

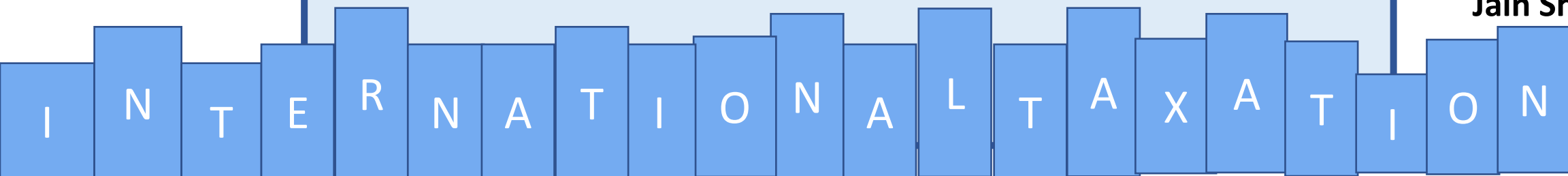
Series on Article 8 – Profit arise from shipping and Air Transport

PART-I

Basic Terminologies used in the Article 8 for understanding the taxability on profit from operation of ships or aircrafts

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Overview of what is covered in Article 8

(1) Profits derived by an enterprise of a Contracting State from the operation by that enterprise of ships or aircraft in international traffic **shall be taxable only in that State.**

- ❑ Until 2017 **profit arising** from operation of ships or aircrafts in international traffic, **taxable to the state where POEM was situated.** It also provided an option of taxation to the state of residence.
- ❑ However, in 2017 both the OECD and UN MC modifies Article 8 and provides that **profit from operation of ships or aircraft in international traffic shall be taxable only in the state of enterprise i.e. state of residence.**
- ❑ India signed tax treaty with country (i.e. Zambia) that does not contains the specific article on shipping then in such cases, rights of states to taxability of profits of ship as per the Article 7 (Business profits) or Article 22 (Other Income).

Meaning of term 'Ship'

❑ As per OECD 2017:

It provides wide meaning that covers any vessel used for water navigation

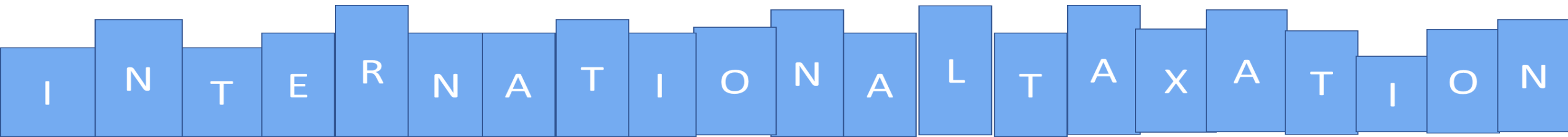
❑ As per Dictionary:

The term 'ship' means a type of vessel used or intended to be used in navigation and includes every description of a vessel used in navigation not necessarily propelled by oars.

❑ General Parlance:

The term 'ship' means any large sea going vessel that carries passenger or cargo.

❑ Oil rigs, platforms, pontoons and fishing vessel may not be termed as ships since they do not serve the purpose of transportation from one place to another



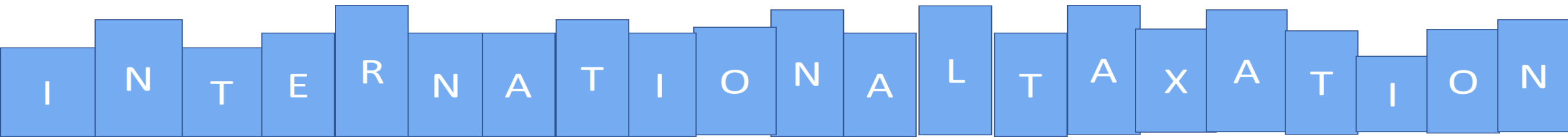
Meaning of term 'Ship'

□ India-Canada Treaty:

The India-Canada treaty specifically provides that Article 8 shall not apply to a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers.

