

Lufthansa Cargo India Private Ltd. vs Dcit [Alongwith T.D.S. Appeal Nos. 66, ... on 30 June, 2004

Equivalent citations: [2004]91ITD133(DELHI), [2005]274ITR20(DELHI), (2005)92TTJ(DELHI)837

ORDER

R.K. Gupta, Judicial Member

1. These are eight appeals filed by assessee and department against the orders of CIT (Appeals). Out of eight appeals, five appeals arise from a consolidated order passed by the CIT (A) for the three Financial Years 1997-98, 1998-99 and 1999-2000 relevant to Assessment years 1998-99 to 2000-01, respectively. The CIT (A) has partly confirmed the orders Under Section 201/201(1A) passed by the Assessing Officer holding the assessee to be in default for non-deduction of tax at source on payments made to non-resident parties for overhaul of its air-crafts, engines and components etc. She however held that such payments to the residents of UK and USA are not chargeable to tax keeping in view the provisions of the DTAA's with those countries. The Assessee is in the appeal before us for all the three years. The Revenue is in appeal for Financial Years 1998-99 to 1999-00 only. As the issues are common in all the three years, these appeals are disposed by a consolidated order.

2. The remaining three appeals are by assessee against sustenance of penalty Under Section 271C for these three years. We will take first the appeals of the assessee and department in regard to levy of interest Under Section 201 and 201(1A).

3. The brief facts of the case are that the assessee is a domestic company which had acquired four Boeing Cargo Aircrafts in mid-1997 from a foreign company. The assessee obtained license from the Director General of Civil Aviation (DGCA), the licensing authority, to operate these aircraft on international routes only. It also engaged crew, technical personnel, engineers and other ground staff and wet-leased the aircrafts to a foreign cargo company. The assessee periodically made payments to non-residents on account of overhaul, repairs of its aircrafts, engines sub-assemblies and rotables (hereinafter referred to as 'components') in workshops abroad. No tax was deducted at source on such payments. No application Under Section 195(2) was filed with the Assessing Officer either. The Assessing Officer held that such payments were in the nature of 'fees for technical services' as 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. The Assessing Officer also rejected the plea of the assessee that the payments for repairs were incurred for earning income from sources outside India and therefore the assessee's case fell within the exclusionary clause of Section 9(1)(vii)(b). The Assessing Officer rejected another plea of the assessee that the business of aircraft leasing was carried on outside India. The assessee's alternate plea that in any case the payments made to residents of USA, UK, Israel, Netherlands, Singapore and Thailand could be taxed as business profits only and not as fees for technical services keeping in

view the relevant provisions of the DTAA with those countries was also rejected. The AO passed orders Under Section 201 of the Act deeming the assessee to be an assessee in default for the Financial years 1997-98 to 1999-2000, and levied tax as well as interest under Section 201 (1A) of the Act.

4. In appeal, the CIT (A) also rejected the assessee's contention that the payments made to the various non-residents for carrying out overhaul repairs were not chargeable to tax. She treated the payments made to Lufthansa Technik, a Germany company (hereinafter referred to as Technik), as the model for considering the question of taxability of payments made to all other foreign companies. CIT (A) took the view that such repairs require knowledge of sophisticated technology and trained engineers are employed by the non-residents for carrying out the overhaul repairs. According to her, the repairs per se constituted 'fees for technical services' and therefore tax should have been deducted at source.

4.1 Regarding payments made to residents of UK and USA the CIT (A) held that the payments were not in the nature of "fees for technical or included services" as per the relevant Article 12 of the DTAA read with the Memorandum of Understanding with USA which equally applied to the UK Treaty. Payments made to the residents of USA and UK were held to be 'business profits' and since those companies did not have a PE in India, their income was not chargeable to tax. The Revenue is in appal against the order of the CIT (A) on this point.

5. Both the assessee and Revenue have raised several grounds of appeal. The learned counsel has filed written submissions on issue-wise. Thereafter the counsel of the assessee argued grounds issue-wise and attention of the Bench was drawn on various documents placed on record. These documents are in shape of copy of agreement; copy of written submissions; details of payments; detail of receipts. Attention of the Bench was drawn on various case laws relied upon by him. The counsel of the assessee has also invited attention of the Bench on issue-wise written submissions placed on record. On the other hand, the learned DR strongly relied upon the orders of Assessing Officer and the findings of CIT (Appeals) to the extent the order of the Assessing Officer was confirmed. Heavy reliance was placed on the decisions relied upon by Assessing Officer and CIT (Appeals) and it was stated that the ratio of the decision of the Tribunal in case of Sahara Airlines is squarely applicable on the facts of the present case. Therefore, the order of the Assessing Officer should be confirmed.

5.1 After having heard the case at length and considered the issues involved, we feel that the grounds raised by the assessee need to be considered first, as these go to the very root of the controversy. Accordingly, we proceed to take up the assessee's appeal first. Several grounds have been raised by the assessee, which for the sake of convenience; we propose to summarize them as the issues for our determination. These are:-

1. Whether payments made to non-resident companies for executing overhaul repairs are not chargeable to tax for the following reasons:-

(a) The payments made to the foreign companies are for execution of normal maintenance repairs without any involvement of or consultation with the assessee, and therefore these do not tantamount to "fees for managerial, consultancy or technical services" as defined in Explanation 2 to Section 9(1)(vii) of the Act;

(b) The income earned by the assessee from the activity of 'wet-leasing' of aircrafts is from sources outside India and therefore payments made for repairs were incurred for earning income from sources outside India.

(c) The payments for overhaul repairs were utilised in the assessee's business of wet leasing of aircrafts carried on outside India.

The assessee has also raised several alternate Grounds of Appeal. These are:-

2. In case the grounds relating to chargeability of tax on the payments to the non-residents fail, payments made to residents of Thailand, Singapore, Netherlands and Israel are not chargeable to tax keeping in view the relevant provisions of the DTAA's read with those treaties.

3. The consideration paid under agreements for purchase/exchange/loan for spares and components is not attributable to technical services and therefore is not taxable under Section 9(1)(vii)(b).

4. Payment made to Ethiopian Airlines, Ethiopia should be taxed @ 15% under Section 115A of the Act. (This issue is relevant for the Financial Year 1997-98 relevant to assessment Year 1998-99 only).

6. We will take up first the Issue No. 1. In support of the plea that the payments to the non-resident workshops are not chargeable to tax under the provisions of the Act, the assessee has raised three pronged grounds, which are discussed under Issues No. 1(a), 1(b) & 1(c).

Issue 1(a) "Whether payments made to the foreign companies are for execution of normal maintenance repairs without any involvement of or consultation with the assessee, and therefore these do not tantamount to "fees for managerial, consultancy or technical services" as defined in Explanation 2 to Section 9(1)(vii) of the Act?"

7. This issue goes to the root of the controversy. The company operates aircrafts which it had acquired in the middle of 1997 from a foreign company. It had wet-leased these aircrafts to another foreign company. The CIT (A) has held that the major payments were covered by a comprehensive 'Technical Support Services Agreement' as per attachment 'A' of the Contract with Technik. She held that services rendered by Technik were not in the nature of routine repairs as they involved modification of aircraft and its designing for airworthiness etc. which involved knowledge of sophisticated technology and that highly trained engineers were employed by these foreign companies in carrying out the repairs. She therefore held that the impugned payments to the

non-residents fell within the ambit of Explanation 2 to Section 9(1)(vi) of the Act. The CIT(A) was of the view that the facts of the case are similar to those in the case of Mannesmann Demag Lauchhammer wherein the repair of machinery was held to be 'fees for technical services' by the ITAT Hyderabad (26 ITD 198).

8. The facts may now be stated in greater detail. The assessee started business of wet-leasing of aircraft sometime in the middle of 1997 after acquiring four old Boeing aircrafts (727-200 Model) from a non-resident company outside India. After the aircrafts were duly registered with the DGCA, the assessee engaged the crew, ground engineers and other technical personnel for the operation of the air-craft. The assessee was granted the license by the DGCA to operate these aircrafts on international routes only. It is stated that the Boeing 727-200 aircraft acquired by the assessee were not used by any other airlines in India and no facilities existed in India their overhaul repairs. On the other hand, as per the directives of DGCA the various components and the aircraft itself was required to undergo the overhaul repairs periodically before the expiry of the number flying hours prescribed for each individual component. Overhaul repairs could be carried out only in such workshops, which are authorised for this purpose by the manufacturer and duly approved by the DGCA.

