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IN THE HIGH COURT OF JUDICATURE AT BOMBAY
ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.3024 OF 2009
WITH
INCOME TAX APPEAL NO.3215 OF 2009

Director of Income Tax
(International Taxation),
Scindia House, Ballard Estate,
Mumbai

....Appellant

V/s.

Balaji Shipping UK Ltd.
C/o.Shah Industrial Estate,
Off Deonar Village Road,
Deonar, Govandi,
Mumbai – 400 088.

....Respondent

Mr.Tejveer Singh with Mr.Suresh Kumar for the Appellant.

Mr.Porus F. Kaka, Senior Counsel with Mr.Divesh Chawla and
Mr.Atul K. Jasani i/b Mr.Atul K. Jasani for the Respondent.

CORAM : S.J. VAZIFDAR AND
M.S. SANKLECHA, JJ.
DATE : 6TH AUGUST, 2012.

JUDGMENT (PER S.J. VAZIFDAR, J.) :-

1. These appeals under section 260-A of the Income Tax Act, 1961 are against a common order of the Income Tax Appellate Tribunal dated 13.8.2008 in Income Tax Appeal Nos.1540/Mum/05 and 2392/Mum/06 pertaining to the Assessment Years 2001-2002

and 2002-2003.

2. By an order dated 29.9.2010, the appeal was admitted on the following substantial questions of law, which we would add, are also of considerable general importance :-

“1) Whether on the facts and circumstances of the case and in law the income of the assessee by way of slot chartering would form a part of income from operations of ships exempt under Article 9 of the Tax Treaty between India and UK ?

2) Whether the income of the Respondent on account of slot chartering and use of containers in India is taxable under Section 44 B or 28 to 43 of the Act ?”

3. As regards the second question, we have proceeded on the basis of the appellant's case that income on account of slot chartering is taxable under section 44B. The question is answered accordingly as regards income from slot chartering. It is not necessary to answer the question in respect of income from use of containers as the respondent's case does not concern the same.

4. The CIT (A) dealt with the appeals filed by the respondent in separate orders. The Tribunal dealt with the appellant's appeals and the respondent's cross-objections by a common order.

5. The respondent - assessee is incorporated in the United

Kingdom and is engaged inter-alia in the international transportation of goods by sea.

The facts of Income Tax Appeal No.3024 of 2009 pertaining to A.Y. 2001-2002 are these. The respondent filed its return of income on 5.10.2001 declaring a total income of Rs.3,00,25,837/-. It showed gross receipts pertaining to freight in the sum of Rs.40,03,44,489/-. Relying upon section 44B of the Act, the respondent computed its profits and gains chargeable to tax at 7.5% of these receipts to be Rs.3,00,25,837/-. The respondent claimed exemption under Article 9 of the *“Convention between the Government of the Republic of India and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains”* (hereafter referred to as the India-UK DTAA or the DTAA).

6. The Assessing Officer held that the respondent was not entitled to the benefit of the DTAA.

7. The Commissioner of Income Tax (Appeals) and the Tribunal however, held the respondent to be entitled to the benefit of the DTAA.

8. The respondent owned 5226 containers and had leased 2767 containers and used them in the course of its business. The

respondent issued bills of lading to its customers for carriage of cargo from India to international ports. The vessels chartered by the respondent did not ply within Indian territorial waters. The respondent therefore, entered into Slot Hire Agreements (or Connecting Carrier Agreements) with M/s.Orient Express Lines Limited (OEL), Mauritius, under which OEL provided container slot spaces to the respondent on its ships (feeder vessels) on an as and when required basis. Availing the slot hire facility, the respondent arranged for the transportation of the goods from ports in India to their final destinations being international ports or to hubs, also ports outside India, from where the vessels chartered by the respondent carried the cargo onwards to the final destination.

The respondent had entered into a charter party agreement with M/s.Littleton Service Inc. in respect of the vessel Orient Aishwarya on which presumably the cargo was transported from the hub ports outside India to the final destination, also to ports outside India. The voyages from India to the final destination or to the hub ports was pursuant to the Slot Hire Agreements. The respondent admittedly earned freight of Rs.38,12,57,139/- out of the Slot Hire Agreements which the Assessing Officer has taxed.

