

# What's New

## Tax Insights



20 January 2023

### Time charter hire charges taxable as profits of shipping business and not 'royalty'

#### In brief

In a recent decision<sup>1</sup>, the Mumbai bench of the Income-tax Appellate Tribunal (Tribunal) held that time charter hire charges (TCHC) for the vessel (equipment) are taxable in India as shipping profits under the presumptive scheme of taxation of section 44B and not as 'royalty' under the provisions of the Income-tax Act, 1961 (the Act). In holding so, the Tribunal relied on the contractual arrangement between parties which, *inter alia*, indicated that the ownership, control and possession over the vessel continued to remain with the owner.

#### In detail

##### Facts

- The taxpayer, a UAE-based company, is engaged in the business of shipping operation.
- The taxpayer (owner) had entered into a time charter agreement (TCA) with an Indian company (ICo or charterer) for transporting coal between two Indian ports for a period of 13 months in consideration for TCHC.
- The taxpayer had, in turn, chartered the vessel from a Dubai-based company on a time-charter basis.
- The taxpayer had disclosed the TCHC earned under the TCA as income from shipping business and offered 7.5% of gross receipts to tax under section 44B of the Act.
- The Tax Officer considered the TCHC as receipt for 'use or right to use the vessel' by way of leasing or letting out and held it to be taxable as royalty under section 9(1)(vi) of the Act.

##### Issue before the Tribunal

- Whether the TCHC should be taxable as shipping profits under section 44B or as 'royalty' for use of equipment in terms of Clause (iva) to Explanation 2 to section 9(1)(vi) of the Act?

<sup>1</sup> ITA No. 1857/Mum/2022

## Revenue's contentions

- Revenue relied on the judgment of the Madras High Court<sup>2</sup> in the case of M/s. Poompuhar Shipping Corporation Limited wherein it was held that TCAs are essentially for the use and hire of ships (being an equipment), and the amount received is not for carriage of goods.
- As per the TCA, ICo had the vessel at its disposal except for space required for officers and crew, control over the officers, master and crew who act according to the instruction and directions of the ICo, expenses of usage were to be paid by the charterer.
- Revenue contended that the taxpayer was merely letting out the vessel on hire for 13 months and was receiving a fixed amount irrespective of whether or not the vessel was being used by the charterer.
- As the receipts were not for carriage of goods, but for the use and hire of the ship (equipment), TCHC is to be treated as royalty under section 9(1)(vi) of the Act.

## Taxpayer's contentions

- The taxpayer is engaged in the business of operation of ships; therefore, income derived from the business of operation of ships has to be taxed under section 44B of the Act.
- Various clauses of the TCA provide that the owner was in possession, ownership and control of the vessel and was responsible for the crew, vessel stowage plan, loading and stowing of cargo was to be made under the Master's (appointed by owner) supervision and control, freight was computed based on the quantity loaded, owner of the vessel was obliged to keep the vessel and the crew up to date with complete certificate, approvals and equipment enabling the vessels to carry the cargo, owner had the liberty of flying their own house flag, etc.
- Thus, the receipt of income cannot be treated as receipt for use or right to use the equipment.

## Tribunal's ruling

- The Tribunal analysed various clauses of the agreement and observed the following:
  - The owner was responsible for the wages, salaries for crew, insurance and stows and for counselor shipping and maintaining the vessel in a proper state. Thus, the taxpayer was in possession, ownership and maintenance of the vessel.
  - The vessel was at disposal of the charterer such that it could not be made available to any other party during that period.
  - TCHC was paid for the use and hire of the vessel per running day calculated on the basis of loading and was to be reduced pro-rata if the vessel was out of service or the load on the vessel gave rise to lesser loading capacity. Thus, it cannot be inferred that it is an outright TCA given on lease rent simplicitor to earn fixed rent.
  - Compensation for loss or damage for non-adherence to loading or breakdown of the vessel is on the owner's account.
  - Control of the charterer was only to the extent of exclusive use by the charterer to load and carry coal.
- The Tribunal further distinguished the decision of the Madras High Court<sup>2</sup> on facts as under:
  - TCHC received was not purely on account of giving use or right to use the ship to the charterer, as payment was not a fixed amount for the use of the ship for specified time but was calculated on per day basis and load capacity, which is a kind of voyage freight and is further evident from method of calculation of freight (on pro-rata basis) and dead freight.
  - The owner of the ship was not separated from the use of the ship nor granted the ship to the charterer.
  - There was no transfer of ship and control over navigation to the charterer.

<sup>2</sup> M/s. Poompuhar Shipping Corporation Limited v. ITO [2014] 360 ITR 257 (Madras)

- In light of the facts, the Tribunal concluded that all throughout, the control of the equipment remained with the taxpayer, and at no point of time did the owner transfer the vessel to the ICo for carriage of goods. Hence, the TCA was for carriage of goods and for operating ships and hence, taxable under section 44B of the Act.
- The Tribunal also held that the dominance or control over the ship by the charterer is paramount in determining the character of payment as payment of 'royalty', and in absence of the same, cannot be treated as royalty.
- The Tribunal relied on the coordinate bench ruling in Smit Singapore Pte Limited<sup>3</sup> wherein under similar circumstances, it was held that the TCHC receipts do not qualify as royalty.

### The takeaways

- This is an interesting ruling from the Tribunal in light of the ongoing controversy on taxability of TCHC for vessels as 'royalty'. The Tribunal, in the present case, has emphasised the aspect of control and possession over the vessel as also the mechanism for calculating the remuneration to determine whether the agreement was a lease simpliciter for the use or right to use of the ship. This ruling also throws light on the applicability of section 44B of the Act to the TCHC earned by foreign ship operators.
- In distinguishing the decision of the Madras High Court in Poempuhar's<sup>2</sup> case on facts, this decision has highlighted the significance of the contractual agreement between the parties. It may be noted that the Special Leave Petition in Poempuhar's case is pending adjudication before the Supreme Court and it would be interesting to see the developments at the Supreme Court.

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<sup>3</sup> M/s. Smit Singapore Pte Limited v. DCIT (ITA No. 7055/Mum/2017 order dated 09.11.2020)

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