9. All the four aircrafts acquired by the assessee were wet-leased out to a foreign company, namely, Lufthansa Cargo AG, Germany (hereinafter referred to as 'LCAG') under an Agreement dated April 28, 1997. "Wet leasing" is a term which in aviation parlance refers to the leasing of an air-craft along with the crew in flying condition to a charterer for a period of time. The responsibility for maintaining the crew and the aircrafts in airworthy condition is that of the lessor. The lessee is free to direct the flight operations by nominating the 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.

10. The Government of India is party to several International Conventions governing the maintenance of the aircrafts. Those under the Aircraft Act of India, 1934 read with Aircraft Rules, 1937, the necessary regulatory and enforcement powers have been delegated by the Government to the DGCA, which issues notifications and guidelines etc. from time to time in regard to the maintenance and upkeep of aircraft. Every aircraft operator has to strictly abide by these guidelines. Failure to do so would result in immediate withdrawal of the license and the aircraft would be grounded. It is stated that since the assessee was under obligation to keep the aircrafts in flying condition, it had to maintain them in accordance with the guidelines of DGCA so that it would have a valid airworthiness certificate without which it would not be possible to carry on the business. It is explained that the engineering department of the assessee would constantly track the flying hours of every component. That before the expiry of flying hour, component for overhaul repairs which ordinary would also involve replacement of parts would be dismantled by the assessee's engineers and flown to Technik workshops in Germany. It is stated that parts were supplied by Technik under Separate agreement of sale, loan or exchange. In due course, the overhauled component would be dispatched by Technik alongwith airway bill for which the freight would be paid by the assessee. The overhauled component would be fitted into aircrafts by the assessee's own personnel.

11. The Ld. Counsel took us through the provisions of Technik Agreement dated 14.3.1997. The crux of his contention is that the Technik carried out maintenance repairs without providing technical assistance by way of advisory or managerial services. The aircrafts wet-leased to LCAG were utilized by LCAG for transporting its cargo mainly to and from Sharjah to Bombay, Delhi, Katmandu, Lahore, Calcutta, Chennai, Bangalore and Colombo. Since the license issued by the DGCA was for operations on international routes only, the aircrafts were not utilized by the LCAG for carriage of cargo within India. The LCAG had apparently integrated its international air transport business at Sharjah with its worldwide network. The cargo brought from South Asian Countries would be put into wide-body aircrafts and flown from Sharjah to various destinations in Europe and American continent. The assessee maintained a base at Sharjah where the aircrafts were normally kept and the crew and the engineering personnel of the assessee were also stationed at Sharjah. The accounts of the branch at Sharjah are duly reflected in the audited Annual Accounts of the Company.

12. It was submitted that the repairs by way of overhauling of components in the workshops of Technik in Germany and other foreign workshops were in the nature of routine maintenance repairs. That no personnel of Technik were ever deputed to India for rendering any technical or advisory services to the assessee. Likewise, the technical personnel employed by the assessee did not participate or involve themselves in the overhaul repairs carried out abroad by Technik or other foreign workshops.

13. It was further submitted that the CIT(A) has highlighted certain services enumerated in attachments 'A' and 'B' of the Technik Contract to say that the contract envisaged rendering of technical services. These services are:-

(a) Provision of Personnel

(b) Engineering Support service's including:

i) engineering work which include air worthiness.

ii) directives and Alert services

iii) development design and modification

iv) familiarization course.

13.1 It was contended that the CIT (A) has failed to appreciate that the Article 2 of the Agreement clearly states that such services would be provided by Technik at the request of the assessee only. It is submitted that the agreement that the responsibility for keeping the aircraft in a state of airworthiness is that of the assessee. Ld. Counsel emphasized before the CIT (A) that these services were not availed of by the assessee and no payment was made on this account. Ld. Counsel took us through the invoices raised by Technik which were filed with the CIT (A) (contained in assessee's Paper Book B), to show that no payment was made for any of those services. It was submitted the modification of an aircraft including development design is an extremely rare event occurring when

the manufacturer (Boeing in the present case) finds something seriously wrong with the aircrafts of a particular model and issues an International alert. Every licensing authority including DGCA insists that the prescribed modification or alert service is carried out in an authorised workshop. It is stated that no such need for modification or alert service arose during the period that the assessee was in business. Therefore, no such work was carried out by Technik. It is submitted that the payments for specific repair work were made in a piecemeal manner on the basis of invoices raised by the Technik. Regarding training, it is stated that the assessee had made payments for training of its crew and engineers to another foreign company, namely, Lufthansa Technical Training GmbH and other US based companies. That tax was duly deducted at source on all such payments and deposited with the Government. The assessee also filed the Annual TDS Returns on account in this regard.

14. Our attention was drawn to para 10 of the order of the CIT (A) which read:-

"The charges for various services are specified in the agreement. Certain charges like Engineering condition are on annual basis while other charges are on a man hour basis. The charges for specialised Services are mentioned at 1700 DM per person and 1500 DM per person whereas the charges for familiarisation course are at 1000 DM per person. The travel expenses, transport and cost are to be borne by the Assessee. On perusal of some of the Bills submitted it is seen that Hotel Charges are also paid by the Assessee. The specialists deputed to the Assessee remained the employees of Lufthansa Technik but receive work direction from the Assessee".

14.1 It was submitted that the CIT (A) failed to appreciate that no technician of Technik was ever deputed to India and no payment was made in this regard. It was stated that the assessee had entered into two major agreements for overhaul repairs-one with Technik for repair of components and other with ATC Lasham UK for overhaul the aircraft including the Hull. As regards hotel bills, it was stated that the CIT (A) has referred to the hotel charges paid by ATC Lasham, UK, whenever the assessee's crew flew the aircrafts to its facilities in UK for aircraft overhaul (C-Check). The attention of the Bench was drawn on the invoices of ATC Lasham at Pages 176 and 180, 250 & 225 of Paper Book 'B' filed before us which show that hotel charges were paid for stay in a hotel in UK. It is stated that the assessee's crew had to necessarily fly the aircraft to UK for "C" check (involving overhaul of the entire aircraft) and later for flying the aircraft back after the overhaul. The crew's lodgings etc. in UK were arranged for by the ATC Lasham and were billed to the assessee. It was explained to the CIT(A) that no hotel bills were paid for by Technik, as it overhauled components only. The components were flown to Technik facilities in Germany with airway bills without any personnel of the assessee accompanying them. However, in so far as payments to ATC, UK are concerned, the CIT (A) has herself finally held that these payments did not constitute 'fees for technical services' as per the provisions of the DTAA with UK. It was further stated that the assessee did not pay any hotel bill for any personnel of Technik as no employee of Technik ever visited India for supervising repairs or any consultancy service to the assessee.

15. It was explained that as per the International Conventions, every component containing rotatable parts is allotted a unique identity number and its historical record is maintained in a tag which

accompanies the component throughout its life. Such component including engines needs to be overhauled periodically in accordance with Boeing's manual. The assessee sends the components together with tag to the workshop abroad. Technik's workshops in Germany are duly authorised by the manufacturer, namely, the Boeing USA. Upon receipt, the Technik overhaul the component in accordance with the Manufacturer's Manual, as per the requirement of the DGCA. The assessee has no say in the matter. It does not even know as to what kind of repairs have been carried out as no employee of the assessee visits Technik's facilities in connection with the repair work. It is submitted that all that the assessee is interested in is that Technik returns the overhauled component certifying that it has carried out the prescribed overhaul repairs. It is evident from the invoices of Technik, ATC Lasham and others and those workshops replace parts at their own discretion in the course of overhaul of a component. The replaced parts however come with tags giving their unique identify number and history. They also issue warranty for free-of-defect functioning of the component for the requisite number of flying hours. It is therefore contended that the repair work carried out by Technik etc. is not in the nature of technical assistance by way of providing managerial, consultancy or technical services to the assessee. Technik performs the entire work on an inanimate object without any involvement or participation of assessee's personnel. That any mental or physical exertion by the engineers of the Technik is employed on the components sent to them and not by way of technical or advisory services rendered to the assessee. In other words, the components are sent out to the authorised workshops for carrying out overhauling of components and not for seeking any technical or advisory services. The assessee thus satisfies the requirements of the DGCA for carrying out prescribed maintenance repairs of the aircraft. 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.