9. The facts relating to the A.Y. 2002-2003 according to the respondent are these :-

The respondent declared a total freight of Rs.71,27,91,727/- from the business of operation of ships and claiming the benefit of Article 9 of the DTAA, filed a nil income return. The respondent carried on its business of transporting the cargo between the ports of India and abroad. The India operations were in the Gulf and the far eastern sectors by using the chartered vessels or availing container slot spaces on vessels owned or chartered by other operators pursuant to Connecting Carrier Agreements. The Connecting Carrier Agreements were entered into by the respondent with OEL, Bengal Tiger Line, GMBH, Germany, Oram Shipping(S) Pte Ltd. Singapore and Shreyas Shipping Limited. The respondent had also chartered two vessels - "Orient Stride" and "Trade Fast" from M/s.Balaji Shipping UK Limited, Dubai and M/s.Orient Express Lines, Mauritius respectively. The respondent owned about 5200 containers and had leased about 2750 containers.

A part of the cargo collected from the Indian ports was delivered to the ports outside India directly availing the slot hire agreements. A part of the cargo was also shipped from the Indian ports availing the slot hire agreements to the hubs outside India from where the same were carried to the ultimate destinations also abroad on vessels hired by the respondent. The bills of lading were however, always issued by the respondent in its own name and

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payment for transportation of the cargo even by connecting carriers on the feeder vessels was made by the respondent. The appellant, as directed by the CIT (A) furnished the details of the cargo collected from the Indian ports in respect of each connecting carrier / charter party agreements as under :-

S.No.	Name of the party connecting carrier / charter party agreement	Port	Amount	Total
1	Orient Express Lines	Mumbai Kandla Chennai Cochin Tuticorin	22,88,43,843 3,94,28,724 2,08,09,081 2,37,48,923 3,16,18,554	
2	Bengal Tiger Line, GMBH	Chennai Cochin Tuticorin	40,52,052 7,92,628 10,47,843	
3	Balaji Shipping (UK) Ltd. <u>Chartered vessel</u> – Orient Stride	Mumbai Cochin Tuticorin	54,68,858 62,55,476 89,31,665	<u>37,09,97,452</u>
4	Others eg. ACL, Integrated Container Feeder Service Samudera Express Container Lines	Mumbai Kandla Cochin Tuticorin	2,61,76,605 46,20,587 1,29,96,599 65,30,016	5,03,23,808
	Add : THC Collected as per Return of Income			72,559,736
	Add : Demurrage as per Return of Income			22,653,004
	Total Freight, Demurrage and THC			516,534,001

Thus income from the chartered vessels was Rs.37,09,97,452 and income from the utilization of the slot hire

facilities was Rs.5,03,23,808. Thus, more than 88% of the cargo from India had been carried on the vessels chartered by the respondent or through vessels for which the respondent had Connecting Carrier Agreements. The cargo collected from feeder vessel provided by the connecting carriers was further transported on the said vessels "Orient Stride" and "Trade Fast" chartered by the respondent.

10. There are thus certain relevant facts common to both the assessment years. The respondent had chartered ships. The respondent owned over 5000 containers and had leased over 2700 containers. The respondent carried on business of transporting goods from India to international ports availing the slot hire facilities obtained on feeder vessels under Connecting Carrier Agreements with the owners / charterers of the feeder vessels. In some cases the cargo was transported directly to the final international destination / ports availing the slot hire facilities. In some cases, the cargo was delivered to an international hub port from where it was further shipped to the final destination / port on the vessels chartered by the respondent. The bills of lading for the entire journey were issued by the respondent in either case.

11. The question that falls for consideration therefore, is whether the freight earned from or attributable to the portion of the

voyage utilizing the Slot Hire Agreements falls within the ambit of Article 9 of the DTAA.

12. Before referring to the provisions of the Act and the DTAA, it is necessary to understand the nature of Connecting Carrier Agreements which provide for the hire of container slot spaces. In Maritime Law (6th Edition) the author Christopher Hill states :-

“SLOT CHARTERPARTIES

This has reference to the carriage of containers, or to use current jargon, TEUs (20-foot equivalent units). The shipowner or operator 'rents out' or hires a 'piece' of space (a percentage of the total space available on the vessel) for carrying TEUs in return for which he receives hire calculated in accordance with the number of slots (accommodation for each TEU) payable whether or not those slots or spaces are actually used.

In his judgment in the Tychy (1999) 2 Lloyd's Rep.21) Clarke LJ said '..... there is no distinction in principle between a slot charter and a voyage charter of a part of a ship. They are both in a sense charterers of a space in a ship. A slot charter is simply an example of a voyage charter of part of a ship'. Clarke LJ further on in his judgment at p. 22 gave his view that a slot charterer could even be described as *the* charterer of the ship, not merely a charterer.”

The reference to this commentary which in turn refers to the judgment is only to indicate what a slot charter is and that such agreements have been in use for decades. Needless to add that our reference to the same has no bearing upon Admiralty law including on the aspect of arrest of ships.

The assessment order sets out clause 2 of the Connecting Carrier Agreement between the respondent and OEL, which reads as under :-

“2(a) The Carrier has offered container slots space to the Line (respondent) and the Line (respondent) has accepted to use such space on as/when required basis.”

