked, the assessee explained that these vessels are under slot/pooling arrangements with various other operators and such activity is allowable under DTAA between India and Germany. The Assessing Officer, after examining the contentions of the assessee as well as considering the decisions of the Tribunal

on the point has observed that the total income shall be assessed under the provisions of sec. 44B of I T Act @ 7.5%.

4.1 Alternatively, the claim of goods moved through feeder vessels may not qualify for the benefit of DTAA between Indian and Germany. Accordingly, the Assessing Officer issued the draft order dated 31.12.2009 u/s 144C(1) for the consideration of the DRP. The assessee filed its objection in form 35A against the draft order.

4.2 Before the DRP, the assessee has filed documents relating to connectivity/linkage in respect of voyages undertaken by the assessee during the year. Accordingly, the assessee has furnished the additional evidence before the DRP to establish the linkage between the feeder vessels and mother vessels and consequently, the DRP directed the Assessing Officer to verify;(i)the link between the goods transported through feeder vessels with mother vessels voyage wise; (ii) whether the goods which were transported through feeder vessels were further loaded on to mother vessels owned or chartered by the assessee voyage wise. The DRP thus observed that in case the aforesaid conditions are fulfilled, the Assessing Officer should allow the benefit of Article 8 of India & Germany DTAA in respect of freight receipts of the assessee other than the receipts from slot sharing arrangement.

4.3 As regards the receipt from slot sharing arrangements, the DRP, after considering the material in relation to the pooling/slot arrangements directed the Assessing Officer to verify from the agreements of the assessee as to whether the arrangement is pooling arrangement within the meaning of the explanation to sub.sec. 2 of sec.115V-I of the I T Act or is a slot arrangement. In case it is a pooling arrangement, then the assessee would be entitled for the benefit of Article 8 of the DTAA between India and Germany. However, if the arrangement

is on slot sharing basis, then in that case the slot charges will not be construed to be income derived from the operations of ships in international traffic and the receipts would be taxable as per sec. 44B of the I T Act.

5 The assessee also took an alternative plea that the income is not assessable u/s 44B as the assessee does not a have a Permanent Establishment (PE) in India and was accordingly not liable to tax in India.

5.1 The said objection did not find favour with the DRP and in their view, the assessee's agent in India who is issuing the bill of lading has the authority to conclude contracts on behalf of the assessee which are legally binding upon the assessee. The business operation of ships of the assessee is being carried on through the office of the Agent in India. Further, it was observed that Article 8 of DTAA presupposes the existence of a permanent establishment and accordingly exempt the profits form operation of ships in International traffic.

5.2 Hence, DRP has given part relief to the extent of the income earned on account of goods transported through feeder vessels, if there is linkage between feeder vessels and mother vessels owned or charted by the assessee. Consequently, the Assessing Officer has passed the final assessment order dt 26.6.2010 whereby given a relief in respect of the freight and THC earnings on feeder vessels as per the directions of DRP of Rs. 95,63,79,908/- and computed the total taxable income of the assessee @ 7.5% of the balance freight and THC earnings on feeder vessels of Rs. 1,67,75,37,979, which come to Rs. 12,58,15,348/.

6 Before us, the ld AR of the assessee has submitted that the revenue has not disputed the fact that the freights earned by the assessee on account of goods transported through feeder vessels to mother vessels as income from

operation of ships and accordingly assessed the same u/s 44B of the I T Act. The ld AR has thus submitted that once the said income has been treated as income from operations of ships, then in view of the facts that the assessee is in the business of operation of ships in international traffic, the benefit of article 8 or DTAA cannot be declined. He has referred Explanation to sec. 115VI(2) and submitted that pooling arrangements has been defined as per the said Explanation as an agreement between two or more persons for providing services through a pool or operating one or more ships and sharing earnings or operating profits on the basis of mutually agreed terms.

6.1 The ld AR has narrated the object of the pool arrangements and submitted that in order to perform the ship operations more efficient, cost effective and lucrative deployment of member's fleet makes pooling arrangements, which is a form of commercial cooperation between ship-owners to improve the efficiency of the service to members entered into pooling arrangement which is permissible under DTAA as well as under the provisions of the Income Tax Act. He has referred the order of the Tribunal in the case of DIT(IT) vs Balaji Shipping(UK) Ltd reported in 121 ITD 61(Mum) and submitted that the Tribunal, while deciding an identical issue has held that the profits derived by Enterprises in respect of the cargo transported by the assessee through feeder vessels under slot/pooling arrangements is taxable only in the state of residence and the benefit of treaty is available to the assessee.

6.2 The ld AR of the assessee has made an elaborate arguments on the point that slot and pooling arrangement is one and the same. The slot chartered arrangement with the other ship companies is nothing but the integral part of its business operation, which is similar to the code sharing arrangements in the airline industry. Therefore, the pooling/slot arrangement is common and

essential practice in the industry and by using these arrangements cannot be said that the assessee does not operate its ships or chartered ships in the international traffic.

6.3 Under the pooling arrangements each party has the absolute obligation to provide the agreed level of tonnage and to provide compatible vessels. He has further submitted that terms and conditions in the agreement are standard terms and such terms are virtually present in each and every such agreement. Merely because in the arrangement referred to terms 'slot' does not alter the pooling arrangement into slot chartered agreement. The substance of the agreement should be seen and not the nomenclature used. Therefore, the terms and conditions contain in the agreement in question are commonly used and as per normal terms.