16. With reference to the decisions relied upon by the authorities below, it was submitted that those decisions are distinguishable and have no application to facts of the present case.

17. The Ld. Counsel, relied on the judgment of Delhi High Court in the case of SRF Finance Ltd. v. CBDT (1955) 211 ITR 861, wherein the Hon'ble High Court has observed that "it is most inappropriate to equate the rendering of a service with carrying out a work" and that, "rendering of a professional services" which is otherwise described as carrying on a profession is in contrast to the concept of 'carrying on any work'. Reference was also made to the Supreme Court decision in the case of Hindustan Aeronautics Ltd. v. State of Karnataka (55 STC 314), wherein the contract for maintenance repairs of aircrafts have been held to be works contract. Reliance was also placed upon the decision of Hon'ble Supreme court in the case of State of Madras v. Ganon Dunkerley and Company (9 STC 353) and Builders' Association of India v. Union of India [1989] 73 STC 370 SC, wherein it was held that works contracts constitute a class of contracts in which the contractor either himself or through his employee uses certain expertise in performing the work for achieving the task contracted for. That it is in the process of achieving such a task that the contractor utilises his expertise. That when the work is carried out on an inanimate object without any participation or interaction the assessee, the 'human element' is absent.

18. The Ld. Counsel also referred to the decision of the Supreme Court in the case of Birla Cement Works v. CBDT [2001] 248 ITR 216, wherein the Apex Court has affirmed the decision of the

Calcutta High Court holding that the word "work" means engagement in the performance of a task, duty or the like and "it covers all forms of physical and mental exertion or both combined for the overall attainment of some object other than recreation or amusement". Reliance was also placed on a recent decision of the Supreme Court in the case of Hindustan Shipyard Ltd. v. State of Andhra Pradesh (119 STC 533) and of the Lucknow Bench of the ITAT in the case of Somani Iron and Steel 86 ITD 750 in support of his contention that maintenance repairs out by Technik are 'works contract' simplicitor.

19. Shri Kapila fairly brought to our notice a recent decision of Delhi Bench of the Tribunal in the case of Sahara Airlines Ltd. v. CIT [2002] 83 ITD 11, which apparently may seem to have taken a contrary view. He referred to paragraphs 26-31 of the order wherein it has been held that on the basis of the Agreement entered into by the assessee with Sochata France, the payments made for repairs of engines and other equipments amounted to fees for technical services as defined in Explanation-2 to Section 9(1)(vii)(b). It was submitted that the facts of Sahara Airlines' case are significantly different. Sahara Airlines, a domestic passenger airline, had acquired a number of aircrafts for which it needed services of an expert organisation to manage its inventories including engineering co-ordination for execution of all considerations for repairs of engines and other equipments. It was further submitted that the Sahara-Sochata contract stipulates a number of mandatory services like "repair engineering coordination facilities", "overall material coordination", "maintenance of current files of all the engines specification", "providing warehousing and inventories control" and supervising transportation coordination for Sahara's equipment from India to France and back. Sochata was obliged to designate to Sahara a 'Liaison officer' to be stationed in India whose primary responsibilities was be to ensure successful programme by providing Sahara with engines status reports on a weekly basis, and any unusual airworthiness related defect. Sochata France was also to provide "engineering management programme and training at Sochata facilities." It is contended that for the contracted consideration, Sochata was obliged to render such services without any request from Sahara. That the payments were admittedly made to Sochata for such services. The Ld. Counsel submitted a chart, comparing the terms of Sochata Sahara Contract vis-a-vis the Technik contract. A copy of this chart was also given to the Ld. DR and he has not disputed the contents. The chart is reproduced below:-

Comparative Chart of terms of contract between Sochata France & Sahara Airlines
Vis-a-vis Lufthansa Technik, Germany & LCI

S.No. Sochata-Sahara Contract Art II Technik LCI Contract PB II

A. Repairs--Engineering Coordination-- Repairs of engines and components.

overall material coordination
coordination.

No engineering or material

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| B. | Provide parts incorporated into equipment in the course of repairs. | Provide parts under separate and independent individual contracts of loan/exchange or sale.
Material used during the repairs were sold and invoiced accordingly. |
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|----|---|---|
| C. | Maintain files on all related engineering specifications etc. | No such requirement. No such facility availed of. No payment was made for any such service. |
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|----|---|---|
| D. | Provide warehousing and inventory control for Sahara. | No such requirement. No such facility availed of. No payment was made for any such service. |
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- E. Reserve the right to sub-contract. Reserves the right to sub-contract
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- | | | |
|----|--|---|
| F. | i. Provide historical part repair | Provide history of the part repairs as required by the aviation authorities. |
| | ii. Configuration tracking and management of Life Limited Parts Equipment. | Done by the Engineering Personnel of LCI.
Note: It is mandatory by the civil aviation authorities to maintain the track record of the history of rotatable parts used in Aircraft. |
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- | | | |
|----|--|---|
| G. | Provide transportation coordination for Sahara's Equipment from/to Sahara to/from Sochata. | Equipment for repair has to be delivered at Technik's facilities in Germany. The delivery of the repaired equipment has to be taken by LCI at Technik's facilities in Germany. To and from transportation of the equipment has to be managed by LCI at its own cost and risk. |
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H.	Sochata to designate to Sahara "Specific Customer Service Manager" who will	
	i. Liaison for successful program, and ii. Provide Sahara with engine status reports every week.	No such Customer manager was ever designated by Technik to LCI. LCI's own technical personnel used to perform these activities.

I.	Report any unusual Airworthiness related defect	Responsibility towards airworthiness is entirely that of LCI.

J.	Provide	
	i. Engineering Management Program	No such requirement
	ii. Engineering support never made.	Only at the request of LcI which was
	iii. Training at Sochata facilities	Only at the request of LCI which was never made. Entire training of LCI's personally was conducted by Lufthansa Technical Training Gmbh, Germany to whom fees was paid during R.Y. 1997-98 and 1999-2000 on which tax was duly deducted before remittance. No payment was made to Technik

Article III(A)		

A.	Deliver to Sochata all equipment CFM 56 engines owned by Sahara repairs or maintenance	No such requirement LCI may send for any engine or component to any authorised workshop in any other country as indeed it often did so.

S.No.	Sochata-Sahara Contract Art V Prices	Technik LCI Contract PB II

A.	1. Labour @ US\$ 48 per man hour	For work performed for repair, overhaul etc. charges will be as per Technik's prevailing man-hour rates.
	2. On-site technical assistance service on a case by case basis.	No technician visited India.

B.	1. New Parts, material and supplies at list price plus 10.5% handling charges.	For Material consumed List Price + 25%.
	2. Used serviceable parts @ 8.5% of the list price.	New or old parts to be loaned or exchanged or sold under separate contracts for each and every such part on
		1. Rental of 5% of Unit Price + 1% of the price per day for first ten days and 1.5% of the listed price per day (P. 437 and 438 of PB III).
		2. In case of sale list price + 75%
		3. Cost of packing, custom duty, taxes and forwarding to be borne by the customer.

Optional Service

No Optional service. All support services including training is covered by the consideration under the contract. The entire management of inventories and maintenance to be carried out by Sochata.

1. Airworthiness Directive would be carried out on a specific request of the customer (LCI). No such request was ever made. Hence no such service was performed by Technik and nor any payment therefore made. (Clause 1.2.1 read with 3.1 of Technik Contract)
2. Modification status will be advised by the Customer (LCI). No such advice was ever issued.
3. Monitoring of Oil consumption

and its analysis (ECM). No such service was availed of as ECM was throughout the period carried out by LCI's own engineers at Sharjah. (DM 1000 per day on this account would be chargeable on if the service were availed of--since this optional service was not availed of no bill was ever raised--no payment ever made). (Clause 1.3.1 read with clause 3.2 of Technik Contract). Similarly, ECM fixed charge of DM 30,000 per annum--never neither charged--nor paid as this optional service was never availed of.