13. The Assessing Officer observed as under :-

“Thus, in the final analysis, the matter rests on the determination of the following question of fact ;
“Whether the assessee operates a ship(s) in international traffic of goods etc., or not ?’ All other issues depend upon the resolving of this basic issue. As has been shown above, the assessee can be said to be operating ships in international traffic, in the case of the vessel orient Aishwarya only. As regard to its receipts from freight etc. pertaining to other vessels, it has to be mentioned that those vessels are not operated by the assessee. The assessee is not using its containers as an independent business, but those containers are integral part of its business of

transporting the containers on slots provided by the connecting carrier. Thus, separate income of the assessee on this account can not be quantified. Even otherwise, such quantification has not been provided by the A.R. of the assessee.

On the basis of the above, it is held that, Article 9 of the DTAA is not applicable in the case of the assessee except in the case of the receipts as arising from the operation of the vessel Orient Aishwarya.”

Accordingly the AO computed the income at Rs.2,87,22,050/- by applying the net profit rate at 7.5% on the total freight of Rs.38,29,60,671/- arising from the slot hire portion of the voyages.

14. Article 9 of the DTAA reads as under :-

“ARTICLE 9 – Shipping

1. Income of an enterprise of a Contracting State from the operation of ships in international traffic shall be taxable only in that State.

2. The provisions of paragraph 1 of this Article shall not apply to income from journeys between places which are situated in a Contracting State.

3. For the purposes of this article, income from the operation of ships includes income derived

from the rental on a bareboat basis of ships if such rental income is incidental to the income described in paragraph 1 of this Article.

4. Notwithstanding the provisions of Article 7 (Business profits) of this Convention, the provisions of paragraphs 1 and 2 of this Article shall likewise apply to income of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise.

5. The provisions of this Article shall apply also to income derived from participation in a pool, a joint business or an international operating agency.

6. Gains derived by an enterprise of a Contracting State from the alienation of ships or containers owned and operated by the enterprise shall be taxed only in that State if either the income from the operation of the alienated ships or containers was taxed only in that State, or the ships or containers are situated outside the other Contracting State at the time of the alienation."

15. The phrase "operation of ships" is not defined in the Convention. Nor is it defined in the Act. It has however admittedly been considered while construing section 44B. Article 3 (3) of the

DTAA reads as under: –

"3 (3). As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Convention."

16. Mr.Kaka submitted that income from slot hire agreements have always been taxed under section 44B. Mr Singh did not dispute this. He further stated that the revenue's case even today is that income from slot hire agreements are liable to be taxed under section 44B. If they are right, and we must in view of their statements accept that they are, the phrase in Article 9 (1) must be given the meaning ascribed to it in section 44 B as the context in which it is used does not require it to be construed differently.

17. Section 44(B) of the Income Tax Act, 1961 reads as under :-

"44-B. Special provision for computing profits and gains of shipping business in the case of non-residents.—(1) Notwithstanding anything to the contrary contained in Sections 28 of 43-A in the case of an assessee, being a non-resident, engaged in the business of operation of ships, a sum equal to seven-and-a-half per cent of the aggregate of the amounts

specified in sub-section (2) shall be deemed to be the profits and gains of such business chargeable to tax under the head "Profits and gains of business or profession".

(2) The amounts referred to in sub-section (1) shall be the following, namely:—

(i) the amount paid or payable (whether in or out of India) to the assessee or to any person, on his behalf on account of the carriage of passengers, livestock, mail or goods shipped at any port in India; and

(ii) the amount received or deemed to be received in India by or on behalf of the assessee on account of the carriage of passengers, livestock, mail or goods shipped at any port outside India.

[*Explanation.*—For the purposes of this sub-section, the amount referred to in clause (i) or clause (ii) shall include the amount paid or payable or received or deemed to be received, as the case may be, by way of demurrage charges or handling charges or any other amount of similar nature.)“

18. Article 9 (1) refers to "Income ... from the operation of ships ... ". Section 44B refers to profits and gains of "the business of operation of ships". The ambit of the identical phrases "operation of ships" in section 44B and Article 9 (1) is the same. This conclusion is

not arrived at by plucking out the three words from both the provisions and comparing them de hors the context in which they are used in the respective provisions. They are used in a similar context namely in the context of "income" [(as used in article 9 (1)] or "profits and gains" (as used in section 44 B) from the operation of ships. Both the provisions relate to the same subject namely taxation. The comparison between Article 9 (1) and section 44 B is, therefore, apposite and in accordance with the mandate of Article 3 (3) of the DTAA. The words not having been defined in the DTAA must be given the meaning which they have under the laws of India relating to taxes which are the subject of the Convention. Thus as income from slot hire agreements fall within section 44 B they must be held to be within the ambit of Article 9 (1).

