

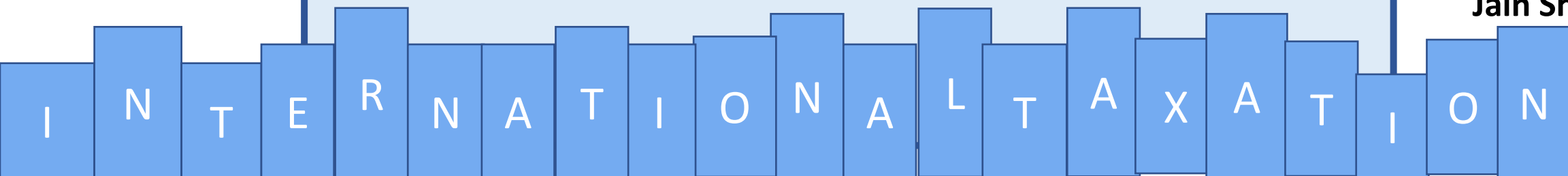
## Series on Article 8 – Profit arise from shipping and Air Transport

PART-III

**Understanding Article 8 of OECD and UN Model conventions for the taxability on profit from operation of ships or aircrafts**

19.10.2024

Jain Shrimal & Co.



# Overview

In the previous two parts of series on Article 8, we have discussed about basic overview of Article 8 in which we explained the basic terminologies used in the Article 8 such as meaning of term 'Ship', 'Aircraft', 'Operation of ship', 'International Traffic' related to the income derived from shipping and Transport.

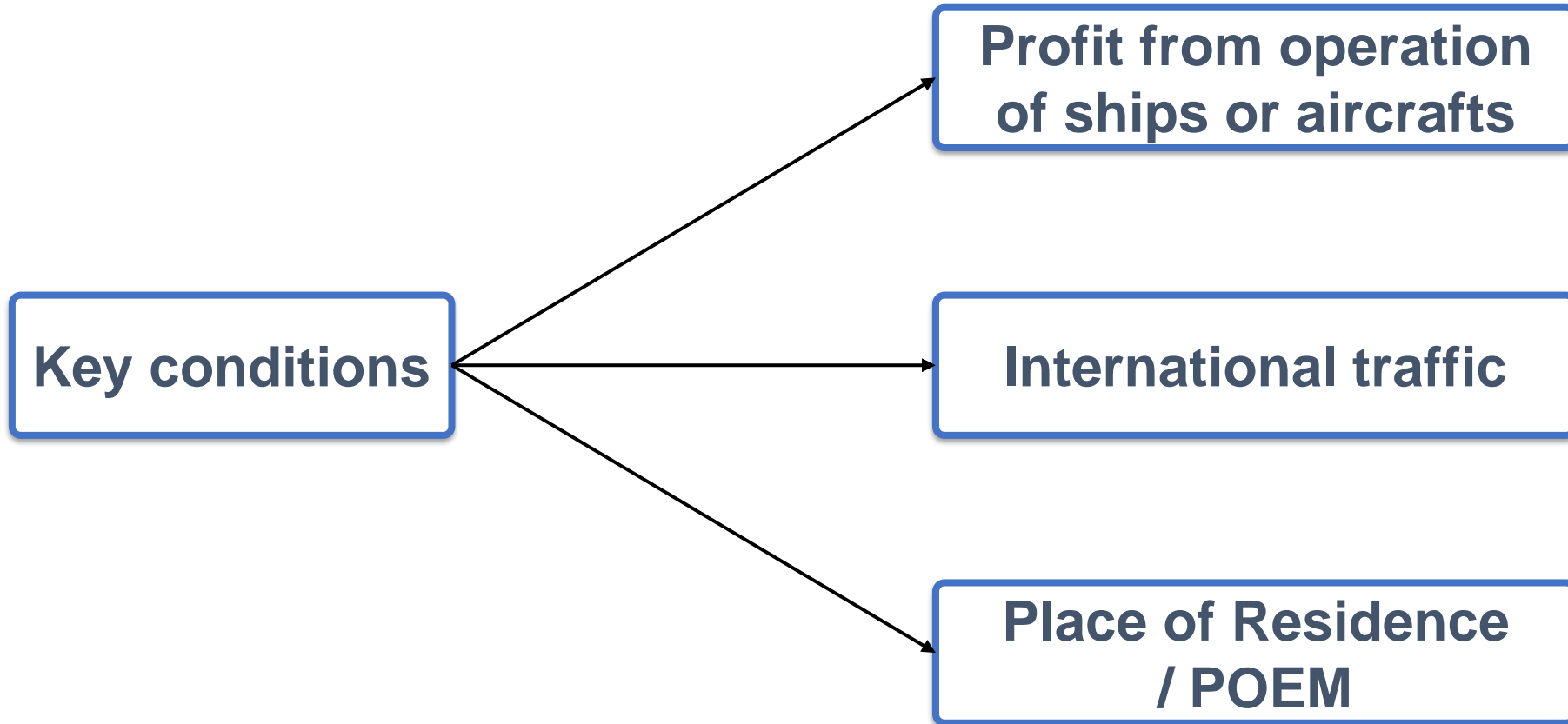
Further, we have discussed about the provisions of the income Tax Act i.e. 44B, 44BBA, 44BBC and 172 related to the profit arise from shipping and Air Transport.

