

Corporate Tax - Cyprus

New decision on wording of Cyprus-India double tax agreement

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In a recent case⁽¹⁾ concerning the application of the double tax agreement between Cyprus and India, the Indian Income Tax Appellate Tribunal confirmed that the wording of the agreement concerning taxing rights in relation to international shipping activities is unambiguous and not open to further interpretation by the tax authorities. This meant that the company concerned was subject to tax in Cyprus and not, as the Indian tax authorities had contended, in India, resulting in considerable savings.

Facts

Cyprus company Glendive Enterprises Limited entered into an agreement with Arabian Resources FZC to provide a ship to transport bauxite ore from India to Sharjah. Glendive entered into an agreement to charter the MV Thelisis, with Shaan Marine Services Private Limited acting as its agent in India.

In its income tax return Shaan claimed that Glendive was not liable to tax in India, on the grounds that Article 8 of the double tax agreement provides that profits of enterprises engaged in international shipping are taxable only in the state in which the headquarters of the enterprise are located. As Glendive was both registered and tax resident in Cyprus, its profits were liable to tax in Cyprus, not India.

The Indian assessing officer did not accept this. He contended that Glendive - a one-person company with no staff and no office - was merely interposed in the transaction as charterer to obtain the benefits of the double tax agreement. He asserted that Glendive had failed to demonstrate that its place of effective management was in Cyprus, and raised an assessment for tax and late payment surcharges. The taxpayer's appeal against this assessment was initially turned down by the commissioners and the taxpayer then appealed to the appellate tribunal.

Decision

The appellate tribunal concluded that Glendive's role in the transaction was real and material. The assessing officer's contention that Glendive was merely interposed in the transaction to obtain the benefits of the double tax agreement was inconsistent with the facts and the underlying documentation. Glendive had received the enquiry from the customer and entered into the agreement with the customer to transport the ore; and all contracts and the bill of lading were in Glendive's name.

The tribunal also dismissed the assessing officer's contention that the effective management of Glendive could not be in Cyprus because Glendive lacked substance in Cyprus, as a one-person company with no staff or substantial office establishment. The tribunal pointed out that Article 8 of the double tax agreement between Cyprus and India explicitly states that if an enterprise is registered and has its headquarters in a country, its place of effective management is in that country and its profits will be taxable in that country. There is no scope for further interpretation of the matter. While the Organisation for Economic Cooperation and Development commentary can be used to interpret tax treaties where 'effective management' is not defined, it was irrelevant in this case.

The tribunal therefore directed the assessing officer to cancel the assessment.

Comment

This decision reaffirms the well-established principle that legally binding agreements between unrelated parties cannot be disregarded and demonstrates the fundamental necessity to clearly document all aspects of transactions.

While the tribunal dismissed the contention that the effective management of Glendive could not be in Cyprus because the company lacked substance there as irrelevant in this particular case, the fact that the assessing officer raised the issue illustrates the ever-increasing attention paid by tax authorities to the question of substance and underlines the importance of having demonstrable business substance to underpin tax residence. Lack of substance could result in structures being challenged under domestic anti-avoidance provisions or tip the balance of residency to one country rather than the other under 'tie-breaker' rules.

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Endnotes

⁽¹⁾ *Shaan Marine Services Private Limited v DDIT [TS-327-ITAT-2014(Pune)]*.

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