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* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 07.05.2015
Pronounced on: 27.05.2015

\+ **ITA 95/2005**

DIRECTOR OF INCOME TAX DELHI ……Appellant
Through: Sh. Rohit Madan, Sh. Ruchir Bhatia and Sh. Akash Vajpai, Advocates.

Versus

M/S. LUFTHANSA CARGO INDIA ……..Respondent
Through: Sh. Ajay Vohra, Sr. Advocate with Sh. Mukesh Butani, Sh. Vishal Kalra and Sh. Khyati Dadhwal, Advocates.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE R.K. GAUBA

MR. JUSTICE S. RAVINDRA BHAT

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1. The following two questions of law have to be answered in this appeal, under Section 260A of the Income Tax Act, 1961 (hereafter "the Act"):

> *1. Whether the Income Tax Appellate Tribunal (ITAT) has rightly interpreted the agreements between the assessee and non-residents and is right in holding that payments made by the assessee to the non-residents are not fee for technical services within the meaning of Section 9(1)(vii) of the Income Tax Act, 1961 so as to oblige the assessee to deduct tax at source under Section 195 of the Act from such payments?*
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> *2. Whether the ITAT was right in holding that payments made by the assessee fell within the purview of the exclusionary clause of*

Section 9(1)(vii)(b) of the Act and were not, therefore, chargeable to tax at source?

2. The assessee was at the relevant time (in mid 1997), engaged in the business of wet-leasing. It had acquired four old Boeing aircrafts (727-200 Model) from a non-resident company outside India. After registration of the aircraft with the DGCA, the assessee hired the crew, ground engineers and other technical personnel for their operation. It was granted the license by the DGCA to operate these aircrafts on international routes only. The assessee's Boeing 727-200 aircrafts were not used by any other airline in India. Consequently there were no facilities in India for their overhaul repairs. However, according to DGCA directives various components and the aircraft itself had to undergo periodic overhaul repairs before the expiry of the number of flying hours prescribed for such individual components. Such overhaul repairs were permissible only in workshops authorized for the purpose by the manufacturer as well as duly approved by the DGCA.

3. The assessee's all four aircrafts were wet-leased to a foreign company, Lufthansa Cargo AG, Germany (hereafter "LCAG") under an Agreement dated April 28, 1997. In airline parlance, "wet leasing" means the leasing of an aircraft along with the crew in flying condition to a charterer for a specified period. The lessor has the responsibility for maintaining the crew and the aircraft in airworthy condition. The lessee is free to direct the flight operations by naming destinations in advance and load any lawful cargo for carriage. The lessee pays rental on the basis of number of flying hours during the period subject to a minimum guarantee as per the terms of the charter party.

4. India is a party to several International Conventions governing aircraft maintenance. Under the Aircraft Act, 1934 read with Aircraft Rules, 1937, the necessary regulatory and enforcement powers have been delegated by the Government to the DGCA. The latter issues notifications and guidelines etc. from time to time in regard to the maintenance and upkeep of aircraft. Every aircraft operator has to strictly abide by these guidelines; non-compliance entails in immediate withdrawal of the license and grounding of aircraft. As the assessee was obliged to keep the aircraft in flying condition, it had to maintain them in accordance with DGCA guidelines to possess a valid airworthiness certificate as a precondition for its business. The assessee's engineering department would track the flying hours of every component; and before the expiry of flying hours, the component needing overhaul/repairs or needing replacement would be dismantled by the assessee's engineers and flown to Lufthansa Technik's (a German company, hereafter "Technik") workshops in Germany. The parts were supplied by Technik under separate agreement of sale, loan or exchange. In due course, the overhauled component would be dispatched by Technik along with airway bill for which the freight would be paid by the assessee. The overhauled component would be fitted into aircrafts by the assessee's own personnel.

5. The assessee had entered into an agreement with the overhaul service provider, called "the Technik Agreement" on 14.3.1997. Technik carried out maintenance repairs without providing technical assistance by way of advisory or managerial services. LCAG utilized the aircrafts wet-leased to it for transporting cargo mainly to and from Sharjah to Mumbai, Delhi, Kathmandu, Lahore, Calcutta, Chennai, Bangalore and Colombo. As the

DGCA license permitted operations on international routes only, the aircrafts were not utilized by LCAG for carriage of cargo within India. LCAG had integrated its international air transport business at Sharjah with its worldwide network. The cargo brought from South Asian Countries would be put into wide-body aircrafts and flown from Sharjah to various destinations in Europe and the American continent. The assessee maintained a base at Sharjah where the aircrafts were normally kept and where its crew and engineering personnel were also stationed. The accounts of the branch at Sharjah are duly reflected in the audited Annual Accounts of the Company.

6. The repairs by way of component overhaul in the Technik workshops in Germany and other foreign workshops were in the nature of routine maintenance repairs. No Technik personnel were ever deputed to India for rendering any technical or advisory services to the assessee. Likewise, the assessee's technical personnel did not participate or involve themselves in the overhaul repairs carried out abroad by Technik or other foreign workshops. The services enumerated in attachments 'A' and 'B' of the Technik Contract are described below:-

(a) Provision of Personnel

(b) Engineering Support Services including:

i) Engineering work which includes air worthiness.

ii) Directives and Alert services

iii) Development design and modification

iv) Familiarization course.