6.4 The intention of the parties of the agreement should be considered and agreement should be interpreted as pooling arrangement and not slot arrangement. The pooling arrangements are on parity and under such arrangement, each party agrees to carry a certain quantity of cargo of the other parties on the given day/date and in reciprocate, the other party also has to carry the same quantity of cargo of the other parties on the day/date as per the arrangements to deploy their vessels on a specific date. He has submitted that the aim of the arrangement is to ensure the efficient service with cost effective. He has further explained that each party to the pooling arrangement would be allocated space on the vessels of each other depend on the nature of vessels deployed by each party. The ld AR has referred the comparative regulations in shipping related industry and submitted that pooling arrangement as understood by the industry are in the form of commercial cooperation between the ship-owners for providing efficient, cost effective and lucrative deployment of

members fleet. The assessee entered into an agreement with a similar ship-owner to ensure efficient, cost effective and lucrative deployment of member's fleet and it is an arrangement in the form of commercial cooperation. The ld AR has heavily relied upon the decision of the Tribunal in the case of Balaji Shipping (UK) Ltd (supra) and submitted that in the said case, the treaty was between India and UK and Article 9 of DTAA between India & UK is similar to the Article 8 of the DTAA between India and Germany.

6.5 He has referred the OECD commentary for the terms 'operation of ships' as guidelines for understanding the meaning. The ld AR referred para 22 of the order of the Tribunal in the case of Balaji Shipping (UK) Ltd (supra) and submitted that the Tribunal has reproduced the Article 9 of India UK treaty as well as OECD commentary for understanding the definition of terms of operation of ships. The ld AR, has then pointed out that Article 9 as reproduced by the Tribunal in para 22 of the order in the case of Balaji Shipping (UK) Ltd is similar to the Article 8 of Indo German treaty. Therefore, the meaning of terms 'operation of ships' as understood by the Tribunal in the case of Balaji Shipping (UK) Ltd has to be taken into consideration in the case in assessee's case. He has further pointed out that only 22% of the total freights is earned through slot/pooling arrangements; therefore, it is only a minor contribution relating to such operations and should not be regarded as separate business or source of business of the assessee but it should be considered to be part and parcel of the operation of ships.

6.6 He has further submitted that the Tribunal in the case of JCIT vs Cma Cgm SA France reported in 27 SOT 367 (Mum) has also taken a similar view by following the order in the case of Balaji Shipping (UK) Ltd (supra). Further the Tribunal while deciding the appeal in the case of DCIT vs Delmas Shipping South

Africa(Pty) Ltd and Parekh Marine AG(P) Ltd in ITA No.8471/Mum/2004 and ITA No.245/Mum/2005 vide order dated 27th Oct 2008 decided the issue in favour of the assessee. The ld AR has submitted that slot charted arrangement is hiring of fixed space on the vessel by one party from another as against pooling arrangements where the vessels are brought together by various parties to the agreement for commercial efficiency and thus, the ld AR has submitted that in the case of the assessee, it is not merely hiring of space on the vessels of other parties but also provides pools in its vessels and resources. Therefore, arrangements entered into by the assessee are in the nature of pool arrangements. He has thus submitted that article 8 of Indo German DTAA of Indo German is applicable and the income earned through transportation of cargo under the slot/pooling arrangements is not taxable.

6.7 On the other hand, the ld DR has submitted that the definition of pooling arrangement is given under the Explanation to sec 115V-I(2). It is an arrangement between two or more persons for providing services through a pool or operating one or more ships and sharing earnings or operative profits on the basis of mutually agreed terms. Thus, the ld DR has submitted that pooling arrangement is putting together the services through one or more ships and then sharing the earnings. In the case of the assessee there is no such agreement of sharing the services and earning but is purely a slot arrangement under which parties to the agreement are provided certain space in each other fleet. In the absence of sharing of earning as there is no clause in the agreement or otherwise establishing of parting of profit the arrangement of the assessee cannot be said as pooling arrangement. He has further pointed out that in the case of Balaji shipping (UK) Ltd (supra) the facts are clearly distinguishable from the facts of the present case. He has referred para 3 of the said order and submitted that in the said case, the mother vessels were owned or chartered by

the assessee and the arrangement was made only for the feeder vessels; therefore, it was held by the Tribunal that the slot arrangement is only a minor part of international operation of ships and it transported cargo from the port in India to mother vessels which was owned or chartered by the assessee. Whereas the freight earned by the assessee through slot arrangement is 38% of the total freight. He has referred the assessment order and particularly computation of income and submitted that the total freight earned by the assessee is 687 crores out of which about 263 crores were earned on slot basis; therefore, it is not a minor part of the total business of the assessee but is substantial part. He has further submitted that in the subsequent decision, the Tribunal in the case of Delmas France reported in 121 TTJ 501 has distinguished the decision in the case of Balaji Shipping (UK) Ltd (Supra) as the facts are different. He has referred the said order and submitted that expression 'operation of ships would include international traffic activity of transportation of cargo by feeder vessels owned or chartered by the assessee and also transportation of cargo by feeder vessels from Indian port to the mother vessels, if such transportation is ancillary or incidental to the main activity. However, the benefit of article 9 would not be available merely on the ground that the assessee is engaged in the business of shipping globally but the benefit would be available to transportation of cargo by feeder vessels only if the assessee is able to establish the link between the transportation of cargo by feeder vessels with transportation by mother vessels owned, leased or chartered by the assessee. Thus, the ld DR has forcefully contended that the Tribunal in the subsequent decision clearly laid down the distinguishing factor and the benefit of DTAA available only to feeder vessels are used as ancillary or incidental to the main activity but not in the case where the transpiration of cargo by feeder vessels to the mother vessels is not owned or chartered by the assessee. The initial requirement is that the main activity of

