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Tax Flash News

17 September 2025

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No permanent establishment on account of leased aircraft at exclusive disposal of the lessee

Executive summary

In the case of *Sunflower Aircraft Leasing Limited*[1], the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) held that mere presence of leased aircraft in India does not constitute taxpayer's Permanent Establishment (PE) under the India-Ireland tax treaty (the Treaty) in the case of dry lease where the lessor does not have any operational control over the aircraft.

Considering the various judicial precedents, the Tribunal further held that simply owning an asset or exercising protective rights associated with ownership does not, by itself, fulfil the disposal test to establish a PE in India.

Furthermore, even if an Indian PE is assumed, the Tribunal concluded that considering the specific provisions under the Treaty governing taxation of profits derived from operations of aircrafts in international traffic, the lease rentals received by the taxpayer from the Indian lessee are not taxable in India.

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[1] *Sunflower Aircraft Leasing Limited* v. *ACIT* (ITA No.1107/Mum/2025)

Facts of the case

The taxpayer, a tax resident of Ireland, was engaged in the business of aircraft leasing. It entered into dry operating lease agreements with an Indian airline (the lessee).

The taxpayer retained the ownership over aircraft but transferred possession, operational control, and maintenance responsibilities to the lessee.

The Aircraft Lease Agreements (ALA) were negotiated, documented, and executed in Ireland. The delivery of the aircraft to the lessee occurred outside India. At the end of the lease period the aircraft were redelivered to the taxpayer.

For the financial year 2021-22, the taxpayer filed ‘Nil’ tax return, asserting that the lease rentals constituted business profits, and in the absence of a PE in India[2], the rental income was taxable only in Ireland under the Treaty[3]. Alternatively, as per the specific provisions under Article 8 of the Treaty (dealing with the taxability of the profits derived from the operation of aircraft in international traffic), its rental income was taxable only in Ireland and not in India.

However, the Revenue alleged that the leased aircraft constituted fixed place PE in India and attributed 25 percent of gross lease rentals to the Indian PE.

Relevant provisions

Article 7(1) of the Treaty provides that business profits of an Irish enterprise are taxable only in Ireland unless such enterprise carries on business in India through a PE situated therein.

However, as per Article 8(1) of the Treaty, the profits derived by an Irish enterprise from operation or rental of aircraft in international traffic and the rental of containers and related equipment which is incidental to the operation of aircraft in international traffic are taxable only in Ireland.

Further, the term “international traffic” means transport by aircraft operated by an enterprise from one Contracting State, except when the aircraft is operated solely between locations within that Contracting State[4].

2 Article 5

3 Article 7 - The payment did not constitute ‘royalty’ as the definition of royalty under the Treaty specifically excludes payment for use or right to use an aircraft.

4 Article 3(1)(f)

Taxpayer's contentions

No Permanent Establishment in India

- All core income-generating functions including marketing, negotiation, execution of ALA, financing, asset management, and strategic decisions were undertaken from the taxpayer's offices in Ireland. The taxpayer had no personnel stationed in India performing core business functions from a fixed location.
- Under the ALA, the lessee was granted the right to the use and possess the aircraft during the lease period. The lessee was obligated to maintain the aircraft and comply with airworthiness directives, licenses, permits, and the Directorate General of Civil Aviation (DGCA)'s regulatory framework.
- The aircraft were not at the taxpayer's disposal as the operational control, navigation, and commercial deployment of the aircraft vested entirely with the lessee. The taxpayer neither provided crew nor offered technical or operational services in India. The taxpayer's rights were limited to ownership protection, such as annual inspections, periodic reports, and repossession of the aircraft on default as per ALA. There is a distinction between control over the asset for income generation and ownership rights to protect the asset.
- A high-value movable asset such as an aircraft, which was capable of deployment in multiple jurisdictions and whose presence in India was dictated solely by the lessee's commercial operations, cannot, *per se*, constitute a fixed place PE for the taxpayer.

Income from operation of aircraft not taxable in India

Even if lease rentals are regarded as taxable business profits, Article 8 of the Treaty allocates taxing rights solely to the resident country, i.e. Ireland.