Article 2 of the Agreement stated that such services would be provided by

Technik at the request of the assessee.

7. In the assessment proceedings, it was contended that Technik carried out normal maintenance repairs including supply of spares, and therefore, had Technik been a domestic company, the payments to it would be covered by the provisions of Section 194C and not by the provisions of Section 194J, which cover fees for technical services as defined in Section 9(1)(vii). The assessee stressed that in terms of International Conventions, every component containing rotable parts is allotted a unique identity number and its historical record is maintained in a tag which accompanies the component throughout its life. Such component including engines needs to be overhauled periodically in accordance with Boeing's manual. The assessee used to send components with tag to the workshop abroad. Technik's workshops in Germany were duly authorized by the manufacturer, i.e Boeing USA. Upon receipt, Technik overhauled the component in terms of the Manufacturer's Manual, as mandated by DGCA. The assessee had no say in the matter; it was unaware of the kind of repairs that had been carried out, as none of its employees visited Technik's facilities in connection with the repair work. It is submitted that the assessee's interest is that Technik returned the overhauled component duly certifying that it has carried out the prescribed overhaul repairs. It is evident from the invoices of Technik, ATC Lasham and others that those workshops replace parts at their own discretion in the course of overhaul of a component. The replaced parts, however, come with tags giving their unique identity number and history. They also issue warranty for free-of-defect functioning of the component for the requisite number of flying hours. It was argued that the repair work carried out by Technik etc. was not in the nature of technical assistance by way of

providing managerial, consultancy or technical services to the assessee. In short, the components were sent to the authorized workshops for carrying out overhauling of components and not for seeking any technical or advisory services. The assessee contended that it satisfied the requirements of the DGCA for carrying out prescribed maintenance repairs of the aircraft. These repairs, therefore, do not constitute 'managerial', 'technical' and 'consultancy services as defined under Explanation 2 to Section 9(1) (vii)(b) of the Act.

8. After considering the record, including the agreement with Technik, the Assessing Officer (AO) noticed that no tax was deducted at source on payments to Technik and no application under Section 195(2) was filed. The AO held that payments were in the nature of *'fees for technical services'* defined in Explanation 2 to Section 9(1)(vii)(b) of the Act, and were, therefore, chargeable to tax on which tax should have been deducted at source under Section 195(1). The AO rejected the assessee's plea that the payments for repairs were incurred for earning income from sources outside India and therefore, the case fell within the exclusionary clause of Section 9(1)(vii)(b). The AO further rejected the assessee's plea that the business of aircraft leasing was carried on outside India. The assessee's alternate plea that in any case the payments made to residents of USA, UK, Israel, Netherlands, Singapore and Thailand could be taxed as business profits only and not as fees for technical services keeping in view the relevant provisions of the DTAAs with those countries too was rejected. The AO passed orders under Section 201 of the Act deeming the assessee to be an assessee in default for the financial years 1997-98 to 1999-2000, and levied tax as well as interest under Section 201 (1A) of the Act.

9. On appeal, the CIT (A) rejected the assessee's contention that the payments made to the various non-residents for carrying out overhaul repairs were not chargeable to tax. The payments made to Technik were treated as the model for considering the question of taxability of payments made to all other foreign companies. CIT (A) held that such repairs required knowledge of sophisticated technology and trained engineers are employed by the non-residents for carrying out the overhaul repairs. According to the CIT (A), the repairs constituted 'fees for technical services' and therefore were subject to TDS. With reference to payments made to residents of UK and USA, the CIT (A) held that they were not in the nature of 'fees for technical or included services' under Article 12 of the DTAA read with the Memorandum of Understanding with USA which equally applied to the UK Treaty. Payments made to residents of USA and UK were held to be 'business profits' and since those companies did not have a PE in India, their income was not chargeable to tax. The revenue appealed against the order of the CIT (A) on that point; the assessee appealed against other findings adverse to it, to the ITAT.

10. The ITAT noticed that the agreement with Technik provided for three categories of services; they were outlined in Attachments A, B and C. It held that the CIT (A) was in error in holding that since the agreement provided for all kinds of services, it amounted to providing for technical services. The ITAT held, pertinently, that:

> *"26. A reading of the Technik Agreement shows that apart from above quoted general clauses, it also contains three other independent and distinct sections. Each such section is by itself a self-contained contract dealing with distinct subject matter stipulating independent and separate terms and conditions. These three sections are:*

a) 'Attachment A' of the Agreement dealing with 'Engineering support services' on request including provision of training.

b) 'Attachment B' of the Agreement relating to 'Assignment of personnel' on request by Technik,

c) 'Attachment C' of the Agreement concerning Repairs and overhauls of the components.

