International Tax Updates
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Non-applicability of LOB clause under India-UAE tax treaty and Relevance of timing as to when the application of LOB to a tax-treaty needs to be referred (Mumbai Tribunal)

Under the context of tax treaties, application of a Limitation of Benefits (LOB) clause would result into denial of treaty benefits if main purpose of the transaction or one of the main purposes of the transaction is to obtain a treaty benefit.

In the backdrop of businesses growing in multi-folds the Governments across the globe have been grappling to provide for regulations to tax upcoming business models and tax their share of revenue. In this backdrop LOB clause is kind of an anti-abuse provision agreed between countries to avoid any treaty-shopping and is expected to be a handful tool for the Tax officers at the time of Tax Assessments. Recently the Mumbai Tribunal in the case of ***Interworld Shipping Agency LLC vs. DCIT (ITA No.7805/Mum/19) (Mumbai ITAT)*** had the occasion to dealt with the application or otherwise of LOB clause to a particular transaction. The same is discussed in detail as under:

BRIEF SUMMARY

Facts of the case:

The taxpayer, a limited company, incorporated in and tax resident of the UAE, is engaged in the business of rendering services like ship chartering, freight forwarding, sea cargo services and shipping line agents. The taxpayer charters ships for use in transportation of goods and containers in international waters, including to Kandla and Mundra ports in India and other ports elsewhere.

• During the Financial Year (FY) 2015-16, corresponding to Assessment Year (AY) 2016-17, the taxpayer had received income towards freight collections and was of the view that its income was not taxable in India, since:

– It was a tax resident of the UAE; and

– Under Article 8 of the India-UAE tax treaty (relating to shipping income), profits derived by an UAE enterprise from the operation of ships in international traffic, was taxable only in UAE.

The Assessing Officer (AO) did not accept claim of the Taxpayer and observed as follows:

- 80% of the profits of the Taxpayer went to one Greek national, hence Control & Management of the Taxpayer was not wholly in UAE.

- The Taxpayer was a partnership firm and not a company and the Tax Residency Certificate ("TRC") and no objection certificate held by Taxpayer was of no support, being obtained by misrepresentation of facts.
- The only purpose of the taxpayer was to avail the benefits of the India-UAE tax treaty. It was a clear case of abuse of organisation as the owner of the entity was a Greek national. The taxpayer entity was a colourable device for avoidance of taxes.
- 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.

Further the Dispute Resolution Panel (DRP) confirmed the AO's order and made further observations:

- Since there is no taxation in UAE in general, it provides opportunity to do treaty shopping.
- The Control and Management 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 LOB clause in Article 29 of the Treaty.

Tribunal ruled in favour of taxpayer and made the following observations:

i). *Validity of Tax payer's claim of being Resident (a prerequisite for claiming benefits under tax treaty) of UAE as per India-UAE tax treaty:*

The ITAT noted the following:

- As per Article 4(1) of the India-UAE tax treaty resident was defined, inter alia, as "in the case of the United Arab Emirates: …*a company which is incorporated in the UAE and which is managed and controlled wholly in the UAE*".
- The taxpayer had 14 expatriate employees who were issued work permits by the UAE Government for working in the taxpayer's company. Thus, the company was being run from the UAE itself.
- As per relevant pages of the passport with clear entry and exit

stamps of the immigration authorities, the Greek national was in UAE for 300 days during the FY under consideration.

- With regards to the Greek national being a non-UAE national, nothing really turned on his being a national of a country other than UAE, because UAE was a major financial center in which not only a large number of foreigners work, but also from where a large number of foreigners conduct their business. When a person lived in a country for 300 days, it was reasonable to assume that he would be running a business from that country.
- When a person had a resident permit for the UAE and his company was incorporated in and doing business from the UAE, there was no reason to doubt the position that business was being controlled and managed from the UAE.
- The taxpayer had its office in UAE, it was in business there since 2000, it had expatriate employees who were given a work permit to work in UAE for the taxpayer, the main driving force for the taxpayer and its director was an expatriate resident in the UAE.
- The taxpayer had provided reasonable evidence in support of its stand that the business was wholly and mainly controlled from the UAE. The fact that the taxpayer could not submit the documents, which he was not required to maintain statutorily anyway (the taxpayer had claimed that UAE law did not mandate keeping of board of directors resolutions) could not be put against the taxpayer.
- Taxpayer cannot be asked to prove a negative, is a settled law in light of the Supreme Court's Judgement in the case of K P Varghese Vs ITO [(1981) 131 ITR 587 (SC)]. Therefore, the taxpayer could not be asked to prove that it was "not managed from outside UAE".

Based on the above, the ITAT held that the taxpayer was resident in UAE as it is incorporated in the UAE and is managed and controlled wholly in the UAE.

ii). *Application of LOB clause to the facts of the case*

- Article 29 of India-UAE treaty reads as under:
  "An entity which is a resident of a Contracting State shall not be entitled to the benefits of this Agreement if the main purpose or one of the main purposes of the creation of such entity was to obtain the benefits of this Agreement that would not be otherwise available. The cases of entities not having bona fide business activities shall be covered by this Article".
- The taxpayer was in business since 2000, and the operations of ships for transportation of goods to and from India had started much later in 2015. It could not, therefore, be said that the taxpayer was formed for the

purpose of availing benefits under the India-UAE tax treaty, which came into play only in 2015.

- When an entity was established in 2000, and the relevance of the India-UAE tax treaty came into play only in 2015, it could not be said that the main purpose of creation of such an entity was to obtain the benefits of the India-UAE tax treaty.

- Unless, the purpose of creating the taxpayer entity was to avail the India-UAE tax treaty benefits, the Limitation of Benefit (LOB) clause in Article 29 of the India-UAE tax treaty could not come into play.

- There was nothing to suggest that the taxpayer's business activities were not bonafide. There was reasonable evidence that the taxpayer was having bonafide business in the UAE, and, as such, the lack of bonafides could not be inferred.
- Once the taxpayer submitted reasonable evidence, including the evidence in support of the existence of an office and dedicated employees in UAE, and the business being carried on from there as also the financial statements showing the business being carried on from the UAE on a regular and commercial basis, unless the tax authorities brought on record some material to dispute the said position, one could not proceed to conclude that the business activities of the taxpayer lacked bonafides.

Conclusion

Basis the affirmative answers to above 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 under Article 8(1) the India-UAE tax treaty.

Our Comments

With respect to the application of LOB clause, 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 LOB clause under a tax-treaty to claim that treaty benefits should not be given.

Hope you find the same an interesting read.

Should you have any clarifications please feel free to contact us.

Regards

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