operation of ships should be transportation of cargo carried out by the mother vessels either owned or leased or chartered by the assessee. He has pointed out that the Tribunal in the case of Delmas France (supra) has followed the order of the Tribunal in the case of ANL Container Ltd P Ltd in ITA No. 1939/Mum/2006. Since the lower authorities have followed the order of the Tribunal in the case of Delmas France (supra); therefore, their action is justified. He has further submitted that as per the agreement at page 62 of the paper book, the parties have agreed for remuneration as per the rate given in the slot allotted or carried. Therefore, it is not an arrangement of pooling but hiring of some space against the slot rate. He has further submitted that sec. 44B of the I T Act deals with the income of operation of ships which includes both local and international operations. Therefore, assessing the income from feeder vessels under slot arrangement as per sec. 44B does not mean to accept the income as income from operation of transportation of goods in international traffic. He has relied upon the decision of the Tribunal in the case of AP Moller Maersk Agency India P Ltd reported in 89 ITD 563(Mum). He has relied upon the orders of the lower authorities.

6.8 The ld DR has countered the arguments that the ld AR for article 8 of Indo German DTAA are similar to article 9 of Indo UK DTAA. He has referred articles 8 of Indo German and submitted that there is variation in the language used in the articles under India UK DTAA as well as Indo Germany treaty.

6.9 In rebuttal, the ld AR has submitted that pooling arrangement is part of the core activity of the assessee. He has referred the section 115VB and submitted that even a ship owned or chartered under any slot arrangement, space chartered or joint charter, such arrangement is regard as operation of ship. Therefore, the slot/pooling arrangement is part and parcel of the operation

of ship activity of the assessee and cannot be regarded as a separate and distinct activity. He has referred para 19 of the order of the Tribunal in the case of Balaji Shipping (UK) Ltd (supra) and submitted that if such word or expression is not defined in the treaty but the same has been defined in the local law then it should be understood in accordance with such definition. This concept was considered by the Tribunal in the case of DCIT vs Safmarine Container Lines NV reported in 24 SOT 211(Mum) as quoted by the Tribunal in para 19 in the case of Balaji Shipping (UK) Ltd. (supra). Thus, he has further submitted that the order of the Tribunal in the case of AP Moller Maersk Agency India P Ltd (supra) has also been considered by the Tribunal in the case of Balaji Shipping (UK) Ltd(supra).

6.10 The ld AR has further submitted that though the slot rates are mentioned in the agreements; however, there is no actual payment or receipt of remuneration but only the corresponding space/slot is provided in each other fleet under slot/pooling arrangements. He has referred clause 6 of the agreement at page 40 of the paper book and submitted that the allocation as per clause 6.2 of the agreement, allocations will be distributed prior to the start of each cycle and will be reviewed in case of changes in fleet composition following stipulations of clauses. Thus, the ld AR has submitted that the rates provided under the agreements are not given effect in practice but only respective space is provided in each other fleet.

8 We have considered the rival contention as well as the relevant material on record. The short question arises from the ground nos.1 to 5 is whether the profit from transportation of cargo under slot arrangement is eligible for the benefit of Article 8 of Indo German DTAA. As per Article 7 of Indo German DTAA, the business profit of an enterprise of a Contracting State shall be taxable only in that State of residence unless the enterprise carries on business in the other

Contracting State through a Permanent Establishment. Therefore, the profit of the enterprise may be taxed in the other state but only so much of them as is attributable to that PE.

9 Article 8 of India German DTAA has carved out an exemption to that Article so far the profit from the operation of ships or aircraft in international traffic. For ready reference, we quote the Article 8 of DTAA of Indo German as under:

Article -8 - SHIPPING AND AIR TRANSPORT

"(1) Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated.

(2) If the place of effective management of a shipping enterprise is aboard a ship, then it shall be deemed to be situated in the Contracting State in which the home harbour of the ship is situated, or, if there is no such I home harbour, in the Contracting State of which the operator of the ship is a resident.

(3) For the purposes of this article, interest on funds connected with the operation of ships or aircraft in international traffic shall be regarded as profits derived from the operation of such ships or aircraft, and the provisions of Article 11 shall not apply in relation to such interest.

(4) The provisions of paragraph I shall also apply to profits from the participation in a pool, a joint business or an international operating agency."

10 As provided in article 7 the business profit of enterprise may be taxed in other than the state of domicile of contracting states, if the enterprise as a PE in the other state. Whereas Article 8 stipulates the exception to the general PE tax jurisdictional state with reference to the profit from operation of ship or aircraft in international traffic and the same shall be taxable only in the contracting state

in which the place of effective management of the enterprise is situated irrespective of a PE situated in other contracting state.