19. Although what we have said thus far may indicate that income from slot hire agreements fall within the ambit of Article 9 (1) per-se we do not wish to go that far. We would restrict this judgement to cases such as those of the respondents in this case. In other words this judgement would not apply to assesseees who carry on the business of shipping cargo only by availing the slot hire facilities obtained by them.

In the present case the respondent admittedly is a charterer of at least two ships and owns and has leased a large

quantity of containers. The respondents income from slot charters is therefore only a part of its total income.

Further the respondent arranges for the transport of cargo availing the slot hire facilities acquired by it in two ways. Some of the cargo is transported directly to the final destinations abroad whereas some of it is transported to a hub port also outside India from where it is transhipped on vessels chartered by the respondent to the final destination.

20. The question whether the income attributable to a voyage undertaken from India by availing the slot hire facilities is liable to be taxed in India must, in this case, be addressed qua these two situations referred to.

Firstly, where the goods are transported by an enterprise by availing of the slot hire facility obtained by it on the ship of another from a port in India upto a hub port abroad and from there transporting the goods further to their final destination upon a ship owned or chartered or otherwise controlled by it. (We will refer to this as a case of first type).

Secondly, where the goods are transported by the assessee from a port in India directly to their final destination to a port abroad by availing a slot hire facility obtained by it on the ship of another. (We will refer to this as a case of the second type.)

21. Mr. Singh contended that in either case Article 9(1) would not be applicable as the voyages undertaken by availing the slot hire facility do not fall within the ambit of the phrase "operation of ships". In other words the appellant advocates a narrower interpretation of the phrase restricting it to cases where the cargo is transported only on vessels owned or chartered or otherwise operated by the respondents itself.

22. Mr. Singh did not dispute that income from slot hires are taxable under section 44B. He in fact stated that the slot hire charges have always been taxed under section 44B and that it is the Revenue's case even today that they fall within section 44B. The question is whether they also fall within Article 9(1) of the DTAA.

23. A case of the first type clearly falls within Article 9 of the DTAA.

Firstly, Article 9 does not require the ship to be owned by an enterprise / assessee. It merely requires the income to be "from the operation of ships in international traffic". There is no warrant for adding to the Article the requirement of the ship being owned by the enterprise. A charter is certainly contemplated by Article 9. So would an enterprise that controls the management/operation of the ship be included in Article 9 even if it does not own the ship. Such enterprises earn income from the operation of ships chartered or otherwise

controlled and managed by them. If Article 9 is to be construed narrowly, as suggested by the appellant, it would be denuded of much of its effect.

24. Slot hire agreements have been and remain a regular feature of the shipping industry for decades. Whether they constitute a charter of a portion of a ship or not is a different matter. In a case of the first type, the carriage of goods by availing of the slot hire facility is an integral part of the contract of carriage of goods by sea. Without it, the enterprise / assessee would be greatly hampered in its business in relation to international traffic, carriage of goods by sea. Enterprises operating in any mode or manner, do not always ply their ships all over the globe. Even if they do, their ships may not be readily available when required on a particular route in connection with a contract of carriage of goods. It is necessary, therefore in such cases for them to resort to slot hire agreements. This enables them to transport the goods not on behalf of the owner of the vessel which has granted them a slot hire facility, but in their own name on behalf of their clients. The contract of carriage of goods by sea is thus performed by such enterprises on a principal to principal basis with their clients and not as agents of the owners of the ships and/or their clients. The slot hire agreements are therefore, at least indirectly, if not directly, connected and interlinked with and are an integral part

of the enterprise's business of operating ships.

25. Without availing slot hire facilities, an enterprise would be unable to carry on its business of operating ships in international traffic at all in many cases. They may well loose much of their business. Even if business expediency is irrelevant to the interpretation of the DTAA, it indicates the close nexus between slot hires and the business of operation of ships in international traffic. If the DTAA is construed to include activities directly or indirectly connected to the operation of ships, it would include slot charters.

26. The second type of case poses some difficulty. We are, however, of the view that even such cases fall under Article 9(1). Article 9 would apply in respect of an enterprise that carries on the business of operation of ships in international traffic but for a valid reason is required to transport the cargo availing entirely a slot hire facility obtained by it on a ship of another. The illustrations we furnished in respect of the first type of case will also apply to these cases.