□ Section 115VD of Income Tax:

For the purpose of section 115VD, definition of 'Qualifying ship' specifically excludes fishing vessels and offshore installations. Further, Bombay High Court in case of DIT(international taxation)v. Balaji Shipping UK Ltd. held that definition of Qualifying ship in chapter XII-G are for the purpose of that chapter only



Meaning of term 'Aircraft'

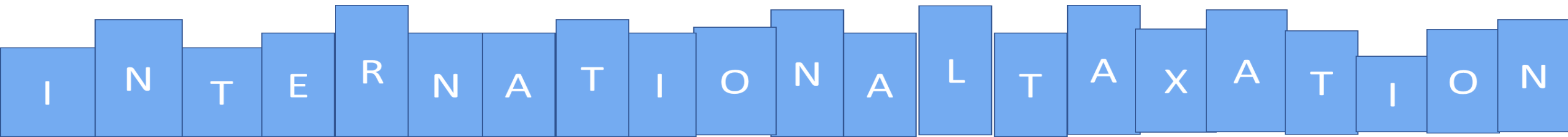
The term aircraft has not been defined term aircraft has not been defined either under the Act or under the MC.

□ Klaus Vogel:

The term aircraft covers all flying machines that takes off from, or touch down on, water or land and are capable of moving in air space. Space craft may also be included under the term, if they provide transportation such as the space shuttle.

□ Authority for Advance Ruling:

AAR observed that the term aircraft understands within it any structure or machine designed to travel through air with the possible exception of hovercrafts. Further, AAR observed that business of plying 'helicopters' would be business of operation of aircraft. Therefore, based on the combined reading of all the definitions, the Tribunal observed that an aeroplane would be covered within the definition of 'aircraft'.



Meaning of term 'Operation of Ship'

The term 'operation' has not been defined or explained under the Act or under any of the MC. It has however been clarified under the OECD MC commentary that the operation of ships or aircrafts by an enterprise could be either in the capacity of an owner, lessor or in any other capacity

In few tax treaties entered into by India, the term "operation of ships" has been defined (e.g. treaties with Brazil, Belgium, China, Mauritius, Singapore, USA. It defines that business of transportation of persons mail, livestock or goods carried on by the owners, lessees or charterers of the ships including the sale of tickets for such transportation on behalf of other enterprises.

I N T E R N A T I O N A L T A X A T I O N

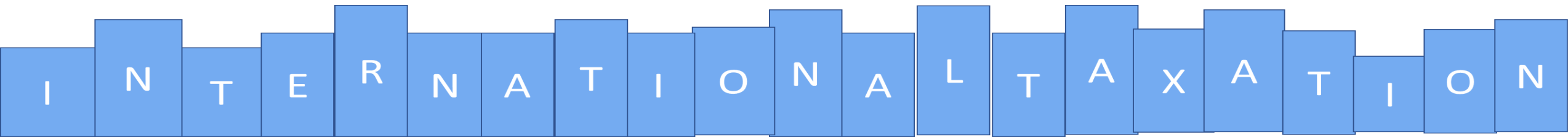
Article 8- PROFIT FROM OPERATION OF SHIPS OR AIRCRAFTS

•Article 8 of both the **OECD** and **UN Model Tax Conventions** covers **income derived from the operation of ships or aircraft in international traffic**. The types of income generally covered under this article include:

1. Profits from the Operation of Ships or Aircraft:

•**Revenue from Passenger and Cargo Transport:** Income earned from transporting passengers or cargo between different countries (i.e., international traffic) is covered.

•**Charter Hire Income:** Profits from leasing ships or aircraft, provided that the leasing is incidental to the operation of the enterprise in international traffic.