4. Reliability Tracking and Reporting--Not availed of--No bill raised--no payment made.
5. Training--not availed of--no bill raised--no payment made.
6. Development and modification--not availed of--no bill raised--no payment made.
7. Consulting--Technik's experts were not consulted. No personnel of Technik was ever assigned to India.

The above chart highlights significant differences in the terms of the two contracts. It was submitted that the dominant object of the Sahara-Sochata contract is that of supervision, and management of a successful programme by Sochata for keeping Sahara's aircrafts in airworthy condition. A Sochata expert was specifically assigned to India for ensuring smooth running of such a programme. Thus, elements of managerial, consultancy and advisory services together with direct participation of personnel constituted "technical services". These elements are absent in the contract between Technik and the assessee. Further, whereas in Sahara - Sochata contract the services were mandatory, all such services in the Technik contract were optional and no such optional services were utilised by the assessee. it was also contended that in the Sahara Airline's case the Tribunal has not held that repair work per-se constitutes "technical services" as defined in Explanation 2 to Section 9(1)(vii).

20. The Ld. Counsel also pressed into service Circular No. 715 dated 8.8.95 issued by the CBDT in the context of Section 194C of the Act. He submits that the CBDT has clarified that routine maintenance repair jobs are in the nature of 'works contract' and not "contract for technical services". Question No. 29 of the circular reads as under:-

"Ques. 29: Whether a maintenance contract including supply of spares would be covered under Section 194C or 194J of the Act?

Ans.: Routine, normal maintenance contracts which include supply of spares will be covered Under Section 194C. However, where technical services are rendered, the provision of Section 194J will apply in regard to tax deduction at source". (Reproduced from pg. 6530 of Chaturvedi & Pithisaria's Income Tax Law, Fifth Edition, and Vol. 4).

It was submitted that Technik carried out normal maintenance repairs including supply of spares, and therefore, had Technik been a domestic company the payments to it would be covered by the provisions of Section 194C and not by the provisions of Section 194J, which cover fees for technical services as defined in Section 9(1)(vii). The Ld. Counsel contends that periodic overhaul repairs of components carried out in accordance with the instructions issued by the DGCA were routine normal repairs as against 'out-of-ordinary' repairs including assignment of technical personnel, which may be required in case of break-down or accident.

21. For the Revenue, the Ld. CIT (DR) strongly relied on the orders of the authorities below. He submits that the decision of Delhi High Court in the case of SRF Finance (Supra) in fact supports the Revenue's case. According to the Ld. Dr. the assessee has used sophisticated technical experience and skills of the personnel of the Technik in the process of repairs and overhaul carried out by them. Ld. DR vehemently submitted that the CBDT Circular No. 715 is of no relevance as it has been issued in the context of Section 194C and not Section 9(1)(vii)(b) of the Act. It was contended that the assessee defaulted in not deducting tax before making payments in accordance with the provisions of Section 195(1) of the Act and therefore, the assessee cannot now raise the plea that the receipts in the hands of the non-residents is not chargeable to tax under the Act.

22. The Ld. DR submitted that if the assessee was of the view that no tax was deductible on the payments made to foreign companies it should have made an application with the AO Under Section 195(2) of the Act. He emphasized that Section 195(1) is concerned with "payment to non residents" and not with the taxability of the corresponding "income of the non-resident". Hence, if the assessee has defaulted by not having deducted tax at source at the time of payment, it cannot later raise the plea that the corresponding income of the non-resident was not chargeable to tax. For this proposition, the Ld. DR relied on a decision of Tribunal in the case of Assistant Commissioner of Income Tax v. Pepsi Food Ltd. [2003] 129 Taxman 73, to which one of us was a party. Ld. DR drew our attention to the findings of the Ld. CIT (A) that all payments made were in accordance with the Agreements signed by the Assessee with Technik. He pointed out that the charges for various services are specified in the Agreement on annual basis while other charges are on man hour basis.

The charges were for specialized and sophisticated services which fell squarely within the ambit of "fees for technical services" as envisaged under Explanation 2 to Section 9(1)(vii) of the Act. He drew our attention to the various findings recorded in the orders of the CIT (A).

23. We have considered the rival submissions and have duly considered the orders of the authorities below and the materials on record. The case of the Department is that the fee paid to Technik is covered by Explanation 2 to Section 9(1)(vii) of the Act, which reads as under:-

Explanation 2: For the purposes of this clause 'fees for technical services' means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services including the provision of service of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

The Explanation defines fees for technical services to mean that any payments made to a non-resident for rendering services like 'managerial' 'technical' or 'consultancy' services would be treated as "fees for technical services". The three type of services envisaged above also include the provision of the services of technical or other personnel.

24. It cannot be disputed that the assessee is under legal as well as contractual obligation to keep its aircrafts in airworthy condition. It has therefore two options available for achieving this object:-

a. to handover the management of maintenance and upkeep of aircrafts and inventories to a contractor for running a successful programme for keeping them in airworthy condition on an ongoing basis; or b. manage on its own all aspects relating to a successful programme for maintenance of aircrafts and components and send them periodically to authorised workshop for executing overhaul repairs as per manufactures manual.

If on facts, as in the case of Sahara Airlines, it is found that the engineering services including management of inventories, material coordination of the equipment and its transportation is carried out by a foreign contractor who also deputes to India experts for this purpose, the dominant object of the contract would be for provision of managerial and technical services and therefore consideration paid for it would constitute fees for technical services. The actual work of repairs etc. in such a case would be incidental to the main object of the contract. If, however, the engineering management programme is carried out by the assessee itself through its own technical personnel and the components are flown out to foreign workshops for prescribed maintenance repairs including supply of parts, such a contract would be 'works contract' and not a contract for technical or consultancy services. In the latter case, the human elements by way of advice, management or supervision is absent.

25. In this background, the terms of the Technik contract could now be examined:-

Article 1 of the contract states the objective that "Technik shall perform the work and render the services stipulated in Article 2."

Article 2 of the agreement gives the "scope of Agreement as under:-

"Engineering support on request in accordance with Attachment 'A'. Personnel assignment on request in accordance with Attachment 'B'. Components overall in accordance with Attachment 'C'.

Other relevant clauses of the Technik Agreement, which for our purposes are relevant, are:

Article 9 (Warranty) "all work covered under this Agreement is performed at established airline standards. This warranty obligates Lufthansa Technik to remedy a defect free of charge at one Lufthansa Technik's basis Hamburg or Frankfurt, provided a detailed claim is raised within 9 months or 1250 flight hours after redelivery to the Customer, whichever may be first.

The Customer agrees to arrange, at his own risk and expense, for transport of such parts."

Article 12 'Excusable Delays' "Lufthansa Technik shall not be held responsible for excess of performance dates and/or non-performance of the agreed work." If unforeseen major defects on airframe, systems, power plants or components have to be rectified, if material ordered from suppliers is temporarily or definitely not supplied, etc....."

Article 14 Legal Provisions 14.1 "This Agreement shall be subject to, and construed exclusively in accordance with, the existing laws of the Federal republic of Germany. The exclusive place of jurisdiction for any legal actions that should arise out of, or in connection with, this Agreement shall be Hamburg/Germany.

14.3 The place of delivery and redelivery shall be the Lufthansa Technik Base Performing the work.

14.4 Lufthansa Technik reserves its ownership rights on all components, engine accessories, and spares supplied until full payment of all invoices has been made.

14.5 In case of non-payment by the Customer, both parties agrees that Lufthansa Technik has by virtue of its work performed a right of retention as well as a contractual lien of the subject matter being in custody of Lufthansa Technik. The right of retention and the contractual lien as well as a set-off-right may also be applied on account of claims from previous orders of supplies or any other claims from customer's business relationship with DEUTSCHE LUFTHANSA AKTIENGESELLSCHAFT and/or its affiliates.

In cases of controversies between the parties regarding the performance of work the work in question may be submitted to the manufacturer for judgment whose decision shall enable the parties to settle the dispute in good faith."