An enterprise may not ply the ships owned or chartered or otherwise controlled or managed by it in respect of certain routes. It would however, on account of the business exigencies, be required to carry cargo on such routes. Business expediency could arise on account of a number of reasons and different situations such as

obliging regular clients, or cultivating new ones. If it were not to do so, it may well loose clientele. Ships owned or chartered or otherwise controlled or managed by an enterprise may not be available on the particular route on a given day or for a particular period. The enterprise may already have entered into contracts or may even be required to enter into contracts for the carriage of goods on that route on that day or during that period. The trade would expect the enterprise to perform its contracts and/or ensure there is no break in its services. This it can do by availing slot hire agreements. Their refusal or failure to do so, may well affect their business and reputation adversely.

27. By availing the facility of slot hire agreements, the enterprise does not arrange the shipment on behalf of the owner of the said vessel, but does so on its own account on a principal to principal basis with its clients. Such cases also have a nexus to the main business of the enterprise of the operation of ships. They are ancillary to and complement the operation of ships by the enterprise. If they are not merely ancillary to the main business of operation of ships but constitute the primary and main activities of the enterprise, it may be a different matter, which we are not called upon to consider in the facts and circumstances of the present case.

28. Our view is supported by the judgment of a Division Bench of the Delhi High Court. It is also in consonance with the various commentaries which deal with similar provisions. We will now refer to the same.

29. Mr.Kaka relied upon the judgment of the Delhi High Court in *Director of Income-Tax .vs. KLM Royal Dutch Airlines (2009) 178 Taxman 291*. Article 8 of the Indo-Netherlands DTAA which fell for the consideration of the Court reads as under :-

“Air Transport :

1. Profits from the operation of aircraft in international traffic shall be taxable only in the State in which the place of effective management of the enterprise is situated. “

Article 8(1) is similar to Article 9(1). In that case the assessee had obtained a licence in respect of premises at Mumbai from the Airport Authority of India. This licence was for the purpose of cargo handling only. The assessee entered into an agreement with CSC (P) Ltd. for cargo handling at Mumbai on its behalf. The agreement provided for payment by the assessee to CSC (P) Ltd. for cargo handling at Mumbai. The payment made by the assessee to CSC was after the adjustment of the licence fee/rent paid by the assessee to the Airport Authority of India. The adjustment was considered by the department as the income of the assessee

chargeable to tax under Article 6 of the Indo-U.K. DTAA. The Division Bench upheld the decision of the Tribunal to the effect that the adjustment was directly and inextricably linked to the cargo handling business of the assessee and was not in the course of a separate business of renting out the premises. As the assessee established a link between the renting of the premises and the business of operating an airline in international traffic, it was held that Article 8 would apply.

30. We are, in respectful agreement with the judgment. In the present case, even assuming that the slot hire agreements are not covered by Article 9(1) of Indo-U.K. DTAA per-se, the respondent would still be entitled to the benefit of the provisions for in any event such slot hire agreements are an integral part of the shipping operations of the respondent, who admittedly had also chartered two ships. A view to the contrary would affect the business of such parties merely because the ships chartered by them do not ply on certain routes such as India.

31. It is necessary to preface a reference to the commentaries with a qualification. The reference to the commentaries is only to the extent that they consider as included within the expression “operation of ships” activities that are connected therewith. Whether a particular activity is to be included or not would depend upon the

terms of the convention in question and based on the facts and circumstances of the case.

32. Mr.Kaka relied upon the July, 2008 edition of the commentary on Model Tax Convention on Income and on Capital (Condensed Version) OECD published by the Organisation for Economic Co-Operation and Development (OECD). It is useful first to note the nature of the OECD, which is briefly referred to in the commentary as under :-

**“ORGANISATION FOR ECONOMIC
CO-OPERATION AND DEVELOPMENT**

The OECD is a unique forum where the governments of 30 democracies work together to address the economic, social and environmental challenges of globalisation. The OECD is also at the forefront of efforts to understand and to help governments respond to new developments and concerns, such as corporate governance, the information economy and the challenges of an ageing population. The Organisation provides a setting where governments can compare policy experiences, seek answers to common problems, identify good practice and work to co-ordinate domestic and international policies.

The OECD member countries are :

(NOTE : India is not a member)

The Commission of the European Communities takes part in the work of the OECD.

OECD Publishing disseminates widely the results of the Organisation's statistics gathering and research on economic, social and environmental issues, as well as the conventions, guidelines and standards agreed by its members.”

33. The publication therefore, is an indication of the views on the basis of which the “Model Tax Convention on Income and on Capital” (hereafter referred to as the Model Tax Convention) was based. It is therefore, to say the least, a useful guideline in interpreting the provisions thereof.

34(A)(i). Article 8(1) of the OECD Convention which is similar to Article 9(1) of the India – U.K. DTAA reads as under :-

“ARTICLE 8

SHIPPING, INLAND WATERWAYS TRANSPORT 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 enterprises is situated.”