Attachments 'A' & 'B' of the Technik Agreement deal with the engineering support services including training and assignment of personnel by the Technik. These are clearly optional services which would be provided by the Technik for the charges specified in the two 'Attachments' only on the specific request of the assessee. The assessee has emphasized that none of these services was availed of and therefore no payment was made on this account. All the invoices raised by the Technik were produced before the lower authorities and no instance of payment for training or other optional support services as per Attachment 'A' and 'B' of the contract has been brought out either by the Assessing Officer or by the CIT(A). Ld. DR has also not cited any instance of payment for any of the optional services enumerated in Attachment 'A' and 'B'. Ld. DR has also could not controvert that payments to Technik were made for specific job work of repairs and replacement of parts, and no technician was assigned to India for consultancy or supervision of repairs. We are therefore of the view that simply because Attachment 'A' and 'B' stipulate charges for optional services, it cannot be said that any payment is attributable to such services. These services are optional and could be performed on specific request by the assessee. On the facts brought out before us such option was not exercised by the assessee. Ld. DR also could not indicate any clause in the Technik Agreement which would oblige the assessee to pay the fees towards optional services even if such an option is not exercised by the assessee. In the circumstances, we hold that CIT (A) was not correct in making attachments 'A' and 'B' of the Technik Contract as the basis for concluding that the payments were primarily made for rendering of technical services..."

Attachment C reads as follows:

"Attachment 'C'

1. SCOPE OF SERVICES

1.1 Repair, overhaul, modification and test of all components as far as identical with Lufthansa Technik's own components. In cases of differences in the dash-number repair/overhaul items shall only be accepted after Lufthansa Technik's prior telex confirmation;

1.2 Material, supply out of Lufthansa Technik stock for above components repair/overhaul in accordance with Article 2 hereof.

1.3 Lufthansa Technik shall be entitled to subcontract repair and overhaul of components in accordance with Article 4 of the GTA.

1.4 Each overhauled component will be redelivered with the following documentation:

1. JAA form (Airworthiness Approval Tag)

2. Workshop Report

3. Test Reports if applicable

2. MATERIAL PROVISIONING

2.1 Repairable and consumables required for the work to be performed on the Customer's components shall be supplied by Lufthansa Technik on the basis of sale provided Lufthansa Technik's stock permits such supply.

2.2 Modification material and, if required serialized subassemblies shall be provided by the Customer.

2.3 If specially requested by the Customer, and if Lufthansa Technik's stock permits such supply, Lufthansa Technik shall provide rotables out of its stock under Lufthansa Technik's normal Loan Agreement conditions. A copy of such Loan Agreement is attached hereto as Annex B.

2.4 If specially requested by the Customer and, if Lufthansa Technik's stock permits such supply, Lufthansa Technik shall provide repairable out of its stock on 1.1 basis using Lufthansa Technik's form Exchange 1.1 Agreement Annex A.

3. SHIPPING

3.1 Any shipments of the customer's components to and form the respective Lufthansa Technik Base shall be effected at the Customer's own risk and expense.

4. CHARGES

Article 4 For the work performed pursuant to Article 1 hereof, the Customer shall be charged according of Lufthansa Technik's man-hour rates valid at that time as stipulated in Annex A1 of the GTA.

For material consumed the Customer shall be charged, with the manufacturer's list prices plus a material handling surcharge of twenty five (25) percent.

Subcontracted work in the sense of Article 4 of the GTA shall be charged according to the amount payable by Lufthansa Technik to the subcontractor plus a handling charge of ten (10) percent plus transportation costs, if any.

In case of repair work the Customer shall pay a minimum charge per event of DM 1,000,-."

Upon an analysis of the various terms of the agreement and the actual services provided by Technik and availed by the assessee, it was held that the amount received by the former was a routine business receipt and not technical fee: *"it cannot therefore be said that Technik rendered any managerial, technical or consultancy service to the assessee."*

11. Upon a consideration of the wet leasing activity of the assessee and the agreements it entered into with foreign companies, the ITAT held that these arrangements showed that:

"(i) The assessee has to maintain the crew and keep the aircrafts in airworthy state.

(ii) The assessee company earns rental income on block-hours basis.

(iii) The assessee cannot wet-lease the aircrafts to a third party without a written permission from the LCAG.

(iv) In case of non-utilisation of aircrafts by the LCAG, it has to pay minimum guaranteed rental 240 block-hours per month in accordance with Clause No. 2.2 read with, Annexure 3 of the contract.

(v) The amount of leasing revenues depends on the number of flying hours utilised by LCAG and not on the value of freight earned by the LCAG.

(vi) The assessee is also assured of minimum rental income in the event LCAG does not actually use the aircrafts.

48. In this view of the matter, we are satisfied that the assessee's immediate source of income is from the activity of wet-leasing of aircrafts under contracts made outside India to non-resident parties. A miniscule fraction of the lease rental (0.2%) has been earned from an Indian party. But, this cannot detract from the fact that virtually entire income has been earned from non-residents through the activity of wet-leasing of the aircrafts carried on outside India.

49. The assessee's activity of wet-leasing of air-crafts is a distinct activity which constitutes a source form which income has been earned. Revenue is not correct in identifying this leasing activity with the transportation activity of the lessee, LCAG, Germany."