26. A reading of the Technik Agreement shows that apart from above quoted general clauses, it also contains three other independent and distinct sections. Each such section is by itself a self-contained contract dealing with distinct subject matter stipulating independent and separate terms and conditions. These three sections are:

- a) 'Attachment A' of the Agreement dealing with 'Engineering support services' on request including provision of training.
- b) 'Attachment B' of the Agreement relating to 'Assignment of personnel' on request by Technik,
- c) 'Attachment C' of the Agreement concerning Repairs and overhauls of the components.

Attachments 'A' & 'B' of the Technik Agreement deal with the engineering support services including training and assignment of personnel by the Technik. These are clearly optional services which would be provided by the Technik for the charges specified in the two 'Attachments' only on the specific request of the assessee. The assessee has emphasized that none of these services was availed of and therefore no payment was made on this account. All the invoices raised by the Technik were produced before the lower authorities and no instance of payment for training or other optional support services as per Attachment 'A' and 'B' of the contract has been brought out either by the Assessing Officer or by the CIT(A). Ld. DR has also not cited any instance of payment for any of the optional services enumerated in Attachment 'A' and 'B'. Ld. DR has also could not controvert that payments to Technik were made for specific job work of repairs and replacement of parts, and no technician was assigned to India for consultancy or supervision of repairs. We are therefore of the view that simply because Attachment 'A' and 'B' stipulate charges for optional services, it cannot be said that any payment is attributable to such services. These services are optional and could be performed on specific request by the assessee. On the facts brought out before us such option was not exercised by the assessee. Ld. DR also could not indicate any clause in the Technik Agreement which would oblige the assessee to pay the fees towards optional services even if such an option is not exercised by the assessee. In the circumstances, we hold that CIT (A) was not correct in making attachments 'A' and 'B' of the Technik Contract as the basis for concluding that the payments were primarily made for rendering of technical services. The only relevant part of the Technik contract which needs consideration is the 'Attachment C' which deals with 'Components Overhaul'.

27. The relevant terms of the contract by way of Attachment 'C' of the Technik Agreement are:-

Attachment 'C'

1. SCOPE OF SERVICES 1.1 Repair, overhaul, modification and test of all components as far as identical with Lufthansa Technik's own components. In cases of differences in the dash-number repair/overhaul items shall only be accepted after Lufthansa Technik's prior telex confirmation;

1.2 Material, supply out of Lufthansa Technik stock for above components repair/overhaul in accordance with Article 2 hereof.

1.3 Lufthansa Technik shall be entitled to subcontract repair and overhaul of components in accordance with Article 4 of the GTA.

1.4 Each overhauled component will be redelivered with the following documentation:

1. JAA form (Airworthiness Approval Tag)

2. Workshop Report

3. Test Reports if applicable

2. MATERIAL PROVISIONING 2.1 Repairable and consumables required for the work to be performed on the Customer's components shall be supplied by Lufthansa Technik on the basis of sale provided Lufthansa Technik's stock permits such supply.

2.2 Modification material and, if required serialized subassemblies shall be provided by the Customer.

2.3 If specially requested by the Customer, and if Lufthansa Technik's stock permits such supply, Lufthansa Technik shall provide rotables out of its stock under Lufthansa Technik's normal Loan Agreement conditions. A copy of such Loan Agreement is attached hereto as Annex B. **2.4** If specially requested by the Customer and, if Lufthansa Technik's stock permits such supply, Lufthansa Technik shall provide repairable out of its stock on 1.1 basis using Lufthansa Technik's form Exchange 1.1 Agreement Annex A.

3. SHIPPING 3.1 Any shipments of the customer's components to and from the respective Lufthansa Technik Base shall be effected at the Customer's own risk and expense.

4. CHARGES Article 4 For the work performed pursuant to Article 1 hereof, the Customer shall be charged according of Lufthansa Technik's man-hour rates valid at that time as stipulated in Annex A1 of the GTA.

For material consumed the Customer shall be charged, with the manufacturer's list prices plus a material handling surcharge of twenty five (25) percent.

Subcontracted work in the sense of Article 4 of the GTA shall be charged according to the amount payable by Lufthansa Technik to the subcontractor plus a handling charge of ten (10) percent plus transportation costs, if any.

In case of repair work the Customer shall pay a minimum charge per event of DM 1,000,-.

28. The law relating to works contracts has been judicially reviewed recently by the Supreme Court in the case of Hindustan Shipyard Ltd. v. State of Andhra Pradesh (Supra). After discussing the law on the subject, the Apex Court in para 15 of the judgment observe.

There may be three categories of contracts:

- (i) The contract may be for work to be done for remuneration and for supply of materials used in the execution of the work for a price;
- (ii) It may be a contract for work in which the use of the materials is ancillary or incidental to the execution of the work; and
- (iii) It may be a contract for supply of goods where some work is required to be done as incidental to the sale.

The first contract is a composite contract consisting of two contracts one of which is for the sale of goods and the other is for work and labour. The second is clearly a contract for work and labour not involving sale of goods. The third is a contract for sale where the goods are sold as chattels and the work done is merely incidental to the sale."

Attachment "C" of the Technik contract is the first type of "work contract "as categorised in the above quoted passage.

29. A Chart was furnished before the CIT (Appeals) and also before us giving the year-wise breakup of the payments made to Technik and others (Pages. 152 of Paper Book B) under the heads; 'labour', 'material', 'repairs' and 'other'. It is noticed that 'repairs' and 'materials' account for about 60 percent of the total amount of payment, and 'labour charges' account about 30 percent. The balance 10 percent of payments falling under the head 'others' primarily include airport charges, fuel and parking charges etc. It is clear that the co-ordination of transportation of the components to the Technik's facilities in Germany was the assessee's responsibility. Technik carried out the job work of repairs and replacement of parts at its own discretion. The overhauled components along with certificate of airworthiness is send back at the assessee's cost. The Technik also gave warranty for the work executed by it. Supply of parts for replacement is made under separate agreements for loan exchange or sale. The proforma agreement of the loan and exchange also form part Attachment 'C'.

30. From the above it appears that the Technik contract is primarily for carrying out routine maintenance of components the use of material being incidental to the execution of work. As pointed out by Hon'ble Calcutta High Court in the case of Calcutta Goods Transport Association v. Union of India (1996) 219 ITR 486:-

"The word 'work' may be used in two senses; it may mean either, labour which a man bestows upon thing or the thing upon which labour is bestowed".

In other words, in a works contract like the present one in which components are repaired and overhauled, the technicians of the contractor bestow their labour upon "things" like engines and aircrafts components or put them through the machines. Technik carries out these activities in the normal course of its business at its facilities in Germany without any involvement of the assessee. From the facts placed on record it appears that there is absence of human element as there is no interaction between the technicians of Technik and the assessee's personnel. This is further supported by the fact that the components are sent for repairs along with airway bills and are redelivered in the same manner and the invoices are raised by Technik with reference to specific job-works and supply of parts etc. The payments by the assessee are clearly business receipts in the hands of Technik.

We will now consider the decisions relied on by the Assessing Officer and the CIT (A).

31. The first decision is that of Oberoi Hotels (231 ITR 148), wherein the Supreme Court has held that professional services like recruitment and training of staff, promotion of the business of the Hotel in Nepal, and running and management of the hotel were in the nature of professional services. The Apex Court held that the expression 'technical services' embraces professional services. This decision has no application as no such controversy is involved in the present case.

32. In GVK Industries (228 ITR 564), relied upon by the Assessing Officer, the question before the Andhra Pradesh High Court was whether financial consultancy by way of advice on structuring of an international loan could be said to be technical services. The Hon'ble High Court held that such financial consultancy services were technical service by observing:-

"The petitioner-company intended to utilise the expert services of qualified and experienced professionals who could prepare a scheme for raising the required finances and tie up the required loan. Being unable to find such a professional in India, it had to seek the services of a consultant outside India. The non-resident company offered its services as financial adviser to the petitioner's project. those services included, inter alia, financial structure and security package to be offered to the lender, study of various lending alternatives for the local and foreign borrowings, making an assessment of export credit agencies world-wide and obtaining commercial bank support on the most competitive terms, assisting the petitioner company in loan negotiations and documentation with lenders and structuring, negotiating and closing the financial for the project in the coordinated and expeditious manner.