11 We are concerned only about paras 1 and 4 of Article 8 as the issue pertains to the profit and gain from transportation of cargo through feeder vessels under slot/pooling arrangements. Para 1 of Article 8 expressly mentions that profit from the operation of ships or aircraft in international traffic shall be taxed only in the state of residence. There is no dispute between the parties so far as para '1' of Article 8 of Indo Gernam DTAA is concerned; but the dispute before us is narrow down to the applicability of para '4' of Article 8 of Indo German DTAA on so much of the profit earned by the assessee by transporting cargo under slot arrangement. The assessee's main thrust of arguments is that slot/pooling arrangement is only part of the core activity and thus, covered under Article 8 of the Indo German DTAA. A strong reliance has been placed on the decision of the Tribunal in the case of Balaji Shipping (UK) Ltd (supra) and subsequent order of the Tribunal following the said decision. The revenue has distinguished the said decision on the facts and placed reliance on the decision in the case of Delmas France (supra). To substantiate its contention, the revenue has emphasised the fact that neither the feeder vessels nor the mother vessel is owned, leased or chartered by the assessee and therefore, the income from transportation of cargo under slot arrangement does not fall under article 8 of DTAA. At this stage, we would like to quote the definition terms 'international traffic as given in article 3(1)(ii) as under:

> *(I). For the purposes of This agreement, unless the context otherwise requires;*
> .....
> .....
> *(iii) The term " international traffic' means any transport by a ship or aircraft operated by an enterprise which has its place of effective management in a contracting state except when the ship or aircraft is operated solely between places in the other contracting state"*

As per the definition given in clause (1) in para '1' of article 3 of DTAA, international traffic means any transport by a ship or aircraft operated by an enterprise except the operations solely between the places of a contracting state where the state the enterprise is not having its place of effective arrangement. Thus, the definition of 'international traffic' as provided under Article 3 of DTAA also excludes the operations of ship or aircraft, those are only between the place of a contacting state in which the assessee is not resident.

12 The Tribunal, while dealing with similar issue in the case of Balaji Shipping (UK) (supra) after taking into consideration the article 9 of Indo German DTAA and OECD commendatory has held in para 23 as under:

> *"23. Let us now consider whether freight income of the assessee on account of transportation of cargo in international traffic through slot charter arrangement by the ships operated by other enterprises can be said to be profits from operation of ship under Article 9 of Indo-UK Treaty in view of the OECD Commentary. Perusal of paragraph 4 of the said commentary shows that two kinds of profits are covered by Article 8 of OECD Commmentary which is similarly worded. In the first category are those profits which are directly obtained by the enterprise from the transportation of cargo/passengers in the international traffic by the ships whether owned or leased or at the disposal of such enterprise. It also covers profits from activities directly connected with such operation. In the second category are the profits from the activities which are not directly connected with operation of ship but are ancillary to such operation. Paragraph 4.2 defines the scope of ancillary activities. According to this para, ancillary activity is that activity which makes a minor contribution relative to the activity of operation of ship and such activity must be so closely related that it should not be regarded as separate business or source of income. Paragraphs 5 onwards discuss about various activities to which paragraph 4 can be applied. Paragraph 6 covers the profits derived by an enterprise from the transportation of passengers/cargo otherwise than by ships that it operates in the international traffic to the extent such transportation is directly covered with the operation of ships in the international traffic by that enterprise. This covers a situation where the assessee is unable to transport the passengers/cargo from its own ship but transports the same through ships operated in international traffic operated by the other enterprises. This has been explained by giving an example also. According to this example, some of the passengers/cargo may be transported internationally by ships operated by other enterprises*

under slot chartering arrangement. In our view, this paragraph would cover the facts of the present case since the assessee not only transports its cargo through the ships chartered by it but also transports the cargo in the international traffic by the ships operated by other enterprises under slot chartering arrangement. Since Article 8 of OECD Model Convention and Article 9 of Indo-UK Treaty are similarly worded. Paragraph 6 of OECD Commentary discussed above would apply in defining the scope of Article 9(1) of Indo-UK Treaty as per the rule of contemporaneous exposition discussed in the earlier part of the order. Accordingly it is held that the freight income earned by the assessee on account of transportation of cargo in the international traffic by ships operated by other enterprises under slot chartering arrangement would be taxable only in State of residence and consequently, such income would be exempt from taxation under the Indian Income-tax Law."

13 The Tribunal in the case (supra) observed that ancillary activity is that activity which makes a minor contribution relative to the activity of operation of ship and such activity must be so closely related that it should not be regarded as separate business or source of income. It is pertinent to note that these observations of the Tribunal are based on the facts as recorded in para 3 as under:

"3. In the course of assessment proceedings for the assessment year 2001-02, the Assessing Officer examined the Charter Hire Agreement between the assessee and M/s. Littleton Services Inc. for the vessel 'Orient Aishwarya' as well as Connecting Carrier Agreement between the assessee and the Orient Express Lines Ltd. Mauritius (the carrier). It was revealed that the carrier operated its feeder services from/to ports in Indian sub-continent to/from UAE, Colombo and Singapore. Clause 2 of this agreement provided that the carrier had offered containers slots space to the assessee and the assessee had accepted to use such space on as/when required basis. However, agreement with Littleton Services Inc. showed that the entire ship was chartered by the assessee and the same was operated by the assessee. The Assessing Officer after referring to the commentary on Double Taxation Convention by Klaus Vogel held that receipts from the operation of the vessel "Orient Aishwarya" was covered by Article 9 of Indo-UK Treaty and consequently, the gross receipt amounting to Rs. 1,73,83,818 on this account was to be excluded from the taxation in view of the said treaty. However, in respect of the cargo transported through the ship of the carrier, it was held by the Assessing Officer that the assessee could not be said to be engaged in the business of operation of ships and consequently, the income arising to the assessee in this regard was assessable under section 44B of the Act."