(ii). Where it is preferred to confer the exclusive taxing right on the state of residence instead of in the state which is the place of

effective management is situated paragraph 2 of the commentary on Article 8 suggests the following clauses :

“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.”

(B). Article 9(1) of the India – U.K. DTAA, Article 8(1) of the Model Tax Convention and the suggested alternative thereto are similar. Each of them refers to profits or income of an enterprise “from the operation of ships in international traffic”. The commentary would therefore, apply equally to Article 9(1) of the India -U.K. DTAA.

(C) This brings us to the following commentary at pages 139 and 140 of the publication on the Model Tax Convention relied upon by Mr.Kaka.

“COMMENTARY ON ARTICLE 8

CONCERNING THE TAXATION OF PROFITS FROM SHIPPING, INLAND WATERWAYS AND AIR TRANSPORT :

4. The profits covered consist in the first place of the 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) that it operates in international traffic. However, as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of

activities to permit, facilitate or support their international traffic operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from activities which are not directly connected with the operation of the enterprise's ships or aircraft in international traffic as long as they are ancillary to such operation.

4.1 Any activity carried on primarily in connection with the transportation, by the enterprise, of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.

4.2 Activities that the enterprise does not need to carry on for the purposes of its own operation of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that they should not be regarded as a separate business or source of income of the enterprise should be considered to be ancillary to the operation of ships and aircraft in international traffic.

4.3 In light of these principles, the following paragraphs discuss the extent to which paragraph 1 applies with respect to some particular types of activities that may be carried on by an enterprise engaged in the operation of ships or aircraft in

international traffic.

5.

6. Profits derived by an enterprise from the transportation of passengers or cargo otherwise than by ships or aircraft that it operates in international traffic are covered by the paragraph to the extent that such transportation is directly connected with the operation, by that enterprise, of ships or aircraft in international traffic or is an ancillary activity. One example would be that of an enterprise engaged in international transport that would have some of its passengers or cargo transported internationally by ships or aircraft operated by other enterprises, e.g. under code-sharing or slot-chartering arrangements or to take advantage of an earlier sailing. Another example would be that of an airline company that operates a bus service connecting a town with its airport primarily to provide access to and from that airport to the passengers of its international flights.”

35. Paragraph 4 of the commentary indicates that Article 9 applies to profits directly obtained from the transportation of passengers or cargo by ships owned, leased or otherwise at the disposal of a person as well as the profits from the activities which are not directly connected with the acquisition of the assessee's ships. In the latter case however, the activities must be ancillary to such operations viz. the operation of ships owned, leased or

otherwise at the disposal of the assessee in international traffic. It indicates that the provision also applies to the activities that permit, facilitate or support the international traffic operations.

36. As far as the first type of case is concerned viz. where the slot hire facility is availed of for carriage of goods from a port in India only upto the hub port abroad and is thereafter transhipped on vessels actually operated by the assessee upto the final destination, it is irrelevant whether slot hire agreements are considered to be directly connected with the operation of ships or not directly connected with the operation of ships by the enterprise. In such cases, the slot hire agreements are inextricably interlinked with and connected to the operation of ships by the enterprise. The first type of case would in fact be covered by paragraphs 4 and 4.1 of the commentary.

37. The commentary however, indicates that even the second type of case would be covered by Article 9(1) if the same is only ancillary to the operation of ships by the enterprise. These cases fall within paragraph 4.2 of the commentary.

38. Mr.Kaka also relied upon the commentary of Klaus Vogel on Double Taxation Conventions. He relied upon the Explanatory Notes on the Model Conventions at page 482 to indicate the possible reasons for introducing such a provision. Paragraph 23 at page 482

reads as under :-

“23. By laying down this rule, the MCs take account of the way in which the international shipping and air transport industries typically manifest themselves. Their operations spread out over a multitude of States in which permanent establishments are frequently set up to handle the business. Because a single flight or voyage will often involve stops in one foreign State after another, taxation under the **permanent establishment principle** would result in the **difficulty** of how to attribute to each of the permanent establishments its proper share in the profits made by the enterprise from transportation activities (*Hund, D., supra* m.no. 1, at 113). A further consequence of attributing shares in profits to the various permanent establishments would be fragmented taxation. It is in order to avoid these drawbacks of the permanent establishment principle that OECD and UN MCs exclusively attach taxation of profits from shipping, air transport and inland waterways transport to the place of effective management and exempt such profits from tax in the State where the activities were exercised, no matter whether or not the enterprise maintains a permanent establishment in that State.”