In the above case there was no dispute that the Swiss company provided advisory services to the Indian company. The only point in dispute was as to whether such financial consultancy services were "technical" or not. This decision is clearly not applicable to the facts of the case.

33. Another decision relied on by the Assessing Officer is that of Cochin Refineries Ltd. (222 ITR 354) which is also not applicable. The head note of the report gives the facts briefly:-

"Cochin Refineries requested a foreign company, F, to evaluate whether the coke produced from a blend of vacuum bottoms and clarified oil from Bombay High crude was suitable for making anodes for the aluminum industry. The tests were carried out in the USA in regard to which the assessee made payment."

Cochin Refineries had sent mineral oils produced by it to laboratories in USA for evaluating whether the coke content was suitable for making aluminum anodes. The American Laboratory sent the report after due evaluation of the samples. The evaluation report was utilized by the Indian Company in its refining business. That case clearly involved consultancy services of technical nature. The evaluation report of the American laboratory is in the nature of technical advice. For this reason Kerala High Court held that the payment made to the American Company was covered by the provisions of Section 9(1)(vii)(b). We may add that this decision was given Under Section 9(1)(vii)(b) of the Act, as there was no DTAA with USA at that time.

34. As regards the decision of Hyderabad Bench in the case of Mannesmann Demag Lauchhammer v. CIT (26 ITD 198), the case of the Department was that the fees paid to DEMAG was covered by Section 9(1)(vii). After setting out explanation 2 to that section, this reads as follows:

Explanation 2: For the purposes of this clause 'fees for technical services' means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.

The Tribunal observed:-

"It will be clear from this section that any consideration paid to a non-resident for rendering services like managerial technical services or consultancy services would be treated as technical fees. The three types of services would also include the provision of services of technical or other personnel. It might be possible to argue that in merely repairing certain machineries for which the warranty period had already expired, there is no consultancy services either the provision of technical or other personnel. Normally, managerial or technical consultancy services would be done by a non-resident company by utilizing the services of their managers and Technicians. The Company has to act only through its employers or Directors. thus, the human

element in such consultancy services is already implied. But, the Legislature in their wisdom had decided to add the words in parenthesis and so the provision of services of technical or other personnel for any purpose would be treated as technical services, be it for a small repair work or a large reconstruction work. We, therefore, do not find any reason why the technical consultancy in respect of repair works cannot be considered as technical fees." (Emphasis Supplied) We find that in Demag's case, the foreign company rendered 'technical consultancy' by way deputing a technician to India for supervising repairs to be carried out on the plant and machinery purchased by National Mineral Development Corporation. It is not the repair work per se which has been held to be technical services but it is the provision of the consultant technician deputed to India for supervising the repairs which has been treated as consultancy services. The foreign technician stayed on in India for 44 days to advise and supervise repair work which was obviously carried out by the engineers and workers of the Indian Company. Thus, the nature of services rendered by the foreign company was consultancy of technical nature through the provision of its technician deputed to India. Our conclusion is supported by the decision of Andhra Pradesh high court in the same case reported in 238 ITR 861, wherein Hon'ble High Court affirming the aforesaid decision of the Tribunal held that the Explanation 2 has expanded the scope of Section 9(1)(vii)(b) by providing that the services of technical or other personnel would be taxable. It has been repeatedly stated by the assessee that no foreign Technician was ever deputed of India. The lower authorities and the DR have not pointed out any instance of a technician having been assigned of India. This decision therefore is of no assistance to the Revenue.

35. As regards, the CBDT Circular No. 715 (para 20, supra) it is clear that the clarification given in Question 29 deals not only with Section 194C, but also Section 194J of the Act. Section 194J clearly includes within its ambit the 'fees for technical services' as defined in Explanation 2 to Section 9(1)(vii)(b). The Section 194J reads as under:-

"(1) Any person, not being individual or a Hindu undivided family, who is responsible for paying to a resident any sum by way of--

(a) fees for professional services, or

(b) fees for technical services Explanation--for the purpose of this section,--

a) ".....

b) "fees for technical services" shall have the same meaning as in Explanation 2 to clause (vii) of Sub-section (1) of Section 9".

The said circular excludes 'routine maintenance repairs' from the scope of Section 194J which deals with TDS on 'fees for technical services'. Both Section 9(1) (vii) Section 194J rely on the definition given in Explanation 2 to Section 9(1) (vii). Therefore, the clarification issued the Board in the

context of Section 194J with respect to normal maintenance repairs would be relevant for understanding true import of the said explanation in the context of Section 9(1)(vii)(b) of the Act.

36. We also find no merit in the contention of the Ld. Dr that since Section 195 deals only with payment to a non-resident, the assessee cannot raise the plea that the income of the non-resident on account of such payment was not chargeable to tax under the provisions of the Act. The law on the subject is quite clear. If the payments to non-resident are not chargeable to tax, the assessee can always take this plea even if it has made no application Under Section 195(2) of the Act. The decision of the ITAT 'E' Bench in the case of ACIT v. Pepsi Foods cited by the Ld. DR does not help him. In that case, transfer of technology was admittedly involved and in that context, the tribunal observed:-

"a bare reading of the provisions of Section 195 clearly shows that if any sum to be paid by an assessee, not falling within the preceding sections, to any non-resident, is chargeable to tax under the Act, then assessee is under obligation to deduct the tax at source either at the time of payment or at the time of credit in the books of the assessee, whichever is earlier."

The language of Section 195(1) is unambiguous on the subject. It is only such sums which are "chargeable under the provisions of this Act (not being income chargeable under the head 'Salaries')" which come within the purview of Section 195. If the payment is not chargeable to tax, the provisions of Section 195 are not attracted. This view was recently endorsed by the Supreme Court in Transmission Corporation of AP Limited v. CIT. (1999) 239 ITR (SC) in the following words:-

"the scheme of Sub-section (1), (2) & (3) Section 195 and Section 197 leaves no doubt that the expression 'any other sum chargeable under the provisions of this Act' would mean 'sum' on which income-tax is leviable. In other words, the said sum is chargeable to tax and could be assessed to tax under the Act. The consideration would -- whether payment to the sum of the non-resident is chargeable to tax under the provisions of the Act or not?"

37. In conclusion, Technik carried out the repair work in the normal course of its business in Germany, without any involvement or participation of the assessee's personnel. The overhaul repairs involved were routine maintenance repairs. It cannot therefore be said that Technik rendered any managerial, technical or consultancy service to the assessee. In this view of the matter, we hold that the payments made by the assessee to non-residents workshops outside India do not constitute payment of fees for managerial, consultancy or Technical services as defined in Explanation 2 to Section 9(1)(vii). The assessee succeeds on this ground.

Issue No. 1 (b) "Whether payments for repairs of aircrafts was made for earning income from sources outside India and therefore to be excluded from 'fees for technical services Under Section 9(1) (vii) (b) of the Act"?

38. The assessee's contention is that payment made to the non-resident is for earning income from sources outside India and these are therefore to be excluded from 'fees for technical services.' Section 9(1)(vii)(b) of the Act reads as under:

"A person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India"

To fall within the ambit of the exclusionary provision of Section 9(1) (vii) (b), the following conditions are required to be fulfilled:-

a) the assessee re resident of India,

b) income is earned from a source outside India, and

c) there exists a direct nexus between the payment (expenditure) and earning of the income All the three conditions should be cumulatively satisfied for exempting "fees for technical services' from chargeability of tax. The first and the third conditions are clearly satisfied. Dispute is in regard to the second condition. The CIT (A) has taken a view that as pe terms of the agreement between the assessee and LCAG merely gets priority over others in the use of the aircraft. That there is no prohibition on the assessee to wet-leasing of the aircrafts to any third party. According to CIT(A), aircrafts have been wet-leased solely to LCAG, Germany. But also to other parties and therefore it cannot be said that the revenues have been earned wholly from a source outside India. The assessing Officer has held that since the income from leasing of aircrafts is assessed to the tax in India, the source of income is situated in India.