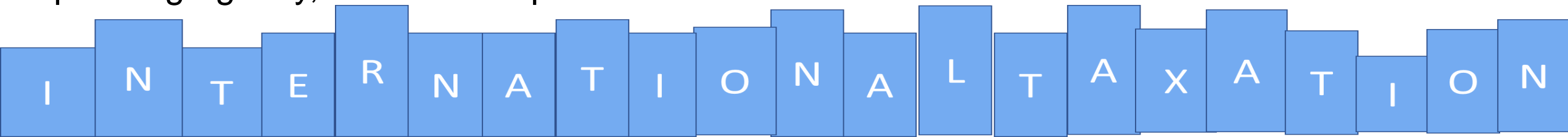
Article 8- PROFIT FROM OPERATION OF SHIPS OR AIRCRAFTS

2. Incidental Income:

- The conventions also cover income that is incidental to the operation of ships or aircraft in international traffic, such as:
- **Income from the rental of containers** used for the transport of goods in international traffic.
- **Profits from the leasing of ships or aircraft on a bareboat or time-charter basis**, but only if the leasing is incidental to the enterprise's primary activity of operating in international traffic.

3. Income from Pools, Joint Businesses, or International Operating Agencies:

If an enterprise is part of a shipping or airline pool, joint business arrangement, or international operating agency, the share of profits it derives from such activities is also covered.



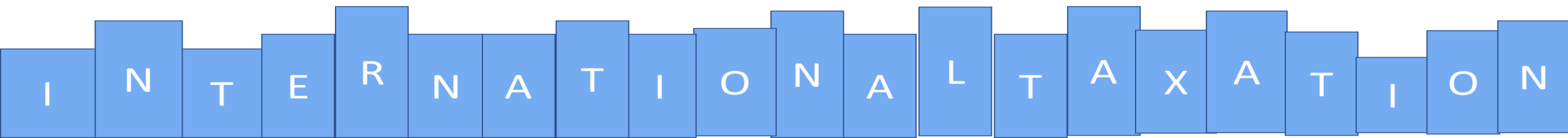
Article 8- PROFIT FROM OPERATION OF SHIPS OR AIRCRAFTS

Examples of Covered Income:

- **Ticket sales** for international flights or voyages.
- **Freight charges** for cargo transported across borders.
- **Profits from the leasing** of ships or aircraft if the leasing is connected to the enterprise's international operations.
- **Income from ancillary services**, such as the transport of goods in containers or even some related repair or maintenance services for ships and aircraft.

Exclusions:

- **Domestic Traffic:** The article does not cover income from transport solely within one country (i.e., domestic transport).
- **Stand-alone leasing operations:** If the leasing of ships or aircraft is not connected to the operation of the business in international traffic, such income may not be covered under Article 8.



Meaning of term ‘International Traffic’

The term “international traffic” means-

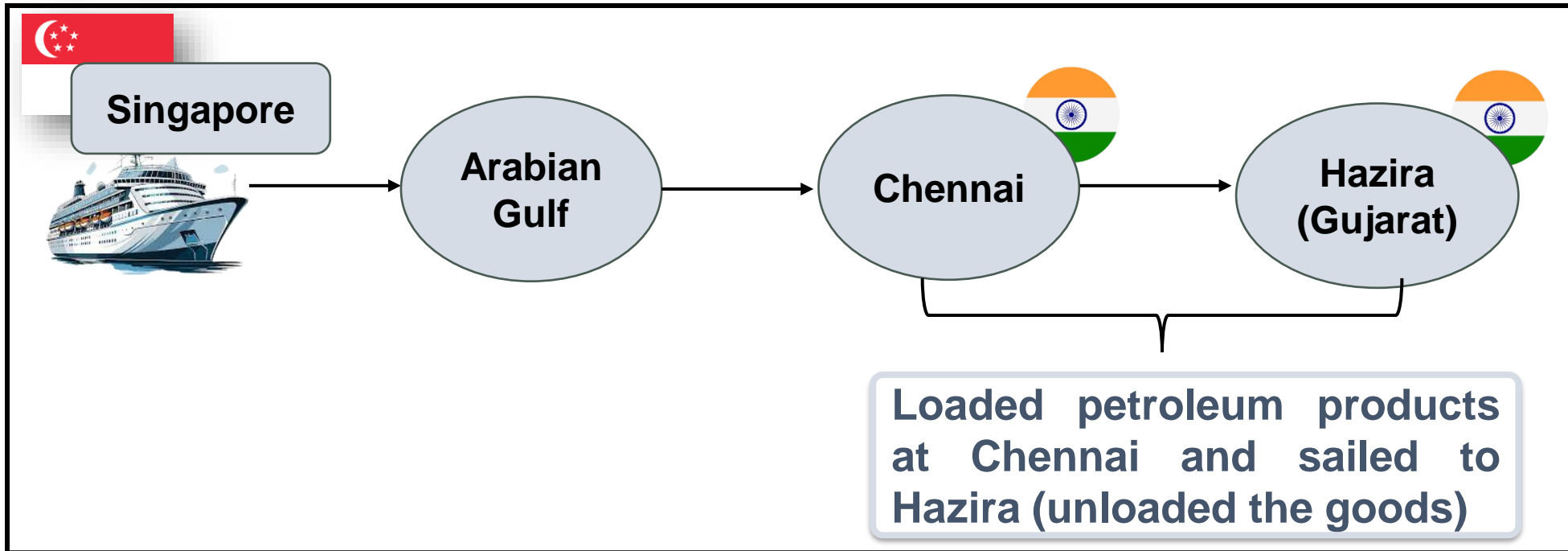
- ❑ any transport by a ship or aircraft,
- ❑ Other than **operated solely between places in other contracting state** and
- ❑ enterprise operates the ship or aircraft has place of effective management in contracting states