The ITAT concluded, on the facts as follows:

"The sources from which the assessee has earned income are therefore outside India as the income earning activity is situated outside India. It is towards this income earning activity that the payments for repairs have been made outside India. The payments therefore fall within the purview of the exclusionary clause of Section 9(1) (vii) (b). Thus, even assuming that the payments for such maintenance repairs were in the nature of fees for technical services, it would not be chargeable to tax.

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As per this chart the leasing revenues earned in foreign exchange were 100%, 99.79% and 99.86% for the Financial Years 1997-98, 1998-99 and 1999-2000, respectively. This chart also gives the figures of direct operational expenses in foreign exchange on actual payment basis as culled out from the Annual Accounts of the company for three years (at pps. 122, 132, 143 of the Paper Book). As per the annual accounts, the direct expenses are mainly on account of lease rent, travelling and training, foreign office expenses, maintenance, interest on aircrafts acquired under hire-purchase, and depreciation. The aggregate of the direct expenditure incurred outside India works out to 55%, 81% and 67% of the total expenses debited to Profit &

Loss Account of each of the three years. It is submitted that remaining indirect expenditure was on account of Head Office expenses in India and expenditure on the ground staff, overnight stay of crew and airport charges etc. When the aircrafts landed in Indian airports for delivering and picking up cargo.

52. The Ld. CIT DR relied on the order the Assessing Officer and contended that the assessee's business was controlled from India and therefore it cannot be said that the business was carried on outside India.

53. We have carefully considered the rival submissions and we have also gone through the annual accounts of the assessee for the Financial Years ended 31.3.98, 31.3.99 and 31.3.2000 respectively, filed in the Paper Book. The question whether a business is carried on in India or outside India cannot be decided by the situs of the Head Office or the place of control of the business. The assessee, being an Indian company, would have the Head Office or the place of control in India. We agree that the assessee's business of wet-leasing of aircrafts have been predominantly carried on outside India. The assessee's business of wet-leasing of aircrafts is composed of a number of operations such as acquisition of aircrafts, wet-leasing, maintenance of crew and engineering personnel, aircrafts maintenance and establishment, etc. It is settled law that profits of a business cannot be said to accrue only in the place where sales take place or the revenue is earned, but they are embedded in each distinct operation of the business, both on the revenue and the expenditure side. For this legal proposition, we are supported by the decision of the Supreme court in the case of Anglo French Textile Company Ltd. v. CIT (1954) 25 IRT 27, where relying on an earlier judgment of the larger bench in the case of CIT v. Ahmed Bhai Umar Bhai and Co. (18 ITR 472)…

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54. The Ld. Counsel for the assessee fairly states that he has no objection to the apportionment on the basis of the above-quoted decision. He, however, submits that virtually 100% of the Revenues were earned outside India and the aggregate direct expenditure incurred outside India is about 71%, and another 10% should atleast be attributed to the business outside India on account of Head Office

expenses incurred in India.

55. Normally, we would have referred the matter to the Assessing Officer to verify the figures and work out the apportionment on a reasonable basis. However, we need not go into this arithmetical exercise because we have already held that the payments made to Technik and other foreign companies for maintenance repairs are not in the nature of fees for technical services as defined in Explanation-2 to Section 9(1) (vii)(b). Further, in any event these payments are not taxable for the reason that they have been made for earning income from sources outside India and therefore fall within exclusionary clause of Section 9(1) (vii)(b).

56. In view of our decision allowing the main ground relating to chargeability of tax, the alternate grounds have become academic. We therefore do not propose to go into them though considerable arguments were advanced on the alternate grounds."

12. Mr. Rohit Madan, learned counsel for the revenue argues that the AO's finding that the assessee used sophisticated technical experience and skills of the personnel of the Technik in the process of repairs and overhaul carried out on the aircraft clearly showed that the services were technical in nature. It was argued that the assessee defaulted in not deducting tax before making payments in accordance with the provisions of Section 195(1) of the Act and therefore, it could not plead that the receipts in the hands of the non-residents is not chargeable to tax under the Act. Counsel also stressed that if the assessee was of the view that no tax was deductible on the payments made to foreign companies it should have made an application with the AO under Section 195(2) of the Act. Stating that Section 195(1) is concerned with "payment to non residents" and not with the taxability of the corresponding "income of the non-resident" it was argued that if the assessee defaulted by not having deducted tax at source at the time of payment, it cannot later argue that the corresponding income of the non-resident was not

chargeable to tax. Learned counsel also relied on the concurrent findings of the CIT (A) that all payments made were in accordance with the Agreements signed by the Assessee with Technik. It was contended that payments for various services were specified in the Agreement on annual basis while other charges are on man hour basis. The charges were for specialized and sophisticated services which fell squarely within the ambit of "fees for technical services" as envisaged under Explanation 2 to Section 9(1)(vii) of the Act. He drew our attention to the various findings recorded in the orders of the CIT (A).