39. Ld. Counsel for assessee has made the following submissions:

i) Section 9(1) (vii) (b) clearly applied to Indian residents only. The assessee is an Indian company liable to tax on its global income, but this does not mean that the 'source of income is also in India'.

ii) The assessee's 'source of income' is the activity of wet-leasing of aircrafts to non-resident companies under contract made outside India and therefore the source of income is outside India.

iii) The leasing revenues were received in convertible foreign exchange directly from the foreign charterers abroad by wire-transfers into the assessee's bank account denominated in US dollars with the Citibank, Connaught Circus, New Delhi allowed to be maintained by the RBI for this purpose.

iv) Payments made to foreign companies for repairs have a direct nexus with the earning of income from sources outside India.

v) Payment were made to Technik etc. for maintenance repairs which were essential for earning income from the activity of wet-leasing of aircrafts.

vi) The CIT (A) is not correct in rejecting the claim merely because leasing income was not received exclusively from LCAG, but also from other foreign airlines. Articles 2 & 3 of the contract with LCAG make it clear that it is only when LCAG informs the assessee in writing well in advance that it may not require certain capacity for a particular period that the assessee is free to wet-lease the aircraft to others for that period. In case, the assessee is not able to do so, and the aircrafts and view remain idle, the LCAG would have to pay the rent for minimum guaranteed block hours. The assessee is not free to lease the cargo space to a third party without prior permission of the LCAG.

40. In support of the contention that the income was earned from sources outside India, a certificate dated 22nd December, 2000 from Lovelock & Lewes, Chartered Accountants, was filed with the CIT (A) which reads as under:-

TO WHOMSOEVER IT MAY CONCERN we have verified from books and records maintained by that M/s Lufthansa Cargo India Limited having Registered Officer at Radisson Hotel, Commercial Plaza Wing B New Delhi-37 and certify that, the Company had a Capacity Purchase Agreement for wet lease of the aircrafts with only foreign companies for the financial year 1997-98, 1998-99 and 1999-2000 for their international air cargo operations. One of the major customer to whom aircrafts were given on wet lease was Lufthansa Cargo AG of Germany.

Annexure 'A' of the certificate gives the year-wise breakup of the lease rentals as under:

Details of Traffic Revenue from wet lease of aircrafts by Lufthansa Cargo India Private Ltd.

	F.Y. 1997-98	F.Y. 1998-99	F.Y. 1999-2000
Traffic Revenue from wet lease of aircraft's received from			
Lufthansa Cargo AG (Germany)	318,513,565	854,612,518	657,569,352
Singapore Airlines (Aingapore)	--	67,352,333	41,020,195
Pacific Asia Cargo Airlines (Indonesia)	--	26,125,451	37,769,600
Shareef Express Travels (UAE)	--	2,038,548	1,065,865
Falcon Air Express Cargo Airlines (UAE)	974,220	--	--
Total	319,487,785	950,128,850	737,425,012

41. Ld. Counsel for assessee, in fairness submitted that though the company Shareef Express Travel had chartered the aircraft in UAE, it is now found to be an Indian company. He however, points out that Shareef Travel accounts for miniscule fraction of gross revenues, being 0.21% and 0.14% for the Financial Year 1998-99 & 1999-2000, respectively. That the LCAG Germany, accounted for 99%, 90% and 89% of the aggregate lease rentals earned by the assessee for the Financial Years 1997-98, 1998-99 and 1999-2000, respectively. The balance income is also earned from non-residents companies outside India; the only exception being Shareef Travels. It is contended that since 99.8% of the aggregate leasing income is earned from non-residents remitting payments directly from outside India, income has been earned from source outside India. it is argued that just because a miniscule fraction of receipt is from an Indian party, it cannot provide the Revenue justification for holding that the income is not earned from sources outside India. It is contended that the income from Shareef Travel is so insignificant (0.2%) that it should be ignored. In the alternative, it is submitted that at most 0.2% of the aggregate payments to Technik etc. would be taxable.

42. Income can be said to have been earned from a 'source of income' outside India if the source from which the income is derived is situated outside India. in the context of an international transaction source can be said to be 'outside India' if:-

i. the payer is a non-resident, or ii. the contract with non-resident is made outside India; or iii. the activity yielding income takes place outside India.

It was submitted that all the three conditions are satisfied in the present case. The payers are non-resident, the wet-leasing contracts are made outside India and the income-yielding activity of wet-leasing has been carried on outside India. it is pointed out that the Article 10.6 of the LCAG contract relating to 'Governing Law' clearly states that the law governing the contract would be German law. In this connection, reliance was placed on a decision of Supreme Court in the case of Dhanrajmal Gobindram v. Shamji Kalidas & Co. (1961) 3 SCR 1020, wherein it has been held:-

"Where the proper law is the *lex loci contractus* or *lex loci solutions* is a matter of presumption; but there are accepted rules for determining which of them is applicable. Where the parties have expressed themselves, the intention so expressed overrides any presumption."

Reliance was also placed on the decision of the Supreme Court in the case of Kunwar Trivikram Narain Singh v. State of Uttar Pradesh (1965) 57 ITR 29, wherein it was held that in certain circumstances the contract itself can be the 'source of income' Thus, if the wet-leasing contract were to be considered as the source from which income is earned, the said source is outside India as the contract has been made outside India. however, if the activity of wet-leasing were to be considered

as the 'source', the same also took place outside India. Hence the situs of the source of the receipts was outside India. The Assessee has put its aircrafts to use by wet-leasing them outside India and earned rental income in US dollars outside India. The activity of leasing also took place outside India as is evident from LCAG contract and arrangement with other airlines. If that be so, the source of leasing income is situated outside India.

43. It is submitted that the authorities below confused the income-earning activity of the hirer (LCAG) which is that of international transportation cargo for freight with the activity the assessee, which is that of wet-leasing of aircrafts for flying on international routes. In this connection, reliance was placed on the Supreme Court judgment in the case of Gosalia shipping wherein it was observed:

"If any guidance is to be sought from the terms of the agreement between the parties, the conclusion seems inescapable that the amount which the time-charters were required to pay to the owners of the ship was not payable on account of the carriage of goods but was payable on account of the use and hire of the ship". (emphasis supplied)

44. Reliance was also placed on recent decision of Delhi Tribunal in the case of Asia Satellite Telecommunications Ltd. v. DCIT (2003) 85 ITD 478, wherein after reviewing the entire case law relating to situs of the 'source of income' in the context of international transactions, it is stated in para 6.28 of the decision:-

6.28 Elaborating the work 'source', it was stated that it may encompass the payer of income or the activity which gives rise to the income. To be more precise it was stated that source could not refer to the payer but only to the activity, which resulted in the income. It was explained that the source is that activity which results into the income.

If the source of any income is situated in India then it is irrelevant whether the business carried on by such non-resident is in India or elsewhere.

"We are agreeable that the source does not refer to the person who makes the payment but it refers to the activities which give rise to the income. In the present context the activity which is resulting into income in the hands of non-resident customers, namely the TV channels, is the ultimate viewership of the programmes transmitted by them through the assessee in the footprint areas including India. Therefore the activity which actually produces the income is not the uplinking or downlinking of the signals but of the actual viewership." (Emphasis supplied) It is clarified that the above-quoted observations were made in the context of a non-resident earning income from a source within India, Under Section 9(1)(vi)(c), but the principle stated therein is equally applicable to a resident Under Section 9(1)(vii)(b) of the Act in determining whether income was earned from a source outside India. Lastly, it is submitted that it is indisputable that payments to the non-resident have been made for overhaul repairs for earning from the activity of wet-leasing. There is therefore a direct nexus between of the payments and the

earning of income from sources outside India.

45. For the Revenue, Ld. DR stated that it could not be said that the entire income was earned from sources outside India. he drew our attention to the relevant paras in the orders of the Assessing Officer and CIT (A), wherein it was found that the entire income of the assessee could not be said to have been earned from sources outside India. He Strongly relied upon the findings in the orders of the authorities below.

46. We have carefully considered the rival submissions. It would be appropriate at this stage to set out the terms of the LACG contract dt. 28.4.97.

These are extracted below:-

1. Scope of Agreement.

This Agreement shall set forth the terms and conditions for the carriage of LCAG-shipments on LCI operated air-cargo services. This shall include, but not be limited to the minimum capacities made available by LCI for the carriage of LCAG-shipments.

the standard and reliability of the services rendered by LCI the block-hour rates to be charges by LCI and the block hours guaranteed by LCAG.

