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TAX FLASH NEWS

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The Delhi High Court restores the matter to the Tribunal to examine the taxability of the payments made under technical support and crew lease agreements under the Income-tax Act as well as under the India-Germany tax treaty

Background

Recently, the Delhi High Court in the case of Modiluft Ltd.[1] (the taxpayer) has dealt with the issue with respect to taxability of payment under technical support and crew lease agreements.

The Income-tax Appellate Tribunal (the Tribunal) held that lease rent and fee for technical services were business profits, and the payments were not taxable in India under the India-Germany tax treaty (tax treaty) in the absence of a Permanent Establishment (PE) in India.

However, there is no discussion in the Tribunal's order whether the payments made under the technical support and the crew lease agreements were for payment for technical services.

The High Court restored the matter to the Tribunal to examine the taxability of such payment under the relevant provisions of the Income-tax Act, 1961 (the Act) as well as under the tax treaty.

Facts of the case

- The taxpayer leased three aircrafts under the 'aircraft lease agreement' from Deutsche Lufthansa Aktiengesellschaft (Lufthansa). Before the lease agreement, the taxpayer had entered into agreement for technical support. In addition, another agreement for provision for flight deck crews was also entered. The 'aircraft lease agreement' was approved by the Central Board of Direct Taxes (CBDT) under Section 10(15A) of the Act.

- The taxpayer's request for withholding tax certificate in respect of crew lease payments for engineers was declined by the Assessing Officer (AO) who held that:

  - crew lease payment was not covered under Section 10(15A) of the Act
  - technical support agreement for providing engineers on lease was not approved under Section 10(15A) of the Act
  - under the tax treaty, payments to a non-resident for providing technical personnel is 'Fee for Technical Service' and the same is taxable in the country in which they arise.

- On appeal, Commissioner of Income-tax (Appeals) [CIT(A)] and the Tribunal followed the Tribunal's previous decision where it was held as follows:

  - Payments under technical support and crew lease agreements were not entitled to exemption under Section 10(15A) of the Act because no approval under the said Section was granted to these agreements
  - Both the lease rent and the Fee for Technical Services were business profits of Lufthansa, inasmuch as the lease of the aircrafts was with the operational staff
  - Having held that lease rent and fee for technical services were business profits, the Tribunal relied on the decision of the

[1] DIT v. Modiluft Ltd. (ITA 772/2004, ITA 15/2005 (Del) – Taxsutra.com

Authority for Advance Ruling (AAR) in the case of Tekniskil (Sendirian) Berhard[2] and held that payment made for provision for technical personnel was not taxable in India within the meaning of Article III[3] of the tax treaty.

Issue before the High Court

Whether the Tribunal was justified in holding that technical service charges payable to the foreign company in Germany constitute business profit of the foreign company and that the same was not taxable in India.

High Court's decision

- The findings of the Tribunal were influenced by the decision of the AAR in Tehniskil (Sendirian) which were rendered in an entirely different context, and in that case the India-Malaysia tax treaty as applicable at the relevant time did not contain the clause for 'Fee for Technical Services'. In that context it was held by the AAR, that the 'Fee for Technical Services' arising out of supply of skilled labour were not liable to tax in India in terms of Article 7 as business profits on the ground that the taxpayer did not have a PE in India in terms of Article 5 of the tax treaty between India and Malaysia.

- In the facts of the present case, in terms of the tax treaty, payments made to Lufthansa may not be liable to tax in India in terms of Article III (business profits) of the tax treaty, yet their taxability in terms of Article VIIIA (Fees for Technical Services) of the tax treaty, as there exists a 'Fee for Technical Services" clause in the tax treaty, was not examined in proper perspective.

- In the present case, the issue of technical fee has to be examined from the point of view of Article VIIIA introduced by the amending protocol, which to the extent is relevant.

- The facts of present case also reveal that only one agreement, i.e., the lease agreement, was approved under Section 10(15A) of the Act. The other two agreements, i.e., the crew lease and technical support agreements were not approved. There is no discussion in the orders of the Tribunal whether the payments made under the technical support agreement or the crew lease agreements were not payment for technical services, apart from a priori assumption that the question of taxation does not arise if there is no PE.

- With respect to payment for services of personnel under the crew lease agreement, both the statute and the tax treaty talk of taxability of payments for services that are managerial, technical or consultative in nature "including provision of services of technical or other personnel."

- In the absence of the agreements and a fuller discussion by the Tribunal which seems to have decided only on the applicability of the AAR's ruling, it was opined that the appeals need to be reconsidered and specific findings rendered in the context of Section 9(1)(vii) of the Act and provisions of the tax treaty.

- The issue thus, is restored to the Tribunal to render its findings in light of the provisions of tax treaty and the other provisions of the Act, in accordance with law.

Our comments

The issue with respect to whether the taxability of payments for lease rent and specified services are fees for technical services has been a matter of debate before the Courts/Tribunal.

The Delhi High Court in the case of Sumitomo Corporation[4] held that supervisory fees received by the taxpayer were taxable as Fees for Technical Services and not as business profits since such fees are not effectively connected with the PE in India under the India-Japan tax treaty. The AAR in the case of Brown & Root Inc.[5] held that income earned from a contract for installing a pipeline was classified as business income and not Fees for Technical Services and since the taxpayer did not have a PE in India, the amount was not taxable in India.

The High Court distinguished the case of Tekniskil on the ground that the clause dealing with 'Fees for Technical Services' is missing in the India-Malaysia tax treaty. Therefore, the issue of technical fees in the present case needs to be examined under the Act as well as under the tax treaty. Accordingly, the matter has been sent back to the Tribunal.

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[2] Tekniskil (Sendirian) Berhard v. CIT [1996] 222 ITR 551 (AAR)
[3] Article on 'business profits'

[4] CIT v Sumitomo Corporation [2017] 80 taxman.com 247 (Del)
[5] Brown & Root Inc. [1999] 103 Taxmann 515 (AAR)

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