i.e. any **ship or aircraft** are plying within the source state the it can't be said to be operating in international traffic.



Case law on International Traffic

Essar Oil Ltd. v. Deputy Commissioner of Income-tax [2006] 5 SOT 669 (Mumbai)



The whole case of destination revolves round the expression 'solely'. If any ship is operated by a non-resident, it shall be considered to have operated in international traffic even after it is operated between two places in India by chance or along with other voyages.



Meaning of term 'Place of Effective Management'

As per the various guidelines for determination of the POEM following can be considered:

- The place where the meetings of the person's board of directors or equivalent body are usually held.
- The place where the chief executive officer and other senior executives (KMP) usually carry on their activities.
- The place where the actions to be taken by the entity as a whole are determined.
- The place where the person's headquarters are located.
- The place where corporate books are located.
- The country's laws govern the legal status of the person

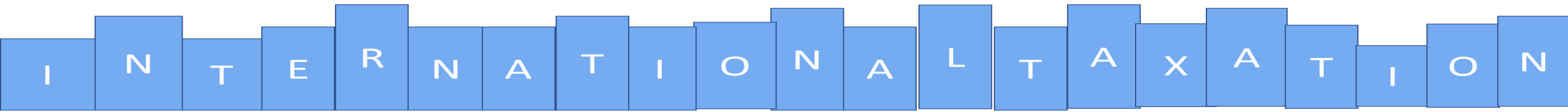


Meaning of term 'Place of Effective Management'

In most of the treaties entered into by India, income from shipping and air transport is taxable in the State where the POEM is situated e.g. treaties with Brazil, Denmark, Germany, Mauritius, Netherlands etc.

In a few cases, it is taxable in the country of residence of the enterprise e.g. Treaties with Armenia, Belgium, France, Italy, Singapore, UK, USA. In some cases, dual residence arises when two States use different principles to ascertain the tax residence of one and the same enterprise. Dual residence may arise when tax residence is determined by one State on the basis of "residence" and the other on the basis of "POEM".

Countries following the OECD Model in such cases, will apply the tie-breaker rule [Article 4(3)] to resolve the dual residence conflict.





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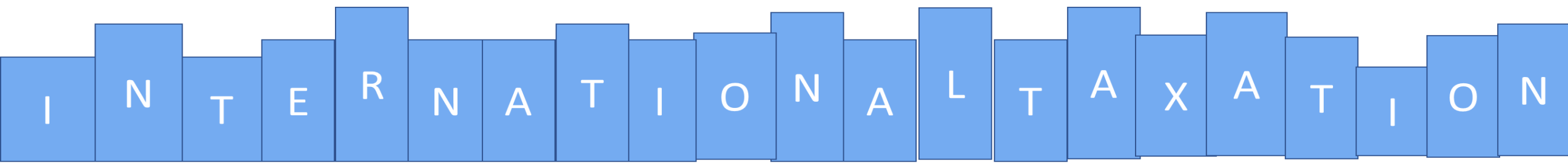


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