Delhi HC upholds Article 8 exemption for income from provision of technical facilities/ services to other airlines at Indian airports; distinguishes British Airways ruling

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In brief

The Delhi High Court (HC) recently analysed the taxability of amounts received by foreign airlines from the provision of technical facilities/ services to other airlines at Indian airports. The Delhi HC held that such receipts were not chargeable to tax in India as per Article 8 of the India-Germany Double Taxation Avoidance Agreement (tax treaty) and Article 8 of India-Netherlands tax treaty. The Delhi HC distinguished a ruling of the Delhi Income-tax Appellate Tribunal (Tribunal) in another case, where receipts from similar services were held to be not falling within the realm of Article 8 of the India-United Kingdom tax treaty.

In detail

Facts

- The taxpayers[1] operated aircrafts in international traffic, including to and from airports in India. As a member of International Airlines Technical 'pool' (IATP), they provided technical facilities/ services (line maintenance facilities) to other airlines at airports in India. These services were predominantly provided with a view to assist other IATP member airlines. The taxpayers also sourced similar services from other IATP member airlines at airports in India for its own operations.
- The amounts for provision for these services were adjusted through notional debits and credits through IATP's accounting mechanism, i.e., the International Air Transportation Association (IATA) clearing house.
- The taxpayers filed their returns of income where they claimed the amounts received from various IATP member airlines towards provision of line maintenance services to be exempt from tax in India.
- The Tax Officer (TO) disallowed the exemption claimed by the taxpayers stating that the activities were commercial in nature and could not be considered to be a part of the profits from transportation of passengers in international traffic. The TO further held that the income of the taxpayers from provision of such services would be chargeable to tax in India as business income under Article 7 of the India-Germany tax treaty and

[1] ITA No. 627, 540/ 2016, ITA No. 610/ 2004, ITA No. 337/ 2005, ITA No. 1017/ 2006, ITA No. 1024, 1026, 1031, 1241/ 2006, ITA No. 856, 259/ 2007, ITA No. 195, 765, 198/ 2008, ITA No. 862, 877, 1162, 1047/ 2011, ITA No. 1861/ 2010

India-Netherlands tax treaty, as the taxpayers had branch offices in India which constituted permanent establishment (PE) under Article 5.

- The Commissioner of Appeals dismissed the appeals filed by the taxpayers. On further appeal, the Tribunal held that receipts of the taxpayers from provision of technical facilities to other airlines was not chargeable to tax in India under Article 8 of the India-Germany and India-Netherlands tax treaties, as the same was profit from participation in a 'pool'. The revenue department filed an appeal against the Tribunal's order before the Delhi HC.

Revenue's contentions

- The Revenue relied upon the decision of the Delhi Tribunal in the case of British Airways[2] and contended that in the present case, the Tribunal should have followed its earlier decision, i.e., the decision in the case of British Airways[2].
- The Revenue argued that the term, 'pool' was not defined under the tax treaties, and therefore IATP could not be considered as a 'pool' referred to in the tax treaties. It further argued that in case of a 'pool', there should have been direct reciprocity between the member airlines, i.e., facilities should have been extended to a particular airline and facilities should have been acquired from that particular airline. However, in the present case, the services were acquired from one set of airlines but extended to an entirely different set of airlines.
- The Revenue contended that for a 'pool', there should have been a unified structure, common management and administration under which the participants had to operate. In the absence of such structure and common management, no 'pool' could have been said to be in existence.
- The Revenue contended that for a 'pool', there should have been a bringing together of assets and resources of various airlines, and there should have been an intention to carry on a joint business, and to share the profits from the 'pool'. However, the IATP agreements did not constitute services on a reciprocal basis, since there was no reciprocity in the services rendered between one airline and another.
- The Revenue also argued that the ground handling services were provided on commercial terms, with the sole purpose of generating revenue from spare and idle capacity, which did not bring in to existence a 'pool', since neither assets nor resources of various airlines were brought together at any international airport to provide the said services.
- The Revenue contended that Article 8(4) of the India-Germany tax treaty and Article 8(3) of the India-Netherlands tax treaty concern themselves with pooling provisions, and these provisions were mere amplifications of Article 8(1) of the respective tax treaties, which pertain to taxation in the country of residence on income earned from transportation in international traffic. In other words, the provisions relating to pooling should relate to the business of air transportation of the taxpayer. However, in the present case, such activities of provision of facilities and services to other airlines could not be said to be related to the business of air transportation carried on by the taxpayers.

