KPMG
cutting through complexity

12 June 2015

Aircraft maintenance and repairs related services are technical in nature under the Income-tax Act. However, the payments were made to earn income from sources outside India and therefore, not deemed to accrue or arise in India

Background

Recently, the Delhi High Court in the case of Lufthansa Cargo India[1] (the taxpayer) held that since aircraft maintenance and repairs require specific level of technical expertise and ability, such services are held as Fees for Technical Services (FTS) under Section 9(1)(vii) of the Income-tax Act, 1961 (the Act). As the payments for such services have been made for earning income from sources outside India, such payments are not deemed to accrue or arise in India.

Facts of the case

- The taxpayer is an Indian company and engaged in the business of wet-leasing of aircrafts.
- It had acquired four old Boeing aircrafts from a non-resident company outside India. After registration of the aircraft with the Directorate General of Civil Aviation (DGCA), the taxpayer hired the crew, ground engineers and other technical personnel for their operation. It was granted a license by the DGCA to operate these aircrafts on international routes only.
- There were no facilities in India for their overhaul repairs. Such overhaul repairs were permissible only in workshops authorised by the manufacturer as well as duly approved by the DGCA.
- The taxpayer wet-leased[2] all its four aircrafts to a foreign company, Lufthansa Cargo AG, Germany (LCAG) under an agreement.
- 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, who issues notifications and guidelines, etc. from time to time in regard to the maintenance and upkeep of an aircraft.
- Every aircraft operator has to strictly abide by these guidelines. As the taxpayer was obliged to keep the aircraft in flying condition, it had to maintain them in accordance with the DGCA guidelines to possess a valid airworthiness certificate as a precondition for its business.
- The taxpayer's engineering department tracks 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 taxpayer's engineers and flown to a German company i.e. Lufthansa Technik's (Technik) workshops in Germany.

[1] DIT v. Lufthansa Cargo India (ITA 95/2005) – taxsutra.com

[2] 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.

- The parts were supplied by Technik under a separate agreement of sale, loan or exchange. In due course, the overhauled component would be dispatched by Technik along with an airway bill for which the freight would be paid by the taxpayer. The overhauled component would be fitted into aircrafts by the taxpayer's own personnel.

- The taxpayer had entered into an agreement i.e. 'The Technik Agreement', with the overhaul service provider. Technik carried out maintenance repairs without providing technical assistance by way of advisory or managerial services.

- 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 deputed to India for rendering any technical or advisory services to the taxpayer. Likewise, the taxpayer's technical personnel did not participate in the overhaul repairs carried out abroad by Technik or other foreign workshops.

- The taxpayer used to send components with a tag to the workshop abroad. Technik's workshops in Germany were duly authorised by the manufacturer, i.e. Boeing USA. Upon receipt, Technik overhauled the component in terms of the Manufacturer's Manual, as mandated by the DGCA.

- The taxpayer submitted in the assessment proceedings that 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. 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.

- The AO held that payments were in the nature of FTS 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) of the Act.

- 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 passed orders under Section 201 of the Act deeming the taxpayer to be an 'assessee in default' for the financial years 1997-98 to 1999-00, and levied interest under Section 201(1A) of the Act.

High Court's ruling

Fees for Technical Services

- The High Court held that unlike normal machinery repair, aircraft maintenance and repairs inherently are such that at no given point of time can it be compared with contracts such as cleaning. 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, an aircraft supplied by a 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 lead to the inference that they are technical services within the meaning of Section 9(1)(vii) of the Act.

Whether taxable in India

- Explanation to Section 9(2) of the Act is deemed to be clarificatory and also retrospective in nature but it does not override the exclusion of payments made under Section 9(1)(vii)(b) of the Act which was clarified by the Supreme Court in the case of G.V.K Industries[3].

- The 'source rule', i.e. the purpose of the expenditure incurred for earning the income from a source in India, is applicable, as stated by the Supreme Court in the case of G.V.K Industries.

- The Tribunal had held that the overwhelming or predominant nature of the taxpayer'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 an income abroad.