14 Thus, a very important and material fact in the said case was that the entire ship was chartered by the assessee and the same was operated by the assessee and other carriers operated its feeder service.

15 It is pertinent to note that in the case of Delmas France (supra), the Tribunal constituting the Bench of same Members as in the case of Balaji shipping (UK (supra) after considering the decision of the Balaji Shipping (UK) (supra) has held in para 10& 11 as under:

> *10. After hearing both the parties, we find some merit in the contention of the learned Departmental Representative on behalf of the Revenue. This aspect of the issue has been considered recently in the case of ANL Container Line (P) Ltd. (ITA No. 1939/Mum/2006) which was also argued by the present counsel, Shri F.V. Irani. In that case it has been held by us as under :*
>
> > *"...This Bench in the case of Dy. Director of IT (International Taxation) vs. Balaji Shipping (UK) Ltd. (supra) has also held that in the absence of any definition such expression would include not only direct activity of transportation in the international traffic but also the indirect activities which are incidental or auxiliary to the main activity. Accordingly, it was held that transportation of cargo through feeder vessels with whom slot charter agreement/ arrangement has been made would be included within the scope of the expression 'operation of ships' and consequently, profits arising from such activity would be taxable only in the State of residence. The commentary by Klaus Vogel further provides that even the inland transport incidental to main transportation of cargo in the international traffic would also be within the scope of such expression. Applying the aforesaid principle, it has to be held that the transportation of cargo in the international traffic by feeder vessel would fall within the ambit of such expression if such transportation is incidental or auxiliary to the main transportation. It is clarified that in order to claim benefit under art. 8, it must be established that cargo in the international traffic was by the ship owned/leased/chartered by the assessee. It is only in such case that transportation by feeder vessel belonging to other parties would be considered as incidental to the main activity. If the entire voyage in the international traffic is through the ship belonging to other enterprises then benefit under art. 8 would not be available. We are not in agreement with the broad proposition laid down by the CIT(A) that benefit would be available under art. 8, even if it is established that the assessee is engaged in business of shipping. Klaus Vogel in his commentary nowhere says that entire voyage through ships belonging to other enterprises would be considered by such expression. The relevant portion of the commentary by Klaus Vogel*

has been reproduced by us in the case of Balaji Shipping (UK) Ltd. (supra) in para 22 of the order. It provides that in the first place, it would cover profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise). Thereafter, it says that this would also cover profits from activities not directly connected with such operation as long as they are ancillary to such operation. Therefore, CIT(A) is not justified in holding that there is no need to link the transportation of cargo by feeder vessel with transportation by the mother vessel owned/ leased/chartered by the assessee. Transportation of cargo by feeder vessel can be said to be ancillary activity only if it can be linked with the main voyage by mother ship. If the proposition of CIT(A) is accepted then it would cover the entire voyage undertaken by the ship belonging to other shipping companies. For example, assessee may transport the goods by one ship from Mumbai to Singapore, belonging to other enterprises and load the cargo in another ship which is also not owned/leased/chartered by the assessee for transporting the cargo from Singapore to Australia. Such type of voyage is never intended to be covered by the expression 'operation of ships'. Therefore, broad proposition laid down by the CIT(A) cannot be accepted. In our opinion, the benefit under art. 8 would be available in respect of transportation of cargo by feeder vessel belonging to other enterprises only if such transportation is ancillary to the main transportation of the cargo by mother vessel. Accordingly, the onus would be on the assessee to establish that cargo transported through feeder vessel from Indian port was loaded in the mother vessel for the transportation of the same to the ultimate destination."

11. Following the aforesaid decision, it is held—(i) that the expression "operation of ships", in the absence of any definition in the art. 9 of the DTAA, would include not only the direct activity of transportation of cargo by ships owned, leased or chartered by the assessee but also transportation of cargo by feeder vessels from Indian port to the mother vessel if such transportation is ancillary or incidental to the main activity; (ii) that benefit of art. 9 would not be available merely on the ground that the assessee is engaged in the business of shipping globally; (iii) that benefit of art. 9 would be available to transportation of the cargo by feeder vessels only if the assessee is able to establish the link between the transportation of cargo by feeder vessels with transportation by mother vessels owned, leased or chartered by the assessee."

16 It is clear from the subsequent order in the case of Delmas France (supra) that the benefit of Article 8 would be available in respect of transportation of cargo by feeder vessels belonging to other enterprise only if such transportation is ancillary to the main transportation of cargo by mother vessels. The benefit of DTAA would be available to the transportation of the cargo by feeder vessels

only if the assessee is able to establish the link between the transportation of cargo by feeder vessels with transportation by mother vessels, owned, leased or chartered by the assessee.

