Tax Hotline

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TRIBUNAL RULES ON NON APPLICABILITY OF LOB CLAUSE; OBSERVES TIMING WHEN A TREATY NEEDS TO BE REFERRED

- Tax residency of company under India-UAE Treaty will be decided on basis where the company is controlled and managed from and not by reason of number of days the director stayed in UAE
- When an entity is established in 2000, and the relevance of the India-UAE Treaty comes into play only in 2015, it cannot be said that the "main purpose of creation of such an entity was to obtain the benefits" of the India-UAE Treaty.
- Taxpayer cannot be asked to prove a negative fact, especially when such facts are warranted to be proved by the documents which Taxpayer is not required to maintain statutorily.

In a recent decision,[1] the Mumbai bench of Income Tax Appellate Tribunal ("**ITAT**" or "**Tribunal**") has held that benefits of India UAE Double Taxation Avoidance Agreement ("**India – UAE Treaty**" or "**Treaty**") should not be denied to Interworld Shipping Agency LLC ("**Taxpayer**"). The Assessing Officer ("**AO**") and Dispute Resolution Panel ("**DRP**") held that the Control and Management ("**C&M**") of Taxpayer was not wholly in UAE and denied Treaty benefits. The ITAT rejected their orders and held that no income of Taxpayer would be taxable in India in light of the India UAE Treaty.

BACKGROUND

The Taxpayer is a Limited Liability Company incorporated in the UAE, engaged in providing services such as ship chartering, freight forwarding, sea cargo services, ship line agents, etc. The amount received by Taxpayer for the above services, was considered by AO to be taxable in India. However, the Taxpayer claimed that it being a tax resident of UAE, as per Article 8[2] of the Treaty profits derived from operation of ships in international water should be taxable only in UAE.

The AO did not accept claim of the Taxpayer and observed as follows:

- As much as 80% of the profits of the Taxpayer went to one Greek national, hence C&M of the Taxpayer was not wholly in UAE.
- The Taxpayer was a partnership firm and the Tax Residency Certificate ("**TRC**") and no objection certificate held by Taxpayer was of no support, being obtained by misrepresentation of facts.,
- AO applied 'look at' approach and noted that TRC of actual beneficiaries i.e. the partners were not provided during the assessment stage, and accordingly held that Taxpayer was not resident of UAE.

The DRP confirmed AO's order and observed as follows:

- Since there is no taxation in UAE in general, it provides opportunity to do treaty shopping.
- The Taxpayer provided sufficient evidence of being a company under laws of UAE and even the revenue did not dispute this fact during proceedings DRP.
- The C&M of Taxpayer was considered solely in hands of the Greek national on two grounds – (a) powers of director(s) with respect to responsibility of management was limited; and (b) there was change in Memorandum of Association ("**MoA**") for year ending 2014-15, compared to 2004-05, with respect to remuneration of directors.
- No details were provided by the Taxpayer for residency of Greek national. Further, post 2012 amendment in the Income Tax Act, 1961 ("**ITA**"), TRC is a necessary but not sufficient condition of availing treaty benefits. The TRC of the Taxpayer should be ignored and the C&M should be proved to be wholly in UAE for the Taxpayer to claim benefits of Treaty.
- The Taxpayer provided no evidence that the Greek national operated the company wholly from UAE, hence no infirmity was found in AO's reliance upon Limitation of Benefit clause ("**LOB clause**") in Article 29 of the Treaty.

Aggrieved by the above, the Taxpayer appealed before the Tribunal.

RULING

The ITAT ruled in favour of the Taxpayer and held that no income was liable to tax in India as per the Treaty, on the following grounds –

- The Tribunal rejecting the arguments of the AO and DRP held that the Taxpayer had its C&M was in UAE and there were no grounds to hold otherwise. It reached the conclusion on the basis that the Taxpayer had its office in UAE

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was in business in UAE since the year 2000 and also has several employees who are on work permit in UAE and there was sufficient evidence provided in this behalf by the Taxpayer.

- The Tribunal rejected the argument of the AO that since the Taxpayer did not have relevant documentation it C&M was not in UAE. The Tribunal observed that the fact that Taxpayer does not have certain documents, which it is statutorily is not required to prepare, cannot be held against him. Placing reliance on the decision of the Supreme Court in the case if *KP Varghese v. ITO*[3], the Tribunal ruled that a Taxpayer cannot be asked to prove a negative and the in the present facts, the burden of proof is on revenue authority to show that the C&M of Taxpayer was not in UAE.

- The main purpose of incorporating the entity could not have been to obtain Treaty benefits. On this aspect the Tribunal ruled that the Taxpayer was incorporated in the year 2000 whereas the income which was being claimed as not taxable under the Treaty was earned in the tax year 2015 – 2016 and hence it cannot be considered that the Taxpayer was 'incorporated' with the main purpose of obtaining treaty benefits. Accordingly, the LOB clause under the Treaty should not be applicable to the Taxpayer.

On basis of the above reasoning, the Tribunal held that the Taxpayer is resident of UAE and accordingly benefits of the Treaty should be provided to the Taxpayer i.e. income from operation of ships in international water should be taxable only in UAE.

ANALYSIS

The Tribunal ruled in favour of the Taxpayer as it observed that the Greek national stayed in the UAE for 300 days in the relevant year, whereas this fact was not considered by the AO or DRP. However, the judgment clarifies that the director's time period of stay in UAE is irrelevant for determining residential status of a company. It was observed that the conditions for a company to be resident of UAE under Article 4(1) of the Treaty is incorporation in UAE and C&M should be wholly in UAE. The Tribunal observed that the 183 days stay requirement is for individuals only and not directors of the company. Hence, even if the directors of the company stayed for less than 183 days in UAE but the C&M was wholly in UAE i.e. conduct of Board Meetings, taking key commercial decisions in UAE etc. then also the company would be resident in UAE.

The ruling provides guidance on what is the relevant time when the Treaty should be looked at. In the present case, the relevant time was not in the year 2000 but when the income was earned in the year 2015 by the Taxpayer. In this context, in M&A transactions, it becomes important to consider what is the relevant time for application of the treaty to claim that treaty benefits should not be given.

An observation was made by the AO and DRP that post amendment by Finance Act, 2012 TRC is a necessary but not a sufficient condition for claiming treaty benefits. However, in this context it should be noted that by way of a Press Release dated March 1, 2013, the Ministry of Finance has already clarified that *"the Tax Residency Certificate produced by a resident of a contracting state will be accepted as evidence that he is a resident of that contracting state and the Income Tax Authorities in India will not go behind the TRC and question his resident status*." Therefore, the TRC should act as a sufficient proof and the residential status of an entity should not be questioned by the Indian tax authorities.

Additionally, it is trite law that corporate veil can be lifted only if an entity was set up with an intent to defraud or the transaction that is carried out is a sham or done in a manner to avoid taxes. Therefore, lifting of the corporate veil by tax authorities in transactions wherein there is no fraud or colourable device is against the law of the land. Even the Tribunal observed that Taxpayer was engaged in the shipping business since year 2000, hence the prior conduct of the Taxpayer should be taken into account before any efforts are made for lifting of the corporate veil.

– Vibhore Batwara, Ashish Sodhani & Parul Jain
You can direct your queries or comments to the authors

[1] ITA No. 7805/Mum/19

[2] Article 8 of India UAE Treaty provides that profits arising to an entity from operation of ships in international traffic should be taxable only in its state of residence.

[3] (1981) 131 ITR 587 (SC)

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