13. Mr. Madan next submitted that to fall under the excepted category in Section 9 (1) (vii) (b), i.e *"except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India"*, there should be clinching evidence to establish that indeed the income is earned wholly out of India. It was argued that the CIT (A) held correctly that in terms of the agreement between the assessee and LCAG the latter only has priority over others in use of the aircraft. Crucially, there was no compulsion restricting the assessee to wet-leasing the aircraft to third parties. The lower authorities found that aircraft were wet-leased to LCAG and also to other parties. Therefore it could not be said that the revenues were earned wholly from a source outside India. The findings of the AO that since the income from leasing of aircrafts is assessed to tax in India, the source of income is situated in India were also highlighted.

14. Learned counsel stated lastly, that the amendment, with retrospective

effect, of Section 9 and substitution of Section 9 (2) meant that such payments amounted to income in the hands of the non-resident Indians. The said amendment reads as follows:

> *"Section 9…(2) For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,-*
>
> *(i) the non-resident has a residence or place of business or business connection in India; or*
>
> *(ii) the non-resident has rendered services in India."*

It was submitted that any doubts as to whether the assessee was obliged to deduct tax at source, is set at rest by virtue of Section 9 (2) which clarifies that income of a non-resident is deemed to arise in India and "shall be included in the total income of the non-resident" regardless of whether such entity has a place of business or business connection and the situs of services provided.

Assessee's contentions

15. Mr. Ajay Vohra, learned senior counsel for the assessee, argued that the findings of the ITAT with respect to the nature of services, i.e they were not technical services is correct and should not be disturbed. It was submitted that the ITAT took pains to analyze the correspondence, invoices raised by Technik and the relevant clauses of the agreement with it. The service obtained from that entity was in line with Attachment C, which was concerned only with overhaul and repair.

16. It was urged that by reason of Section 5(2) of the Act, a non-resident is liable to tax in India in respect of all income from whatever source

derived which – (a) is received or is deemed to be received in India by or on behalf of such person; or (b) accrues or arises or is deemed to accrue or arise to him in India during the year. Section 9 of the Act deems certain income to accrue or arise in India. Counsel submitted that the said provision prescribes that fees for technical services payable, *inter alia*, by a person resident in India is deemed to accrue or arise in India and, therefore, liable to tax in India in the hands of non-resident service provider. He relied on the Supreme Court judgment in *Ishikawajima – Harima Heavy Industries Ltd. v. DIT* 2007 (288) ITR 408 to say that to apply Section 9(1)(vii), services should not only be rendered in India, but also utilized in India. It was argued that to nullify the said decision Parliament enacted Explanation to Section 9(2) by Finance Act, 2007 which was again substituted by Finance Act, 2010 w.e.f. 1.06.1976. The effect of those amendments by enactment of Section 9(2) is to clarify beyond doubt that income by way of, *inter alia*, fees for technical services would be deemed to accrue or arise in India and consequently taxable in India, in the hands of the non-resident recipients, if the payer is a resident, irrespective of the situs of services, i.e. the place where the services are rendered.

17. Mr. Vohra said that Section 9(1)(vii) (b) of the Act provides an exception to the general source rule by providing that where the services rendered by the non-resident service provider (recipient of income) are utilized by the resident payer for purpose of earning income from any source outside India, then, in that situation, such fees would not be deemed to accrue or arise in India. It was highlighted that the Explanation to Section 9(2), added by Finance Act, 2010 w.e.f. 1.06.1976 merely clarifies the source rule, i.e., income is deemed to accrue or arise in India where the

payer is an Indian resident and the situs of services, i.e. the place where services are performed is immaterial. The Explanation is not intended to take away the exception provided in clause (b) to Section 9(1)(vii) of the Act. The assessee submits that there is no conflict between the provisions of Explanation to Section 9(2) and clause (b) to Section 9(1)(vii) of the Act; the two provisions operate in different fields. Resultantly, the exception provided in Section 9(1)(vii) (b) of the Act is not taken away by the retrospective insertion of Explanation to Section 9(2) of the Act.

18. The assessee relied on Supreme Court judgment in *Sundaram Pillai v. Pattabiraman* 1985 (1) SCC 591 to highlight that the object of an Explanation to a statutory provision is to explain the meaning and intendment of the Act itself, where there is any obscurity or vagueness in the main enactment or to clarify the same so as to make it consistent with the dominant object which it seems to sub-serve. It cannot, however, take away a statutory right with which any person under a statute has been clothed or set at naught the working of an Act by becoming a hindrance in the interpretation of the same. Counsel lastly relied on the recent Supreme Court judgment interpreting Section 9(1)(vii) of the Act in *GVK Industries Ltd. v. ITO* 371 ITR 453. Explaining the interplay between Section 9(1)(vii) and the amendment made by Finance Act, 2007 and Finance Act, 2010 resulting in retrospective insertion of Explanation to Section 9(2) of the Act, the Court clarified that the exception provided in terms of clause (b) to Section 9(1)(vii) was not overridden by insertion of Explanation to Section 9(2) of the Act and that for *"fees for technical services"* to be taxed in India, it is imperative that the payer is resident in India and that the services are utilized in India. As a sequitur, where the resident utilizes the services provided by

the non-resident service provider for purpose of earning income from any source outside India, payment for such services is not deemed to accrue or arise in India and hence not taxable in India. The Supreme Court also dealt with the two principles, namely situs of residence and situs of source of income and pointed out that the "Source State Taxation" rule which confers primacy to right to tax a particular income or transaction to the State/nation where the source of the said income is located, is accepted and applied in international taxation law. In the said judgment, it was observed that *"deduction of tax at source when made applicable, it has to be ensured that this principle is not violated."*