Unlike the OECD Model Convention, the Treaty specifically covers "rental of ships or aircraft in international traffic" in the operative clause reflecting a conscious policy choice by the two Contracting States to tax such income exclusively in the resident country, regardless of whether the lessor itself operates the aircraft. Passive leasing to an airline engaged in "international traffic" suffices condition for allocating taxing rights to the resident country[5]

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[5] *Kuwait Airways Corporation v. DCIT* (ITA No. 1310/Mum/2005); *Federal Express Corporation v. ADIT* [2011] 45 SOT 46 (Mumbai Tribunal)

The ALA placed no contractual restrictions on the deployment of the aircraft for international routes. Thus, the rental income from such leased aircraft was within the scope of "international traffic" as envisaged under the Treaty.

Revenue's contentions

Permanent Establishment in India

- The regular and predictable presence of leased aircraft in India when not in flight constituted fixed place PE.
- Even through the lessee exercised day-to-day operational control over the leased aircraft, the ownership of such aircraft, combined with extensive contractual rights including periodic inspection, monitoring of technical condition, imposition of mandatory maintenance standards, and the ultimate right of repossession conferred a sufficient degree of disposal on the taxpayer. Such rights went beyond mere 'protective covenants.'
- By situating the leased aircraft in India for extended periods to derive income from an Indian lessee, the taxpayer was carrying on business in India through that fixed place, irrespective of whether personnel were present in India or not.
- A place of business can, in certain circumstances, be constituted by a movable asset if it is located at a particular site for a sufficient period. In the instant case, the aircraft were physically based in India for the entirety of the lease tenure, fulfilling this test.

Income from operation of aircraft taxable in India

The Treaty provisions relating to taxability of income from aircraft operations were not applicable in the instant case since the taxpayer was a pure lessor with no airline operations of its own.

The Treaty intends to restrict the taxing rights on lease rentals to the resident country (i.e. Ireland) where leasing arrangements are ancillary to the lessor's own international operations, not passive leasing to a domestic operator for primarily domestic use by the lessee.

The occasional or incidental operation of the leased aircraft on the international sectors did not qualify as being operated in "international traffic" under the Treaty.

Tribunal’s decision

The Tribunal ruled in favour of the taxpayer and held that the taxpayer did not have a fixed place PE in India. Further, the rental income from leased aircraft was not taxable in India by virtue of the Treaty article dealing with the taxation of income from operation of aircraft.

No Permanent Establishment in India

Taxpayer’s business is that of dry leasing aircraft – an activity executed entirely from Ireland, with negotiations, contract execution, and management undertaken outside India. The aircraft, though valuable business assets, did not serve as a ‘place’ through which the taxpayer’s leasing business was carried on in India.

The lessee assumed the possession of the aircraft outside India and, consequently, by the time the aircraft entered the Indian territory, they were already under exclusive control and disposal of the lessee and not that of the taxpayer.

The Revenue‘s contention that the aircraft themselves constituted a “place of business” because they were the source of the taxpayer‘s income overlooks the distinction between the situs of the asset and the locus of business activity. The aircraft were never placed at the disposal of the taxpayer in India to conduct its business as they were at the disposal of the lessee, which operated them for its own commercial purposes[6].

The leased aircraft could not be accessed or used by the taxpayer at will for its business. Every entry to airside/ hangar areas required the lessee’s operational consent and regulatory clearances.

Operational control over the aircraft, including deployment, routing, scheduling, and crewing, vested exclusively with the lessee. The absence of taxpayer’s personnel or operational infrastructure in India further reinforced the absence of a fixed place PE.

The rights retained by the taxpayer such as periodic inspection, ensuring compliance with maintenance standards, and repossession in default are standard

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[6] *Formula One World Championship Ltd.* v. *CIT* [2017] 394 ITR 80 (SC); *ADIT* v. *E-Funds IT Solution Inc.* [2017] 399 ITR 34 (Supreme Court); *Hyatt International Southwest Asia Ltd*. v. *ADIT* [2025] 176 taxmann.com 783 (SC)

lessor protections safeguarding the value of the asset, not indicative of the asset being at the lessor's disposal for carrying on business in India.

Rental income not taxable in India

The Treaty provides that profits derived by an Irish tax resident from operation or rental of aircraft in international traffic is taxable in Ireland. The Treaty disjunctively pairs "operation" and "rental" as independent income-yielding activities. Further, it contains no requirement that the rental be merely ancillary to the lessor's (i.e. the taxpayer in the instant case) own operation of aircraft.