16.1 We make it clear that the order in the case of Balaji Shipping (UK) Ltd (supra) was passed on 13.8.2008 and thereafter in the subsequent order dated 28.11.2008 in the case of Delmas France (supra), the Tribunal has made the distinction of facts for applicability of Article 9 of DTAA in the respective cases. Though, the Article 8 of Indo German DTAA and Article 9 of Indo UK DTAA and Indo France DTAA are not identical; however, as we are concerned with para 1 & 4 of Article 8 of Indo German DTAA, the wording of Article 9 of Indo-UK so far as corresponding to paras 1 & 4 is similarly.

17 In the case in hand, the DRP has already granted relief to the assessee to the extent of the profit earned from transportation of cargo by feeder vessels and the assessee is able to establish the link between the feeder vessels with mother vessels voyage wise. The DRP in para 3 in the direction passed u/s 144C(5) has observed as under:

> *"The assessee has furnished additional evidence before the DRP to establish the linkage between feeder vessels and the mother vessels. The A.O is accordingly directed to verify the following*
>
> > *(i) To link the goods transported through feeder vessels with mother vessels voyage wise.*
> >
> > *(ii) Whether the goods which were transported through feeder vessels were further loaded on to mother vessels owned or chartered by the assessee voyage wise.*
>
> *In case the aforesaid conditions are fulfilled, the A.O should allow the benefit of Article 8 of India and Germany DTAA in respect of freight receipts of the assessee except receipts from slot sharing agreement as discussed in Ground No.4".*

17.1 The Assessing Officer, while passing the consequential final order has allowed the claim to the extent of transportation of the cargo by feeder vessels to the mother vessels owned, leased or chartered by the assessee. However, transportation of cargo by feeder vessels under slot arrangement and where the mother vessels was not owned, leased or chartered by the assessee, the Assessing Officer treated the said income not derived from the operation of ships in international traffic and taxed the same as per sec. 44B of the I T Act. The assessee has not disputed the fact that freight receipts taxed u/s 44B is towards transportation of the cargo by feeder vessels under slot/pooling arrangements and the mother vessels was not owned, leased or chartered by the assessee. Hence, when there is no link between the transportation of cargo by the feeder vessels and transportation by mother vessels owned or chartered by the assessee, then the said activity cannot be termed as operation of ships in international traffic and subsequently the benefit of Article 8 of Indo German DTAA would not be available on such profit.

17.2 Before parting with the issue, we may clarify that sec 44B deals with computation of profit and gain of shipping business of non-resident and therefore, computation of profit and gain of shipping business u/s 44B, which is a deeming provision would not necessarily and always mean that the said profit or gain is from operation of ships in international traffic. Therefore, we do not find any merit in the contention of the ld AR that once the income is computed u/s 44B, the benefit of treaty is available.

17.3 As it is clear from the language and contents of the treaty that the benefit of Article 8 would be available only on the profit from the operation of ships in international traffic would not necessarily be available to the profits computed

u/s 44B. The computation of profits and gains u/s 44B is from shipping business as a whole, including in international traffic, if any.

18 One of the main arguments of the assessee which has to be adjudicated, is whether clause (iv) of Article-8, applies or not. This reads as follows:-

Article -8 - SHIPPING AND AIR TRANSPORT

(1) Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated

(4) The provisions of paragraph I shall also apply to profits from the participation in a pool, a joint business or an international operating agency."

18.1 The assessee, in this case, has a slot charter arrangement or slots swap arrangement with other parties. The issue to be considered is whether the slot charter arrangement or slot swap arrangement can be considered as a "pool arrangement". If it is a pool or a joint business, then it would be considered as operation of ships or vessels.

18.2 Legal definition of space charter, slot charter and pool arrangement, are as follows:

Space *Charter*

A voyage charterparty under which the space charterer has the right to use only part of the vessel's capacity.

Slot Charter

A time of voyage charter under which the slot charter has the right to use only a specified amount of the ship's container carrying capacity. In

container liner trades, such charters may be reciprocal ("cross slot charters") between operators | carriers, in order to share capacity.

Pool Agreement

An agreement between a number of persons who have the right (because they are bareboat or time charterers, so disponent owners) to exploit the earning capacity of similar ships to cooperate in the Commercial Management and Commercial Operation of (typically) all such ships controlled by them. (whilst each retaining any responsibility which they may have for Technical Operation). Various legal structures may be adopted, including the establishment of a full function joint venture "Pool Manager" to whom ships may be time chartered, but the most important characteristic is agreement on a formula (a "distribution key") pursuant to which each ship shall earn from the Pool a share in actual Pool net income (however defined) which is proportionate to that ship's agreed theoretical earning capacity, not its actual earnings in the Pool (save insofar as there is provision for any adjustment, e.g. by way of offhirc, in respect of the operational risks retained by the "owners"). The Pool Manager becomes a ship operator or disponent owner and has the right to exploit the earning capacity of the vessel. No standard form documents in popular use. No national regulation of detailed terms."

18.3 Coming to the issue as to what is a participation in a pool, we find as follows:"

"Within EU Law (Murray, 1994), shipping pools are defined as "....joint ventures between ship-owners to pool vessels of similar types, with central administration, which are marketed as a single entity, negotiating voyage/time charter parties and contracts of affreightment, where the revenues are pooled and distributed to owners..."