Analysis and reasoning

Question No.1:

19. The ITAT, in the impugned order has returned a finding that the services provided by Technik did not fall within the expression "technical service" and that Section 9(1)(vii) did not apply at the threshold. To arrive at this conclusion, the ITAT held that the assessee had no say in the work done by Technik and did not know what kind of repairs were carried out and that none of its employees ever visited Technik's facility in connection with such work. The ITAT surmised that since what the assessee asserted is that the overall components are returned duly certified by Technik that it had carried out the prescribed repairs, along with warranty and tax, there was no technical assistance by providing managerial, consultancy or technical services. It concluded that Technik performed the entire work on *"an inanimate body without any involvement or participation of assessee's personnel"*. It also held that managerial or physical exertion by Technik's

engineers on the assessee's components did not render such services managerial, technical and consultancy services within the meaning of Section 9(1)(vii)(d).

20. This Court is of the opinion that the ITAT was unduly influenced by all the regulatory compulsions which the assessee had to face. Besides international convention and domestic law that mandated aircraft component overhaul, the manufacturer itself – as a condition for the continued application of its warranty, and in order to escape any liability for lack of safety, required periodic overhaul and maintenance repairs. Unlike normal machinery repair, aircraft maintenance and repairs inherently are such as at no given point of time can be compared with contracts such as cleaning etc. Component overhaul and maintenance by its very nature cannot be undertaken by all and sundry entities. The level of technical expertise and ability required in such cases is not only exacting but specific, in that, aircraft supplied by manufacturer has to be serviced and its components maintained, serviced or overhauled by designated centres. It is this specification which makes the aircraft safe and airworthy because international and national domestic regulatory authorities mandate that certification of such component safety is a condition precedent for their airworthiness. The exclusive nature of these services cannot but lead to the inference that they are technical services within the meaning of Section 9(1)(vii) of the Act. The ITAT's findings on this point are, therefore, erroneous. This question is accordingly answered in favour of the Revenue.

Question No.2.

21. This question relates to the treatment of expenditure incurred by the

assessee (i.e. the payments made) towards its activities outside India. Here, the assessee's submission was that the payment made fell within the exclusionary part of Section 9(1)(vii)(b) and was not affected by the Explanation to Section 9(2). The assessee stressed upon the fact that no foreign technician was deputed to work in India. The assessee's submission is that the source of its income is wet-leasing activity to non-resident companies and consequently the source of income is outside India. Secondly, leasing revenue was received in convertible foreign exchange directly from foreign charterers through wired transfer in assessee's account denominated in foreign currency but maintained in India with the permission of the RBI and that the remittances to the foreign company for repairs had a direct nexus with the income. It was underlined here that payments to Technik for maintenance and repairs was essential and crucial for earnings from the wet-leasing activity. It was argued that Articles 2 and 3 of the contract with LCAG clearly state that only when the latter informed the assessee in writing that it did not require a certain capacity for a particular period, that the assessee could wet-lease the aircraft to others for that period. In all other periods, the assessee is committed to wet-lease the aircraft to LCAG, and the assessee's failure to do so would imply that LCAG was obliged to pay the rent for the minimum guaranteed block hours. The assessee relied upon the revenue earned on a comparative basis from LCAG and other wet-lease charters. The said chart is reproduced below:

	F.Y. 1997-98	***F.Y.1998-99***	***F.Y.1999-00***
Traffic Revenue from wet lease of aircraft's received from			

Lufthansa Cargo AG (Germany)	*318,513,565*	*854,612,518*	*657,569,352*
Singapore Airlines (Singapore)	--	*67,352,333*	*41,020,195*
Pacific Asia Cargo Airlines (Indonesia)	--	*26,125,451*	*37,769,600*
Shareef Express Travels (UAE)	--	*2,038,548*	*1,065,865*
Falcon Air Express Cargo Airlines (UAE)	*974,220*	--	--
Total	***319,128,850***	***950,128,850***	***737,425,012***

22. It was submitted that the revenue earned from LCAG accounted for 99%, 90% and 89% of the aggregate lease rentals earned by the assessee in A.Y. 1997-98, 1998-99 and 1999-2000 respectively. The balance income was also earned from foreign wet-lease. The Revenue's contention, on the other hand, was that the materials did not show that entire income was earned from sources outside India and consequently, the payment made to Technik could not be excluded. The Revenue also relied on the retrospective amendment to Section 9(2) made in 2010 to say that regardless of the question as to whether the expenditure is towards income earned abroad, the payee is deemed to have earned income in India by virtue of the amendment.

23. Before proceeding to analyse the merits of the rival contentions, it would be essential to extract the stipulations in the contract between LCAG and the assessee. They are as follows:

> *"**3.1 Operations***
>
> *The Aircrafts employed shall hold a valid Certificate of Airworthiness issued by the Civil Aviation Authority of India (DGCA) or by any other*

country should such issuance become necessary to perform the obligations of LCI as set forth under this Agreement. The Aircraft shall remain registered under the registration of LCI during the entire period of this Agreement. LCI shall ensure that Aircraft registrations and authorizations are suitable to perform flights to all countries set forth in the flight schedules hereunder.