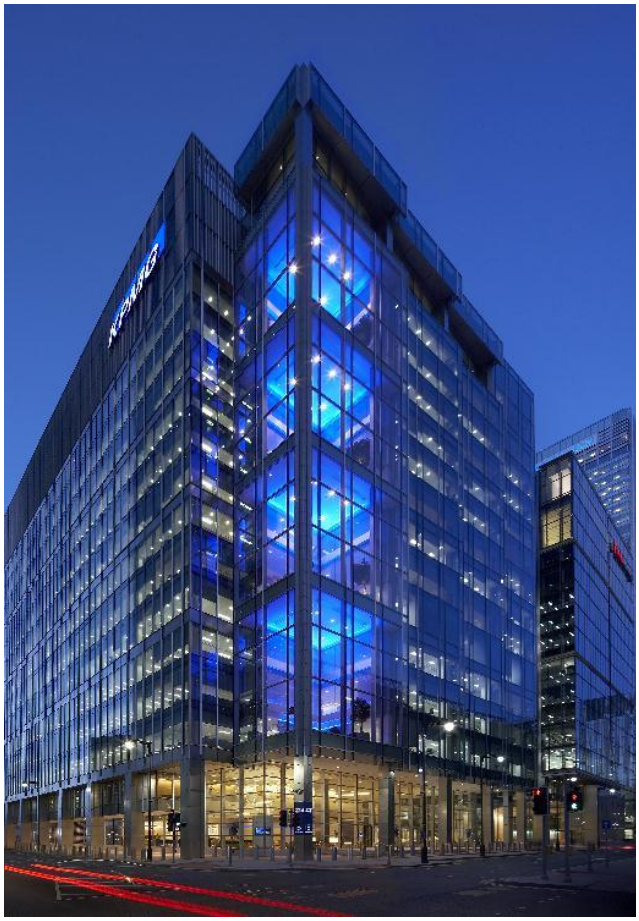
- Accordingly, these payments are not taxable because they have been made for earning income from sources outside India and therefore fall within the exclusionary clause of Section 9(1)(vii)(b) of the Act.

---

[3] GVK Industries Ltd. v. ITO [2015] 371 ITR 453 (SC)

Our comments

The Delhi High Court, in the present case, observed that aircraft maintenance and repairs require specific level of technical expertise which are exclusive services and therefore, technical services under the Act. The payments were made to earn income from sources outside India since aircrafts were allowed to be used only on international routes. Such payments are expressly excluded from the scope of FTS under the Act and therefore, not deemed to accrue or arise in India.



www.kpmg.com/in

Ahmedabad
Commerce House V, 9th Floor,
902 & 903, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051
Tel: +91 79 4040 2200
Fax: +91 79 4040 2244

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala, Bangalore 560 071
Tel: +91 80 3980 6000
Fax: +91 80 3980 6999

Chandigarh
SCO 22-23 (Ist Floor)
Sector 8C, Madhya Marg
Chandigarh 160 009
Tel: +91 172 393 5777/781
Fax: +91 172 393 5780

Chennai
No.10, Mahatma Gandhi Road
Nungambakkam
Chennai 600 034
Tel: +91 44 3914 5000
Fax: +91 44 3914 5999

Delhi
Building No.10, 8th Floor
DLF Cyber City, Phase II
Gurgaon, Haryana 122 002
Tel: +91 124 307 4000
Fax: +91 124 254 9101

Hyderabad
8-2-618/2
Reliance Humsafar, 4th Floor
Road No.11, Banjara Hills
Hyderabad 500 034
Tel: +91 40 3046 5000
Fax: +91 40 3046 5299

Kochi
Syama Business Center
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682019
Tel: +91 484 302 7000
Fax: +91 484 302 7001

Kolkata
Unit No. 603 – 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata 700 091
Tel: +91 33 44034000
Fax: +91 33 44034199

Mumbai
Lodha Excelus, Apollo Mills
N. M. Joshi Marg
Mahalaxmi, Mumbai 400 011
Tel: +91 22 3989 6000
Fax: +91 22 3983 6000

Noida
6th Floor, Tower A
Advant Navis Business Park
Plot No. 07, Sector 142
Noida Express Way
Noida 201 305
Tel: +91 0120 386 8000
Fax: +91 0120 386 8999

Pune
703, Godrej Castlemaine
Bund Garden
Pune 411 001
Tel: +91 20 3050 4000
Fax: +91 20 3050 4010