In this current SITG, we explained the Article 8 of OECD and UN Based Model convention and case studies which relates to the taxability of income derived from shipping and Air Transport.

In the next and last part of this series, we will discussed about the Limitation of Relief (LOR) article of DTAA and countries DTAA related to Article 8



# Article 8(1) – Key conditions

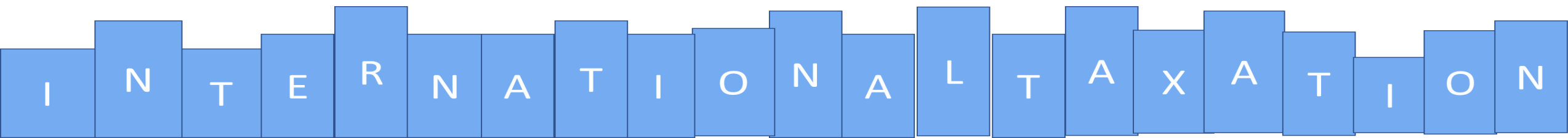


I N T E R N A T I O N A L T A X A T I O N

# Article 8- OECD MODEL CONVENTION

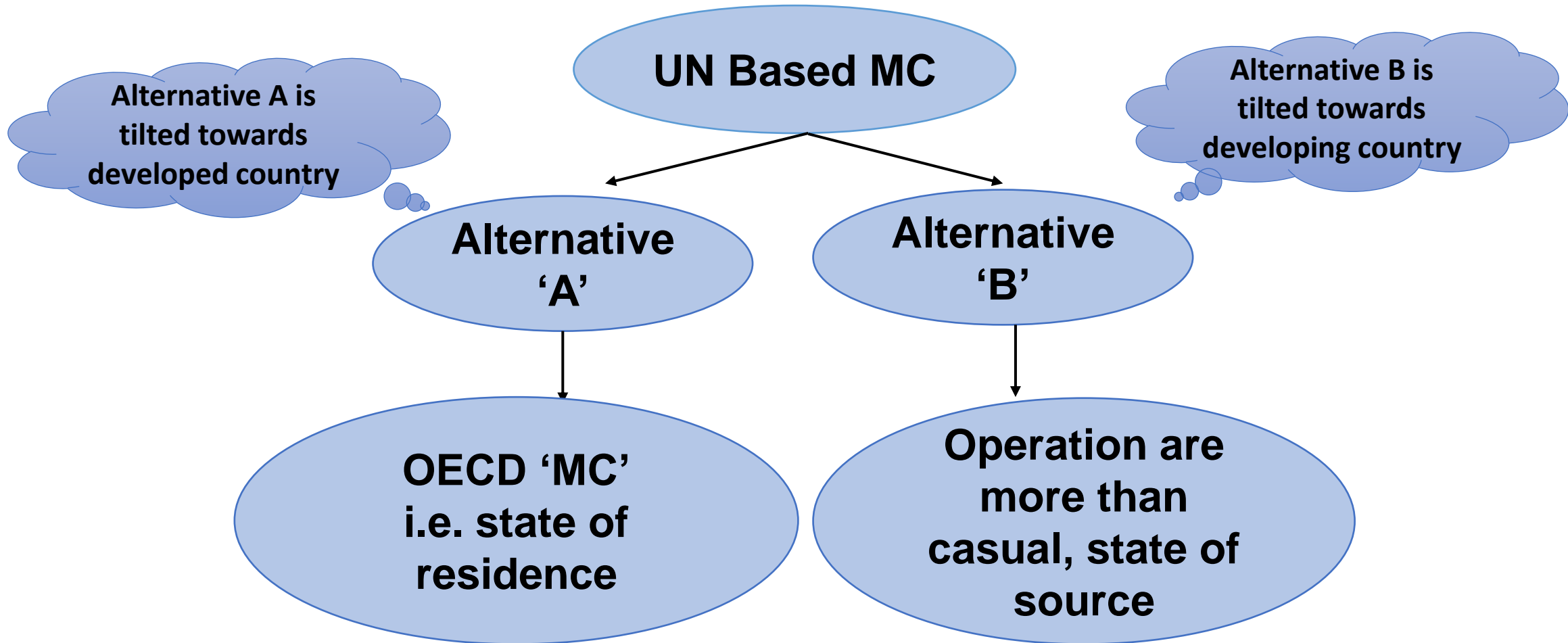
- (1) Profits from the operation of ships or aircraft in **international traffic** shall be taxable only in the Contracting State in which the **place of effective management of the enterprise is situated.**”
- (2) The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency

**\*Amended on 21 November 2017**



# Article 8 of the OECD and UN Model Conventions

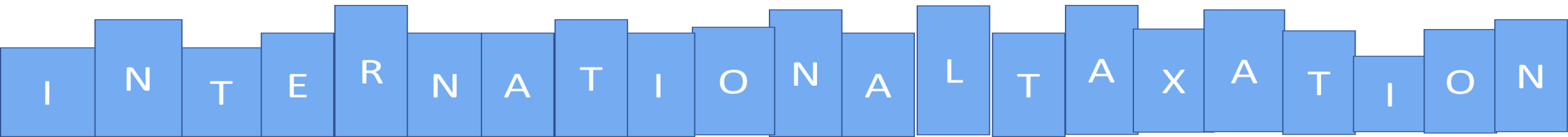
Article 8 of the OECD and UN Model Conventions deal with income from, shipping and air transport. Taxability of profit as per UN and OECD Based MC are as below:



# Article 8- UN MODEL CONVENTION

## Alternative A

- (1) Profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.
- (2) The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency.



