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Time charter hire charges not taxable as 'royalty' but subject to deemed taxability under section 172 of the Income-tax Act, 1961

In Brief

In a recent decision of Poompuhar Shipping Corporation Ltd.¹, the Chennai Income-tax Appellate Tribunal (the Tribunal) held that hire charges paid to foreign shipping companies (FSC) under a time charter arrangement would not be considered as payment for use of equipment and hence not 'royalty' under section 9(1)(vi) of the Income-tax Act, 1961 (the Act). Further, it also held that simultaneous proceedings under sections 201 and 163 of the Act are not justified.

Facts

The assessee is a state government undertaking exclusively engaged in transporting coal to various ports in India. The assessee hired certain ships from FSC for transportation of coal.

Its assessments were reopened to disallow following expenses under section 40(a)(ia) of the Act for failure to withheld tax:

- Dry docking expenses
- Charter hire charges paid to FSC

¹ Poompuhar Shipping Corporation Ltd. v. ADIT [ITA No 145 to 148/ 2012, order dated 29 June 2012]

As regards charter hire payments, the assessing officer (AO) held that since FSC performed the transportation activity in Indian coastal waters, the charter hire income arose/accrued in India as per the provisions of section 9 of the Act.

The AO treated the assessee as agent of FSC under section 163(2) of the Act since the FSC had not filed return of income in India. The assessee was also treated as an assessee in default for not withholding tax on payments to FSC.

The AO's order was confirmed by the Commissioner of Income-tax (Appeals) (CIT(A)) and hence the assessee approached the Tribunal for relief on following grounds:

- Validity of treating the assessee as 'representative assessee' with respect to income of FSC from time charter
- Validity of reopening the assessment
- Liability of the assessee to withhold tax from payments made to FSC for hiring ships under time charter agreement

Assessee's contentions

Before the Tribunal, the assessee contended that payment made to FSC under time charter agreement are outside the purview of section 9(1)(vi)(a) of the Act.

The assessee contended that the time charter agreement has following characteristics:

- Possession of ship remains with the owner
- The assessee has no control over the ship or the crew
- Ship is used by owner for transportation of goods of the assessee

In view of the above, the consideration paid is not for the use of ship but for the use of services of transportation of cargo. For this purpose, the assessee relied on the decision of Madras High Court (HC) in the case of Essar Shipping Ltd.²

The assessee also contended that the revenue has taken inconsistent stand in as much as treating it as the representative assessee and simultaneously treating it as an assessee-in-default for not withholding tax. The assessee further contended that reopening was barred by limitation since the notice was served upon the assessee after expiry of limitation period.

Revenue's contentions

The Revenue relied on the Tribunal's order in the assessee's own case³ for earlier years to contend that under the time charter arrangement the assessee had control over the ship as well as crew. The Revenue also relied on the Chennai Tribunal's decision in West Asia Maritime Ltd.⁴ wherein, it was held that 'ship' is an equipment and hire charges paid for its use is in the nature of 'royalty'.

Tribunal's ruling

Taxation of payment to FSC under time charter

The Tribunal observed that the Madras HC in Essar Shipping Ltd. had referred to the commentary by B.C.Mitra in his book 'Law of carriage by sea' for explaining the meaning of 'time charter'. As per the commentary, under a time charter:

- Legal or beneficial ownership over the ship remains with the owner and is not passed on to the charterer
- The charterer only gets contractual rights for services of ship by the ship owner

² State of Tamil Nadu v. Essar Shipping Ltd. [2012] 47 VST 209 (Mad).

³ Poompuhar Shipping Corporation Ltd. v. ITO [2006] 109 ITD 226 (Chennai)

⁴ West Asia Maritime Ltd. v. ITO [2006] 297 ITR 202 (Chennai)

In light of the above findings, the Tribunal held that time charter payment made by the assessee to the FSC was not for the use of industrial, commercial or scientific equipment but for services. Therefore, it does not partake character of 'royalty'.

The Tribunal further alluded that income of the FSC would be liable to tax in India under the deeming provisions of section 172 of the Act dealing with taxation of non-resident shipping companies. The Tribunal observed that the assessee did not place on records any document to show that FSC were exempted by tax treaties from payment of tax. Thus, the assessee was held liable to deduct tax under the provision of section 195 of the Act.

Validity of treating the assessee as 'representative assessee'

On the issue whether the assessee can be regarded as representative assessee as also carrying out simultaneous proceeding under section 201 of the Act, the matter was restored back to the AO with a direction to initiate proceedings under one of the provisions of the Act.

Validity of reassessment proceedings

As regard the assessee's ground on limitation, the Tribunal held that as long as notice was issued on time but served after expiry of time limitation, the reassessment proceeding were held to be valid.

Conclusion

The Tribunal did not follow its earlier ruling in the case of assessee which merely emphasised on the terms of the agreement rather than actual character of time charter. Based on the observations of the Madras HC as well as expert commentaries, the Tribunal concluded that time charter hire charges cannot be treated as 'royalty' but is taxable under deeming provisions of section 172 of the Act.

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