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India | Tax & Regulatory | 15 June 2015

Global Business Tax Alert
Sharp Insights

Explanation to Section 9 does not override the 'source rule' exclusion under section 9(1)(vii)(b) of the Act.

Issue no: GBTA/21/2015

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Synopsis

The Delhi High Court in the case of Lufthansa Cargo India has held that the expenses incurred outside India in respect of services utilized for the purpose of making or earning any income from a source outside India is not subject to tax in India and so there is no requirement to withhold tax at source in India. The Delhi High Court held that the substitution of Explanation[1] to section 9 does not affect the 'source rule' in section 9(1)(vii)(b) of the Income-tax Act, 1961 and the retrospective amendment makes no difference to the non-taxability of such income.

Facts

- The taxpayer company, Lufthansa Cargo India acquired four old Boeing aircrafts from a non-resident company. After registration of the Aircrafts with the Directorate General of Civil Aviation ('DGCA') the taxpayer hired crew, ground engineers and other technical personnel for their operation.
- The DGCA granted the license to the taxpayer to operate the aircrafts on international routes only and issued directives that various components and the aircraft itself had to undergo periodic overhaul repairs within specific time period.
- The Aircrafts were not used by any airline in India and there were no facilities in India for the repairs of the aircraft. The taxpayer wet-leased (i.e. leased aircraft along with crew) its four aircrafts to the Lufthansa Cargo AG, Germany under an Agreement. The lessee used the aircrafts for transporting cargo in its business from Sharjah to India.
- The taxpayer company had entered into an agreement with another Group Company Lufthansa Technik Germany ('Technik' or 'German Company') for overhaul / repair of the aircraft and its components. Technik did not provide technical assistance by way of advisory or managerial services.
- Before the expiry of the flying hours, the taxpayer used to dismantle outside India, the component needing overhaul/ repairs as per DGCA guidelines, which were sent to the Technik workshop. Technik used to dispatch the overhauled / repaired component to

[1] Explanation to section 9 substituted by Finance Act, 2010 w.r.e.f. 1-6-1976.

the taxpayer outside India, as mandated by DGCA.

- No personnel of Technik was deputed to India for rendering any services.
- As per the taxpayer, repairs services did not constitute 'managerial', 'technical' and 'consultancy' services as defined under Explanation 2 to section 9(1)(vii) of the Act. Even if considered as fees for technical services, the income is not deemed to accrue or arise in India for Technik as the payment though made by a resident company, i.e. the taxpayer, is in respect of services utilized for the purpose of making or earning any income from a source outside India
- The Assessing officer (AO) held that the payments for repairs/overhaul charges were in the nature of 'fees for technical services' as defined in Explanation 2 to section 9(1)(vii) and were therefore, chargeable to tax. The AO held 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 to Explanation to section 9. Since the taxpayer had not deducted tax at source on such payments, the AO passed order under section 201 and levied interest under section 201(1A) of the Act.
- The Commissioner of Income-tax (Appeals) upheld the order of the AO.
- However the Tribunal allowed the appeal and held that the payments were made for repairs and overhaul of components of aircraft, which was in the nature of business income and not in the nature of 'fees for technical services'. Even if assumed to be in the nature of 'fees for technical services', was not chargeable to tax in India under section 9(1)(vii)(b).

Issue before the High Court

- Whether the Tribunal 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.
- Whether the Tribunal 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.

Decision of the High Court

- The Delhi High Court held that services in the nature of repair /overhaul rendered by the German company, were technical services within the meaning of section 9(1)(vii).
- The High Court observed that the wet-leasing operations were carried out outside India and the expenses towards repairs and maintenance of aircraft components were incurred outside India.
- The High Court observed that the Tribunal's decision on facts, that the source of income of the taxpayer was situated outside India could not be faulted.
- The High Court held that there was nothing in the wordings of the Explanation to Section 9 which overrides the exclusion of deemed income under section 9(1)(vii)(b).
- Explanation to section 9 was substituted by the Finance Act 2010 w.r.e.f. from 1 June 1976 to provide that interest or royalty or fees for technical services earned by a non-resident shall be deemed to accrue or arise in India whether or not the non-resident has a residence or place of business or business connection in India or the non-resident has rendered services in India.
- The High Court relied on the decision of the Supreme Court[2], for clarifying the 'source rule' in the section 9(1)(vii)(b) of the Act.
- The High Court held that payment by resident company for repair / overhaul to a non-resident company was for earning income from source outside India and so covered by exception under section 9(1)(vii)(b) of the Act and hence not chargeable to tax in India.

[2] GVK Industries v/s. ITO (2015) 371 ITR 453 (SC)

Comments

- The Delhi High Court in CIT vs. Havells India Ltd (2013) (352 ITR 376)(Del HC) had held that the customer located outside India is not the source of the income though he is the source of the monies received.
- The Panaji Tribunal vide order dated 16 March 2015 in the case of Ajit Ramakant Phatarpekar (ITA NOS. 145 & 146/PNJ/2014) (assessment year 2010-11) held that if an amount becomes taxable due to retrospective substitution of Explanation to section 9, payments made prior to the amendment cannot be disallowed for lack of withholding tax.

Source: Delhi High Court decision dated 27 May 2015, in the case of DIT v/s. Lufthansa Cargo India (ITA No. 95/2005)

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