A similar definition is given by Packard (1989): "... a pool is a collection of similar vessel types under various ownerships, placed under the care of an Administration. This Administration markets the vessels as a single, cohesive unit and collects the earnings which, in due course, are distributed to individual owners under a pre -arranged weighing system by which each entered vessel should receive its fair share...."

CHARACTERISTICS OF BULK SHIPPING POOLS

The latter definition introduces also the idea of the weighing system which, from an academic point of view, is perhaps the most interesting one among the other pooling arrangements.

The underlined parts in the above two defmitions summarise the main, more or less common to all, characteristics of bulk pools. These could be described as: (I) similar tonnage, (ii) central administration (pool management company), (III) joint marketing, (iv) negotiation of freight rates, (v) centralization of voyage costs, (vi) freight collection, (Vii) weighing system, (VIII) revenue distribution, (ix) fair share."

18.4 The assessee has failed to demonstrate that the agreement in question fulfilled the characteristic of shipping pool. The learned Counsel argued that there is no payment but only a Barter system exists as per the agreement. So there is no revenue which are shared or distributed.

18.5 From the above, it is clear that slot sharing is not the same as participation in a pool or a joint business or an international operating agents. Hence the nature of arrangement does not fall in Article 8(4).

18.6 Section 115V-(2)(ii)(A) Explanation (a), explains pooling arrangement. This does not include slot charter, etc. Section 115VB definition cannot be applied to DTAA as the definition is for the purpose of that chapter only and even then the requirement is that the slot has to be chartered. Just because the legislature makes the basis of taxation of slot charter same as other type of charter, it does not show that the this has to be applied to Article 8(4) of DTAA as asked by the assessee.

19 The assessee has also raised additional grounds as under:

"Without prejudice to the ground numbers I to 5, the learned AO erred in holding that the appellant has a permanent establishment in India, without appreciating the facts and circumstances of the case.

Without prejudice to the above, even if the appellant is considered to have a permanent establishment in India, no further income can be attributed to the permanent establishment of the appellant as the agents of the appellant have been remunerated at arm's length.

20 the ld AR of the assessee has submitted that The Assessing Officer has taxed the income of the assessee u/s 44B of the Act denying the benefit of Article 8 of the DTAA between India and Germany. If Article 8 of the DTAA between India and Germany does not apply to the said income, the said income being business income ought to be taxed under Article 7 of the DTAA.

20.1 The ld AR has further submitted that as per Article 7 of the DTAA between India and Germany, the profits earned by an enterprise of Germany shall be taxable only in Germany unless the enterprise carries on business in India through a Permanent Establishment situated therein. Thus, for the income to be taxed as business profits, the assessee should have, in the first instance, a PE in India. The ld AR has submitted that to analyze whether the assessee has a PE in India or not, the provision of Article 5 of the DTAA between India and Germany should be applied. However, the Assessing Officer has not analyzed the provisions of Article 5 and has held that the assessee has a PE in India, merely because the agent of the assessee signs the Bill of Lading. He has submitted that agents sign bill of lading as a part of their duty and also, issuing bill of lading merely provides administrative convenience to the assessee and the agents issue the bill of lading as a part of their duty.

20.2 Without prejudice to the above, the ld AR has submitted that where the assessee is considered to have a PE in India, no further attribution of profits can be made to such PE of the assessee as the agents have been remunerated at arm's length. In support of his contention, the ld AR has relied upon the following judicial precedents:

> *i) The Hon'ble SC in the case of DIT v/s Morgan Stanley and Company Inc (292 ITR 416) has held that once the transactions are held to be at arm's length taking into account all the risk- taking functions of the multinational enterprise, then nothing further would be left to attribute to the PE of such a multinational enterprise.*

ii) The Hon'ble Bombay HC in the case of SET Satellite (Singapore) Pvt. Ltd. v/s DDIT (307 ITR 205) has held that if the foreign enterprise was paid at the arm's length price, nothing further would be left to be taxed in the hands of the foreign enterprise. Accordingly, no further income can be attributed to the PE of the foreign enterprise in India.

iii) The Hon'ble Delhi ITAT in the case of BBC Worldwide Ltd. (2010) (TIOL 59 ITAT DEL) has held that where an agent is compensated on an arm's length basis for its agency services in India, there should be no additional income attribution in the hands of the taxpayer which is a foreign enterprise.

20.3 Accordingly, the ld AR has submitted that since the agents have been remunerated at arm's length, no further income be attributed to the PE, if any of the assessee in India.

20.4 On the other hand, the ld DR has relied upon the orders of the DRP and the Assessing Officer and submitted that the assessee is issuing the bill of lading has the authority to conclude contracts on behalf of the assessee which are legally binding on the assessee; therefore, the business of operation of ships of the assessee is being carried on through the office of the agent in India which constitute the PE in India.

20.5 As regards the second additional ground raised by the assessee, the ld DR has submitted that the assessee has raised altogether fresh plea at this stage which cannot be entertained and admit. The ld DR alternatively submitted that even if the agent is remunerated at arm's length, the same would not affect the taxability of the income u/s 44B.