39. This difficulty would arise particularly in cases of the first type and where the freight is not apportioned for each sectors. A lump-sum freight may be charged. It would be difficult if not

impossible to ascertain the manner in which the freight is structured. It is not necessary that every enterprise would charge the “normal” (if there be such a thing) freight for the respective sectors. It is not necessary that the slot charges paid by the enterprise is apportioned proportional to the area occupied by each client. There would be a variety of factors that would determine the lump-sum freight. It is difficult then to treat each case differently under Article 9. The Article would be unworkable.

40. Mr.Kaka's reliance upon the commentary in Philip Baker “Double Taxation Conventions And International Tax Law” A Manual on the OECD Model Tax Convention on Income and on Capital of 1992 (Second Edition) is also well founded. Paragraphs 8.06 and 8-12 (4), (7) and 8) read as under :-

“8.06 A problematic issue in the application of Article 8 is the meaning of “profits from the operation of ships or aircraft”. The Commentary states that, in the first place, this covers profits from the carriage of passengers or cargo, but that it also covers other classes of profits which by reason of their close relationship may be placed in the same category. Certain specific items are discussed in the Commentary. Profits from the leasing of ships or aircraft except where the leasing is on the basis of a bare boat charter are included. **(NOTE :- Article 9(3) of the India – U.K. DTAA is different.)** This may also

cover profits from the cross-leasing of spare aircraft between airlines. Auxiliary activities more or less closely connected with the direct operation of ships and aircraft (discussed in paragraphs 8 and 9 of the Commentary) are also included. An example of this is found in a Rhodesian case where, for a commission, an airline arranged onward sea passages for its passengers with shipping lines. The Board held that this income was entirely incidental to the business of operating aircraft and was therefore exempted by the relevant convention. Similarly, the Internal Revenue Service have ruled that the gains from the sale of obsolete aircraft, engines and spare parts of aircraft previously used for international airline activities are exempted as falling within the scope of "profits from the operation of aircraft and international traffic".

4. The profits covered consist in the first place of the profits obtained by the enterprise from the carriage of passengers or cargo. With this definition, however, the provision would be unduly restrictive, in view of the development of shipping and air transport, and for practical considerations also. The provision therefore covers other classes of profits as well, i.e. those which by reason of their nature or their close relationship with the profits directly obtained from transport may all be placed in a single category. Some of these classes of profits are mentioned in the following paragraphs.

7. Shipping and air transport enterprises – particularly the latter – often engage in additional activities more or less closely connected with the direct operation of ships and aircraft. Although it would be out of the question to list here all the auxiliary activities which could properly be brought under the provision, nevertheless a few examples may usefully be given.

8. The provision applies, *inter alia*, to the following activities :

- (a) the sale of passage tickets on behalf of other enterprises ;
- (b) the operation of a bus service connecting a town with its airport ;
- (c) advertising and commercial propaganda ;
- (d) transportation of goods by truck connecting a depot with a port or airport.”

41. The 2007 edition of the same work by Philip Baker is also relevant. Dealing with Article 8 of the Model Tax Convention, the author observed in paragraph 8B.01 and 8B.07 as under :-

“8B.01 The central focus of the Article is on profits from the carriage of passengers or freight, together with income from activities which are ancillary to the carriage of passengers and freight.

8B.07 The meaning of “profits from the operation of ships or aircraft”

..... Auxiliary activities more or less closely connected with the direct operation of ships and aircraft (discussed in paragraphs 8 and 9 of the Commentary) are also included. An example of this is found in a Rhodesian case where, for a commission, an airline arranged onward sea passages for its passengers with shipping lines. The court held that this income was entirely incidental to the business of operating aircraft and was therefore exempted by the relevant convention. Similarly, the Internal Revenue Service has ruled that the gains from the sale of obsolete aircraft, engines and spare parts of aircraft previously used for international airline activities are exempted as falling within the scope of “profits from the operation of aircraft and international traffic.”

42. Our views on the two types of cases involved in the present appeal are in consonance with the view of the Delhi High Court, the OECD commentary and the commentaries referred to above.

43. Indeed if certain activities connected with the actual operation of ships in international traffic are included in Article 9(1), it must follow that income from utilizing slot hire facilities as availing of in these cases would fall within Article 9(1) for slot hires have a

closer nexus, connection and relationship to the actual operation of ships than the illustrative activities mentioned in the above commentaries.