LCI shall maintain the Aircraft during the term of this Agreement in accordance with LCI's maintenance program and schedule as approved by the Civil Aviation Administration of India or any such program or schedule mutually agreed upon between the parties.

All flights operated under this Agreement shall be performed under the operational control of LCI in all respect.

LCI shall obtain and maintain throughout the term of this Agreement all necessary licenses and permits required for any operation of the Aircraft under this Agreement."

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*"**CAPACITIES AND FLIGHT SCHEDULES Annex. No.-2***

1. <u>Capacities to be made available by LCI</u>

Should LCAG anticipate that the capacity provided by LCI under the Agreement couldn't be utilized by LCAG in its entirety in any calendar month, LCAG shall give promptly written notice of such determination to LCI. In the instance such notice is given more than 60 days before the date of the flight concerned, LCI will use its utmost efforts to re-market the capacities and flights not to be utilized by LCAG.

Should LCI be able to sell any such agreement the following terms and conditions apply for the calculation and payments of any charges by the LCIL for the capacity provided under the agreement.

1. "Block Hour" is defined as the period of time operated by the Aircraft gate to gate expressed in hours commencing when the Aircraft moves from the blocks to begin a flight and ending when the chocks have been inserted under the wheels after touchdown at the next point of landing. Such Block hours shall the respective Flight Deck Crews/OPS Dept give charged and invoiced in accordance of the Movement Message.

2. LCAG shall pay to LCI a guaranteed rate as set forth in this Annes. For each effectively completed Block Hour of operation or fractions thereof. Such rate (Rate A) shall be:

Until October 31, 1997:
US$ 1,845.00
(US $ One Thousand Eight Hundred and Forty-Five)
per Block Hour
from November 1, 1997:

US-$ 1,630.00
(US $ One Thousand Six Hundred and Thirty)
Per Block Hour.

The aforementioned price shall apply to all block hours performed by LCI up to a total of 960 (nine hundred and sixty) Block Hours performed under this Agreement per calendar month. Unless otherwise agreed upon in this Capacity Agreement, LCAG shall guarantee to LCI a payment totaling the amount of 960 (nine hundred and sixty) Block Hours performed under this Agreement per calendar month.

Should the number of Block Hours actually performed during a calendar month fall short of the number of Block Hours being in the minimum Block Hours guaranteed by LCAG, the rate (Rate B) for such Block Hours not actually performed for reasons not proved to be under the control of LCI shall be US$ 1,225.00 (US $ One Thousand Two Hundred and Twenty Five) per Block Hour."

The explanation to Section 9(2) was inserted by the Finance Act, 2007 with retrospective effect from 1.6.1976. The said Explanations read as under:

"For the removal of doubts, it is hereby declared that for the purposes of this section, where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub- section (1), such income shall be included in the total income of the non-resident, whether or not the non-resident has a residence or place of business or business connection in India."

The Finance Act, 2010 substituted the same explanation with effect from 1.6.1976. It now reads as follows:

> *"Explanation.- For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the non-resident, whether or not,-*
>
> *(i) the non-resident has a residence or place of business or business connection in India; or*
>
> *(ii) the non-resident has rendered services in India."*

24. It is evident that Parliamentary endeavor – through the later retrospective amendment, was to target income of non-residents. But importantly, the condition spelt out for this purpose was explicit: "*where income is deemed to accrue or arise in India under clauses (v), (vi) and (vii) of sub- section (1), such income shall be included in the total income of the non-resident... whether or not,- (ii) the non-resident has rendered services in India."* The revenue urges that the fiction created by the said amendment is to do away with the requirement of the non-resident having a place of business, or business connection, irrespective of whether *"..the non-resident has rendered services in India."* Did this amendment make any difference to payments made to such companies – even in relation to income accruing abroad? The revenue grounds its arguments in the assumption that the later, 2010 retrospective amendment, overrides the effect of Section 9 (1) (vii) (b) exclusion. While no doubt, the explanation is deemed to be clarificatory and for a good measure retrospective at that, nevertheless there is nothing in its wording which overrides the exclusion of payments made under Section 9(1)(vii)(b). The Supreme Court clarified this in *G.V.K Industries* (supra):

"22. The principal provision is Clause (b) of Section 9(1)(vii) of the Act. The said provision carves out an exception. The exception carved out in the latter part of clause (b) applies to a situation when fee is payable in respect of services utilized for business or profession carried out by an Indian payer outside India or for the purpose of making or earning of income by the Indian assessee i.e. the payer, for the purpose of making or earning any income from a source outside India. On a studied scrutiny of the said Clause, it becomes clear that it lays down the principle what is basically known as the "source rule", that is, income of the recipient to be charged or chargeable in the country where the source of payment is located, to clarify, where the payer is located. The Clause further mandates and requires that the services should be utilized in India.