The language of relevant provisions under the OECD Model Convention is narrower as it only refers to "operation" of aircraft, not rental.

Where both the Contracting States have consciously departed from the OECD Model Convention to include "rental" as an alternative to "operation," the Treaty language must be given effect in its ordinary sense. Imposing additional conditions—such as requiring the lessor to be an operator in international traffic, or that the rental activity be subordinate to such operation—amounts to reading into the provision words that are not present in the Treaty text.

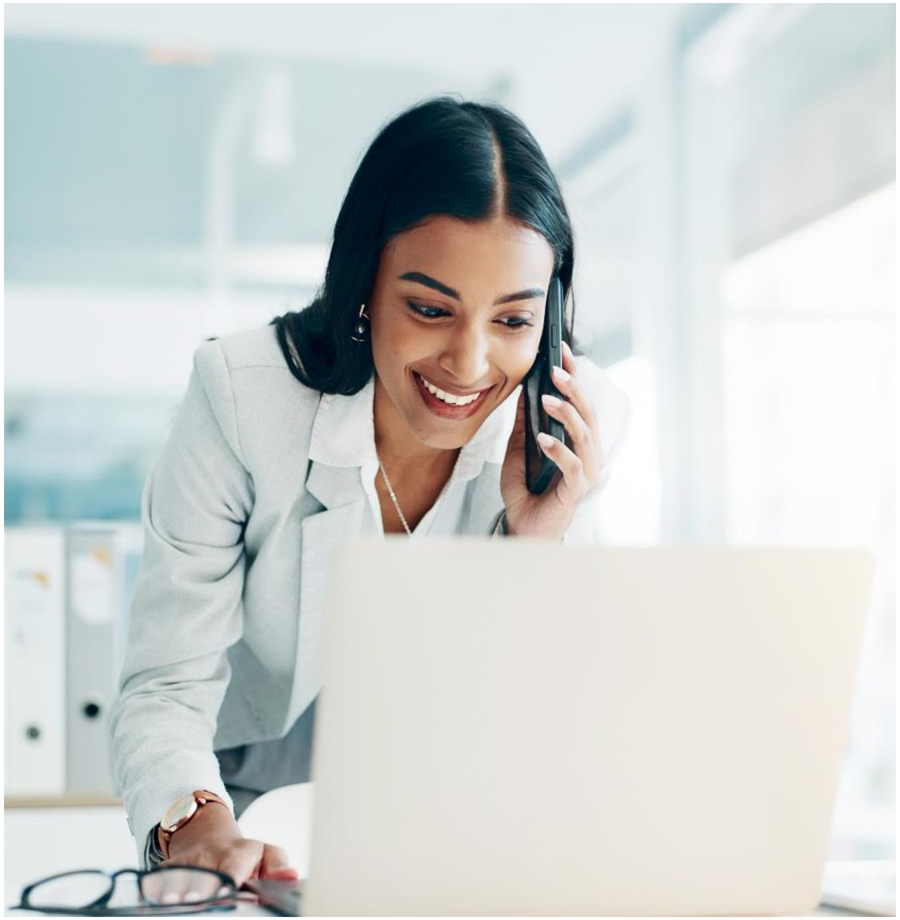
Further, to avail Treaty benefit, it is important that aircraft must be used on international routes and not operated solely on domestic routes. The Treaty does not stipulate any predominance or threshold of international usage. Since the lessee is an international carrier airline and leased aircraft formed part of a fleet used on both domestic and international routes, the Treaty benefit is available and accordingly the rental income was not taxable in India.

The Treaty article dealing with taxability of income from operations of aircraft is a specific provision which prevails over the general rule for taxability of business profits as per the Treaty in case of existence of PE. Even if the taxpayer was found to have a PE in India, as per the specific provisions under the Treaty, the profits from such rental income would have been taxed only in Ireland, and not India.

Our comments

The Tribunal reaffirmed that the ‘disposal test’ remains an essential criterion for establishing PE under the tax treaties.

The determination of a PE necessitates a thorough factual analysis and careful application of the conditions specified in the relevant treaty.



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