44. Mr.Kaka then relied upon section 115-VB of the Act, which reads as under :-

“115-VB. Operating ships.—For the purposes of this chapter, a company shall be regarded as operating a ship if it operates any ship whether owned or chartered by it and includes a case where even a part of the ship has been chartered in by it in an arrangement such as slot charter, space charter or joint charter:

Provided that a company shall not be regarded as the operator of a ship which has been chartered out by it on bareboat charter-cum-demise terms or on bareboat charter terms for a period exceeding three years.” (emphasis supplied)

He submitted that an assessee is therefore, regarded under our law as operating a ship even if it charts a part of the ship inter-alia by an arrangement of a slot charter. He submitted therefore, that though the Indo-U.K. DTAA does not define the phrase “from the operation of ships” in view of Article 3, the Court ought to ascribe to it the meaning it has under Indian law relating to taxes as taxation in the subject of the convention. Accordingly, the

Court ought to ascribe to the phrase the meaning given to it in section 115VB.

45. Section 115VB falls under Chapter XII-G, which was inserted by Finance (No.2) Act, 2004 with effect from 1.4.2005. The present appeal however, relates to the period prior thereto viz. AY 2001-2002. Mr.Kaka however, submitted that section 115VB is only a clarificatory provision and that slot charters were always included within the expression “engaged in the business of operation of ships”. This, he submitted, was evident from the fact that income from slot charters have always been taxed under section 44B.

46. Chapter XII-G (Section 115V to 115 VZC) is of no assistance in determining the ambit of the phrase “from the operation of ships”. Chapter XII-G provides “SPECIAL PROVISIONS RELATING TO INCOME OF SHIPPING COMPANIES”. Section 115VB falls within Part B of Chapter XII-G which relates to “B”. *Computation of tonnage income from business of operating qualifying ships*. The opening words of section 115VB “For the purpose of this chapter” do not permit a blind incorporation of the provisions of the section into the other provisions of the Act.

47. The force of section 115VB as an aid in interpreting Article 9(1) of the DTAA is further reduced by section 115V-I(2) relied upon by Mr.Singh, which also falls within Chapter XII-G :-

“115-VI. Relevant shipping income.—(1) For the purposes of this chapter, the relevant shipping income of a tonnage tax company means—

- (i) its profits from core activities referred to in sub-section (2);
- (ii) its profits from incidental activities referred to in sub-section (5):

The provision is not relevant.

(2) The core activities of a tonnage tax company shall be—

- (i) its activities from operating qualifying ships; and
- (ii) other ship-related activities mentioned as under:—
 - (A) shipping contracts in respect of—
 - (i) earning from pooling arrangements;
 - (ii) contracts of affreightment.

Explanation.—

(B) specific shipping trades, being—

- (i) on-board or on-shore activities of passenger ships comprising of fares and food and beverages consumed on board;
- (ii) slot charters, space charters, joint charters, feeder services, container box leasing of container shipping.

(3)

(4)

(5) The incidental activities shall be the activities which are incidental to the core activities and which may be prescribed for the purpose”.

48. While section 115VB includes slot charter agreements in the phrase “operating a ship”, section 115-VI draws a distinction

between “operating ships” on the one hand and “other ship related activities” such as slot charters on the other. Therefore “slot charters” are not considered as “operating ships”. In other words, a slot charter is considered to be a ship related activity but not the activity of “operating ships”. We hasten to clarify that section 115VI does not lead to the exclusion of slot charters from the ambit of the phrase “operation of ships” in Article 9 of the DTAA. Nor does section 115VB include them within the phrase in the DTAA. Chapter XII-G is of no assistance in this regard as the definitions therein appear to be for the purpose of the Chapter alone unless otherwise required.

49. Mr.Singh then relied upon section 172(1), which reads as under :-

“172. Shipping business of non-residents.—(1) The provisions of this section shall, notwithstanding anything contained in the other provisions of this Act, apply for the purpose of the levy and recovery of tax in the case of any ship, belonging to or chartered by a non-resident, which carries passengers, livestock, mail or goods shipped at a port in India.”

He submitted that in view of section 172 (1), the income can fall within the ambit of the words operation of ships only if it relates to the ships owned or chartered by the assessee.

50. Section 172 (1) has no bearing upon the interpretation of Article 9 of DTAA. It only provides that the provisions of the section apply for the purpose of levying and recovering the tax in the case of ships belonging to or chartered by a non-resident. It does not deal with the ambit of the expression "operation of ships". Section 172 in fact falls under Chapter XV relating to law in special cases. It is the only section in part (H) of Chapter XV the heading of which is : "Profits of non-residents from occasional shipping business".

51. As a result of the view that we have taken, it is not necessary to consider the submissions as to the manner in which an international treaty must be interpreted. We are of the opinion that Article 9 of the Indo-U.K. DTAA includes slot charters / slot hire agreements as availed of and utilized in these cases.

52. Question (A) is therefore, answered in favour of the assessee.

53. Both the appeals are dismissed. There shall be order as to cost.

(M.S. SANKLECHA, J.)

(S.J. VAZIFDAR, J.)