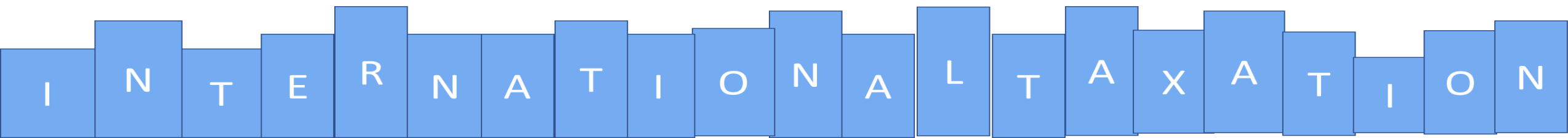
# Article 8- UN MODEL CONVENTION

## Alternative B

- (1) Profits of an enterprise of a Contracting State from the operation of aircraft in international traffic shall be **taxable only in that State.**
- (2) Profits of an enterprise of a Contracting State from the operation of ships in international traffic shall be taxable only in that State **unless the shipping activities arising from such operation in the other Contracting State are more than casual. If such activities are more than casual, such profits may be taxed in that other State.** The profits to be taxed in that other State shall be determined on the basis of an appropriate allocation of the overall net profits derived by the enterprise from its shipping operations. The tax computed in accordance with such allocation shall then be reduced by \_\_\_ per cent. (The percentage is to be established through bilateral negotiations.)
- (3) The provisions of paragraphs 1 and 2 shall also apply to profits from the participation in a pool, a joint business or an international operating agency

# Alternative B of UN Model Conventions

- ❑ Under alternative B, if operations are more than casual in the source state, the State of source gets right to tax its arm's length share of overall net profits of the enterprise. The taxation shall be at a rate of tax determined by bilateral negotiations.
- ❑ **The Hon'ble Mumbai Tribunal in case of James Mackintosh & co. (P.) Ltd. v. Asstt. CIT held that the expression 'more than casual', as used in the UN Model Convention, means scheduled or planned visits to a particular country and it includes 'regular and frequent' shipping visits, as also 'irregular and isolated visits', as long as the same are planned and not merely fortuitous, or, say, something happening completely by chance.**





# Case Study – 1 – Ancillary service

## **Query:**

An airline company AIR Airline operates a bus service for the passengers of its international flights. The bus service connects the town with the airport, thus providing access to and from the airport to the passengers of its international flights. It charges the passengers for using the bus service and earns income from sale of tickets. Would the income earned by providing bus service for the passengers of its international flights be covered under the provisions of Article 8?

## **Solution:**

The bus service provided by AIR Airline for the passengers of its international flights is a service which is so closely related to its business of operation of aircraft that it cannot be regarded as a separate business or source of income. Accordingly the income earned by AIR Airline for providing bus service for the passengers of its international flights should be covered under the provisions of Article 8.

# Case Study – 2 – Charter of Ship or Aircraft

## Query:

JKL Shipping is a company resident in Indonesia which is engaged in the business of leasing ships on bareboat charter basis. JKL Shipping leases a ship to an Indian company UVW Shipping under a 2 year agreement. As per the terms of the agreement, the responsibility of hiring crew and bearing the operating costs during the period of lease would be of UVW. UVW would make payment to JKL only for the lease rental of the ship. Will the lease rental income earned by JKL be covered under Article 8?

## Solution:

The agreement entered into by JKL and UVW is on a pure bareboat charter basis. Profits arising from a bareboat charter generally do not get covered under the provisions of Article 8 as it cannot be regarded as income from 'operation of ships' in international traffic.

As per the India – Indonesia DTAA, royalties under Article 12 include payments for the use of, or the right to use, industrial, commercial or scientific equipment. Thus, the lease rental received by JKL will partake the character of Royalty and be covered under Article 12 of the DTAA.



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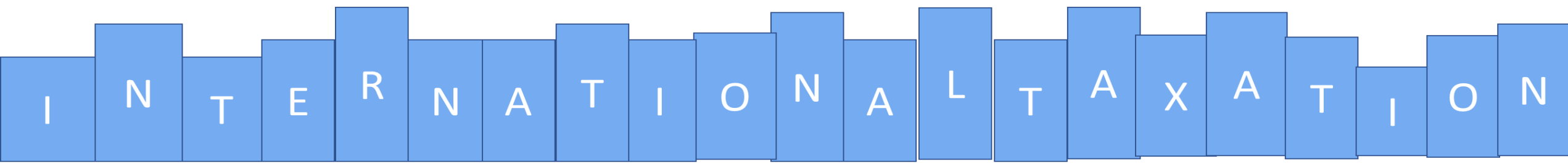


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