Taxpayer's contentions

- The tax treaties between India-Germany and India-Netherlands provide that the provisions of Article 8(1) shall apply to profits from participation in a 'pool' or joint business. Consequently, any income from a pooling arrangement shall be taxable in the country of residence or effective place of management. In the international airline industry, there is no 'pool' other than IATP, under which every participating member would be required to provide services and avail services from other airlines. Hence, the contention that IATP arrangements could not be held to be pooling arrangements, as argued by the Revenue, was factually incorrect.
- The taxpayers argued that provision of services to other IATP member airlines was with the objective of collaboration among various member airlines of the IATP. Provision of line maintenance services to member airlines at international airports was mandatory and non-derogable from the point of view of flight safety requirements, in the absence of which aircrafts would have to return to their base for availing of technical facilities, which was highly commercially unviable in a high cost industry such as aviation.
- The taxpayers held that the primary objective of a 'pool',

[2] British Airways Plc *v.* DCIT [2001] 73 TTJ 519(Delhi-Tribunal)

and the context in which the term was used, was to ensure sharing of resources between members of IATP so as to ensure efficient business functioning. A common management was incidental and would be in place only to expedite the process of sharing of resources.

- The taxpayers also contended that the Tribunal had correctly differentiated its ruling in the case of British Airways,[2] based on the following:
  - The Tribunal held that British Airways[2] had provided facilities to other airlines, but did not acquire any such facilities from other airlines;
  - Receipts from provision of facilities and non-incurring of any expenses suggested that there was a motive of earning profits from such activities of providing line maintenance services. It was, therefore, understood that the work performed was a planned commercial activity, and that the entire establishment was set up for rendering such services to other airlines;
  - British Airways had also employed excess staff for provision of such services to other airlines, whereas in the taxpayers' case, there was no such excess staff employed, but existing and idle staff alone were deployed for performance of such line maintenance services.

Issue before the High Court

Would profits from providing technical services to other airlines be covered under participation in a 'pool', joint business, or an international operating agency, and thereby be exempt from tax in India?

Held by the High Court

- The HC at the outset observed that the Tribunal, at the time of the ruling in the case of British Airways,[2] adopted the dictionary meaning of the term 'pool' which, as per the Revenue, is the apt interpretation and, therefore, should have been adopted.
- The HC held that the IATP was the only known 'pool' in the aviation industry. The HC further held that the contention of the revenue that a 'pool' did not mean mere sharing of resources, but a unified structure administering such 'pool' and facilitating the provision of services by member airlines to one another, was just stereotyping the meaning of the term.
- The IATP Manual states that it was an organisation of airlines formed for the purpose of providing reciprocal technical support and line stations throughout the world. The reciprocal technical support includes aircraft spare parts, ground and ramp handling equipment and manpower. The primary goal of the IATP was to generate economic setting savings to member airlines by minimising investments that would otherwise have been required for purchase of equipment and spare parts to be established at various airports to aid in operation of aircrafts.
- On perusal of the Articles of the IATP, it held that members were mandated to provide services and facilities to other member participants at more than one station to provide for optimisation of resources.
- It was also held that the aviation industry, being cost intensive, would require arrangements such as the IATP for acquiring facilities from other member airlines in various airports instead of investing in manpower and machinery all across the world to comply with technical and safety standards. Such arrangements allowing optimisation of resources and services were a compulsion in the airline industry, in the absence of which the shape of the airline industry would have been very different, i.e., there would probably have been lower air traffic than there was currently.
- The HC further held that the Revenue could not take extraneous aids or dictionary meanings, or the help of tax treaties entered into with other states, to interpret the meaning of a term in a Tax Convention. The only recourse to determine the meaning of a term used in a tax treaty was to determine the intentions of the contracting parties. The HC also referred to the Vienna Convention to determine the manner in which tax treaties were required to be interpreted.
- On interpretation of the tax treaties between India-Germany and India-Netherlands, and the IATP manual, the HC held that there was a clear reciprocity between the participating members in rendering and availing of services, and hence, there was a clear participation in a 'pool'. As a result, the income from participation in the 'pool' could not be taxable in India.
- The HC also differentiated the Tribunal's ruling in British Airways[2] on factual grounds by stating the following:
  - There was a lack of reciprocity in the agreements entered into between British Airways[2] and other airlines, which

was not the same in the taxpayers' case;

- British Airways had a separate establishment and a separate office set-up to monitor ground handling services, and the different establishment did not form part and parcel of the operation of British Airways[2] pertaining to operation of aircrafts in international traffic;
- Services and facilities provided by British Airways was a commercial activity, and excess or idle capacity was provided to other airlines at a price;
- British Airways had a branch in India, which constituted a PE in India, and therefore, the income derived from the PE was taxable in India; and
- The India-United Kingdom tax treaty provided that Article 8(1) of the India-United Kingdom tax treaty shall apply in participation in pools of any kind, which was missing in the tax treaties with Germany and Netherlands.

- Taking all the above factors into account, the HC upheld the Tribunal's order and ruled in favour of the taxpayers.

The takeaways

- In the context of India-Netherlands and India-Germany tax treaties, the HC has held that IATP was the only internationally recognised 'pool'.
- Further, the principles laid down by the Tribunal under the India-United Kingdom tax treaty for the interpretation of the term 'pool' based on the dictionary meaning which requires the pooling of assets, and resources, have not been reversed.
- It would be important to see how further decisions on the interpretation of the term 'pool' in case of services not associated with the IATP are concluded.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor.

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