21 We have considered the rival contention as well as the relevant material in record. There is no dispute that the assessee carrying out the business of operation of ships in India through its Agent M/s Hapag-Lloyd India Pvt Ltd. The agent in India concluding the contract of cargo transportation by issuing bill of

lading which are legally binding on the assessee; therefore, the assessee is carrying out the business of operation of ships in India and thus is having a PE in India as per article 5 of DTAA. We quote para 1 & 5 of Article 5 as under:

> *(1) For the purposes of this agreement, the term "permanent Establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.*
>
> *(5) Notwithstanding the provisions of paragraphs 1 and 2, where a person -other than an agent of an independent status to whom paragraph 6 applies--is acting in a Contracting State on behalf of an enterprise of the other Contracting State that enterprise shall be deemed to have a permanent establishment in the first- mentioned State, if this person;*
>
> > *(a) has and habitually exercises in that State an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise;*
> > *(b) has no such authority, but habitually maintains in the first mentioned State a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the enterprise; or*
> >
> > *(c) habitually secures orders in the first mentioned State wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that enterprise.*

22 This is not a case of availing service of agent in support of the business but the assessee is carrying out business through the agent in India. Therefore, the source of income to the extent of booking of cargo by the agent in India and physically transported the cargo from port in India to the mother vessels is in India and constitute a PE in India. The assessee has earned income through such business in India and thus certainly said to have a source of income in India Apart from having a PE, when the assessee is carrying out the business in India and earned income from such source in India, then, the contention of the assessee is not acceptable that the income is not assessable to tax in India.

23 The article 4 of Indo German DTAA makes it clear that even if a person, who is liable to tax in resident contracting state by reasons his domicile may also

be liable to tax in the other contracting states in respect of the income arises from that state. We reproduce para 1 of Article 4 as under;

> *(1) For the purposes of This agreement, it term 'resident of a contracting State' means any person who under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any criterion of a similar nature. But this term does not include any person who is liable to tax in that Sate in respect only of income from source in that state or capital situated therein."*

24 Once it is clear that the assessee is carrying out the business through PE in India, then remunerating the agent at arm's length is irrelevant. The assessee's reliance on the decision of the Hon'ble Supreme Court in the case of DIT vs Morgan Stanley and Company Inc., reported in 292 ITR 416 is misplaced as the Hon'ble Supreme Court has observed in clear terms that the Indian company engaged by the non-resident assessee company had no authority to enter into or conclude contract and that the Indian company was engaged in supporting the front office functions of the USA company for providing research and IT enabled services such as data processing support centre and technical services and in light of those facts, it was held by the Supreme court that it would not constitute a fixed place/permanent establishment under article 5(1) of Indo US DTAA. In our humble view the said decision is not applicable in the facts of the present case.

25 Similarly, in the case of SET Satellite (Singapore) Pvt Ltd vs DDIT reported in 307 ITR 205, it was observed by the Hon'ble jurisdictional High Court that the contracts to sell are made outside India; and the sales are made on a principal-to-principal basis and when the agent in India was remunerated on ALP principle, which is more than the profit computed under the provisions of the Act, then advertisement revenue received by the assessee was not taxable in India.

26 As it is clear from the facts in the case in hand that the assessee has carried out the business in India and the agent was concluding the contract

which is legally binding on the assessee; therefore, remuneration paid to the agent is not relevant factor for taxing the profits and gain at source from India.

27 Apart from this, it is pertinent to take note as to why it was felt necessary to make the provision of Article 8 in the Indo-German DTAA when all business incomes are covered under Article 7. There is no doubt that the profits from operation of ships and aircraft including in international traffic is business profits of the enterprise as the term used in Article 7 of Indo German DTAA. Thus, Article 7 covers all business profits and taxable only in the contracting state of domicile except in case of PE in another contracting state. Article 8 creates an exception to the rule of PE and makes the profit from operation of ships and aircrafts in international traffic taxable only in the contracting state of domicile even if the assessee has a PE in another contracting state. Therefore, a special treatment has been given to the profits from operation of ships and aircrafts in international traffic to be taxed only in state of domicile in exception to Article 7.

28. In view of the above discussion, we conclude that profits from participation of cargo under “Slot Arrangement” are not eligible for benefit of Article-8 of Indo-German DTAA and that the assessee has an agency PE in India. Now, the next question is what is the profit that is attributable to the PE? It is well settled that only such profit that is attributable to PE can be brought to tax in India. In this case, neither the Assessing Officer nor the DRP have undertaken this exercise. Thus, for this limited purpose, we set aside the matter to the file of Assessing Officer for denovo adjudication in accordance with law. Thus, the additional ground no.1, is partly allowed.

29 Next issue is regarding levy of interest u/s 234B. Since the levy of interest is consequential in nature; therefore, the same is dismissed in view of our findings on the other grounds of the appeal.

30 Last issue regarding initiation of penalty proceedings.

31 This issue is premature, as before passing the order of levy of penalty u/s 271(1)(c), the initiation cannot be challenged directly before the Tribunal; accordingly the same is dismissed.

32 In the result, the appeal filed by the assessee is partly allowed.

Order pronounced on the 7th day of Mar 2012.

Sd/	Sd/-
(J SUDHAKAR REDDY) Accountant Member	**(VIJAY PAL RAO)** Judicial Member

Place: Mumbai : Dated: 7th Mar 2012

Raj*

Copy forwarded to:

1	Appellant
2	Respondent
3	CIT
4	CIT(A)
5	DR

/TRUE COPY/
BY ORDER

Dy /AR, ITAT, Mumbai