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24. The two principles, namely, "Situs of residence" and "Situs of source of income" have witnessed divergence and difference in the field of international taxation. The principle "Residence State Taxation" gives primacy to the country of the residency of the assessee. This principle postulates taxation of world-wide income and world-wide capital in the country of residence of the natural or juridical person. The "Source State Taxation" rule confers primacy to right to tax to a particular income or transaction to the State/nation where the source of the said income is located. The second rule, as is understood, is transaction specific. To elaborate, the source State seeks to tax the transaction or capital within its territory even when the income benefits belongs to a non-residence person, that is, a person resident in another country. The aforesaid principle sometimes is given a different name, that is, the territorial principle. It is apt to state here that the residence based taxation is perceived as benefiting the developed or capital exporting countries whereas the source based taxation protects and is regarded as more beneficial to capital importing countries, that is, developing nations. Here comes the principle of nexus, for the nexus of the right to tax is in the source rule. It is founded on the right of a country to tax the income earned from a source located in the said State, irrespective of the country of

the residence of the recipient. It is well settled that the source based taxation is accepted and applied in international taxation law.

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28. Coming to the instant case, it is evident that fee which has been named as "success fee" by the assessee has been paid to the NRC. It is to be seen whether the payment made to the non-resident would be covered under the expression "fee for technical service" as contained in Explanation (2) to Section 9(1)(vii) of the Act. The said expression means any consideration, whether lumpsum or periodical in rendering managerial, technical or consultancy services. It excludes consideration paid for any construction, assembling, mining or like projects undertaken by the non-resident that is the recipient or consideration which would be taxable in the hands of the non-recipient or non-resident under the head "salaries". In the case at hand, the said exceptions are not attracted. What is required to be scrutinized is that the appellant had intended and desired to utilize expert services of qualified and experience professional who could prepare a scheme for raising requisite finances and tie-up loans for the power projects. As the company did not find any professional in India, it had approached the consultant NRC located in Switzerland, who offered their services. Their services rendered included, inter alia, financial structure and security package to be offered to the lender, study of various lending alternatives for the local and foreign borrowings, making assessment of expert credit agencies world-wide and obtaining commercial bank support on the most competitive terms, assisting the appellant company in loan negotiations and documentations with the lenders, structuring, negotiating and closing financing for the project in a coordinated and expeditious manner.

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34. In the case at hand, we are concerned with the expression "consultancy services". In this regard, a reference to the decision by the authority for advance ruling In Re. P.No. 28 of 1999[5], would be applicable. The observations therein read as follows:

> *"By technical services, we mean in this context services requiring expertise in technology. By consultancy services, we mean in this context advisory services. The category of*

technical and consultancy services are to some extent overlapping because a consultancy service could also be technical service. However, the category of consultancy services also includes an advisory service, whether or not expertise in technology is required to perform it."

35. In this context, a reference to the decision in C.I.T. V. Bharti Cellular Limited and others 2009 (319) ITR 139 would be apposite. In the said case, while dealing with the concept of "consultancy services", the High Court of Delhi has observed thus:

"Similarly, the word "consultancy" has been defined in the said Dictionary as "the work or position of a consultant; a department of consultants." "Consultant" itself has been defined, inter alia, as "a person who gives professional advice or services in a specialized field." It is obvious that the word "consultant" is a derivative of the word "consult" which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Consult has also been defined in the said Dictionary as "ask advice for, seek counsel or a professional opinion from; refer to (a source of information); seek permission or approval from for a proposed action". It is obvious that the service of consultancy also necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant."

36. In this context, we may fruitfully refer to the dictionary meaning of 'consultation' in Black's Law Dictionary, Eighth Edition. The word 'consultation' has been defined as an act of asking the advice or opinion of someone (such as a lawyer). It means a meeting in which a party consults or confers and eventually it results in human interaction that leads to rendering of advice."

Thus, it is evident that the “source” rule, i.e the purpose of the expenditure incurred, i.e for earning the income from a source in India, is applicable. This was clearly stated by the Supreme Court, when it later held that:

> *"The exception carved out in the latter part of clause (b) applies to a situation when fee is payable in respect of services utilized for business or profession carried out by an Indian payer outside India or for the purpose of making or earning of income by the Indian assessee i.e. the payer, for the purpose of making or earning any income from a source outside India. On a studied scrutiny of the said Clause, it becomes clear that it lays down the principle what is basically known as the "source rule", that is, income of the recipient to be charged or chargeable in the country where the source of payment is located, to clarify, where the payer is located. The Clause further mandates and requires that the services should be utilized in India."*

25. In the present case, the ITAT held that the overwhelming or predominant nature of the assessee's activity was to wet-lease the aircraft to LCAG, a foreign company. The operations were abroad, and the expenses towards maintenance and repairs payments were for the purpose of earning abroad. In these circumstances, the ITAT's factual findings cannot be faulted. The question of law is answered in favour of the assessee and against the revenue.

26. For the foregoing reasons, the revenue's appeal fails and is dismissed without any order as to costs.

S. RAVINDRA BHAT
(JUDGE)

R.K. GAUBA
(JUDGE)

MAY 27, 2015