2.2 BLOCK-HOUR RATES TO BE CHARGED BY LCI The rates to be charged by LCI for the Cargo Capacities provided including any minimum block hours guaranteed by LCAG to LCI shall be set forth in the respective Annexes to this Agreement.

3. STANDARD OF SERVICES RENDERED BY LCI 3.1 Operations The Aircraft employed shall hold a valid Certificate of Airworthiness issued by the Civil Aviation Authority of India (DGCA) or by any other country should such issuance become necessary to perform the obligations of LCI as set forth under this Agreement. The Aircraft shall remain registered under the registration of LCI during the entire period of this Agreement. LCI shall ensure that Aircraft registrations and authorizations are suitable to perform flights to all countries set forth in the flight schedules hereunder.

LCI shall maintain the Aircraft during the term of this Agreement in accordance with LCI's maintenance program and schedule as approved by the Civil Aviation Administration of India or any such program or schedule mutually agreed upon between the parties.

All flights operated under this Agreement shall be performed under the operational control of LCI in all respects.

LCI shall obtain and maintain throughout the term of this Agreement all necessary licenses and permits required for any operation of the Aircraft under this Agreement.

10.6 Governing Law This Agreement shall be governed by and construed in accordance with, and any and all disputes arising out of, in connection with or in relation to this Agreement shall be decided exclusively in accordance with German law with reference to the choice of law provisions thereof.

Any disputes arising from or in connection with this Agreement shall be finally settled by internal consultation and/or arbitration between the parties by three arbitrators according to the rules of the International Chamber of Commerce, Paris. The arbitration, if so required, shall be held in the English language. The place of arbitration shall be Geneva, Switzerland or any place mutually agreed upon between the Parties.

CAPACITIES AND FLIGHT SCHEDULES Annex No-2

1. Capacities to be made available by LCI should LCAG anticipate that the capacity provided by LCI under the Agreement cannot be utilised by LCAG in its entirety in any calendar month, LCAG shall give promptly written notice of such determination to LCI. In the instance such notice is given more than 60 days before the date of the flight concerned, LCI will use its utmost efforts to re-market the capacities and flights not to be utilised by LCAG.

Should LCI be able to sell any such capacities on its own behalf, LCAG shall be entitled to a refunded as set forth in Annex 3 of the Agreement, but only within the minimum block Hours Guaranteed to LCAG to LCI under this Agreement.

Charges and Payments Annex No-3 As set forth in Article 3.2 of the agreement the following terms and conditions apply for the calculation and payments of any charges by the LCIL for the Capacity provided under this agreement.

1. "Block Hour" is defined as the period of time operated by the Aircraft gate to gate expressed in hour commencing when the Aircraft moves from the blocks to begin a flight and ending when the chocks have been inserted under the wheels after touchdown at the next point of landing. such Block hours shall be charged and invoiced in accordance of the Movement Messages given by the respective Flight Deck Crews/OPS Dept.

2. LCAG shall pay to LCI a guaranteed rate as set forth in this Annex for each effectively completed Block Hour of operation of fractions thereof. Such rate (Rate A) shall be:

Until October 31, 1997:

US\$ 1,845.00 (US-\$ One Thousand Eight Hundred and Forty-Five) per Block Hour from November 1, 1997:

US-\$ 1,630.00 (US-\$ One Thousand Six Hundred and Thirty) per Block Hour The aforementioned price shall apply to all block performed by LCI up to a total of 960 (nine hundred and sixty) Block Hours performed under this Agreement per calendar

month. Unless otherwise agreed upon in this Capacity Agreement, LCAG shall guarantee to LCI a payment totaling the amount of 960 (nine hundred and sixty) Block Hours performed under this Agreement per calendar month.

Should the number of Block Hours actually performed during a calendar month fall short of the number of Block Hours being in the minimum Block Hours guaranteed by LCAG, the rate (Rate B) for such Block Hours not actually performed for reasons not proved to be under the control of LCI shall be US-\$ 1,225.00 (US-\$ One Thousand Two Hundred and Twenty-Five) per Block Hour.

47. The following conclusions can be drawn from the above quoted terms of the LCAG contract.

- (i) The assessee has to maintain the crew and keep the aircrafts in airworthy state.
- (ii) The assessee company earns rental income on block-hours basis.
- (iii) The assessee cannot wet-lease the aircrafts to a third party without a written permission from the LCAG.
- (iv) In case of non-utilisation of aircrafts by the LCAG, it has to pay minimum guaranteed rental 240 block-hours per month in accordance with Clause No. 2.2 read with, Annexure 3 of the contract.
- (v) The amount of leasing revenues depends on the number of flying hours utilised by LCAG and not on the value of freight earned by the LCAG.
- (vi) The assessee is also assured of minimum rental income in the event LCAG does not actually use the aircrafts.

48. In this view of the matter, we are satisfied that the assessee's immediate source of income is from the activity of wet-leasing of aircrafts under contracts made outside India to non-resident parties. A miniscule fraction of the lease rental (0.2%) has been earned from an Indian party. But, this cannot detract from the fact that virtually entire income has been earned from non-residents through the activity of wet-leasing of the aircrafts carried on outside India.

49. The assessee's activity of wet-leasing of air-crafts is a distinct activity which constitutes a source form which income has been earned. Revenue is not correct in identifying this leasing activity with the transportation activity of the lessee, LCAG, Germany. The following observations of the Supreme Court in the case of Gosalia Shipping (1978) 113 ITR 307 (SC) are apposite:-

"If any guidance is to be sought from the terms of the agreement between the parties, the conclusion seems inescapable that the amount which the time-charters were required to pay to the owners of the ship was not payable on account of the carriage

of goods but was payable on account of the use and hire of the ship.

Indeed, the other terms of the charter-party and the general tenor of the documents show that the payment was in fact to be made by the time-charterers for use and hire of the ship.

If the charterers are liable to pay the amount irrespective of whether they carry the goods or not, it would be difficult to say that the amount was payable on account of the carriage of goods. Under the terms of the charter-party, the owners of the ship received the amount as charges for the use and hire of the ship. The character of the payment cannot change according to the use of which the charterers put the ship or according as to whether the ship is loaded with goods in a port in India. What is payable as hire charges for the use of the ship cannot transform itself into an amount payable on account of the carriage of goods, by reason of the circumstance that the ship was loaded with goods in India.

That the owners were entitled to payment for the use and hire of the ship, that the amount was payable irrespective of what use the ship was put to by the time-charterers or, indeed, whether it was put any use at all and that no part of the payment can be said to have been made on account of the carriage of goods."

50. The above quoted passage is clearly applicable to the facts of the case. The sources from which the assessee has earned income are therefore outside India as the income earning activity is situated outside India. It is towards this income earning activity that the payments for repairs have been made outside India. The payments therefore fall within the purview of the exclusionary clause of Section 9(1) (vii) (b). Thus, even assuming that the payments for such maintenance repairs were in the nature of fees for technical services, it would not be chargeable to tax.

50.1 We allow the assessee's appeal on this point by holding that the payments for repairs of aircrafts was made for earning income from sources outside India and therefore to be excluded from 'fees for technical services' Under Section 9(1) (vii) (b) of the Act.

Issue 1(c) "The payments have been utilized in the assessee's business of wet leasing of aircrafts has been carried out outside India and therefore to be excluded from 'fees for technical services' Under Section 9(1) (vii) (b)"

51. Ld. Counsel for the assessee submits that Clause (b) of Section 9(1)(vii) also excludes any payment of fees for technical services if such services are utilised in a business or profession carried on by the assessee outside India. It is submitted that the assessee's business of leasing of aircrafts alongwith crew is carried on outside India. All the aircrafts were acquired by the assessee outside India--three under hire-purchase agreement and one under dry-lease lease agreement--from a foreign company for which payments were made in foreign exchange. The leasing revenues were earned outside India from non-resident lessees. The Ld. Counsel referred to the Annual Accounts of the assessee for the three financial years (at pps. P. 122, 132, 144 of the Paper Book-1) to show that

leasing revenues were earned in foreign exchange from foreign airlines companies. He also submitted a chart indicating transactions in foreign exchange for each of the three financial years as obtaining from the annual Accounts of the assessee. As per this chart the leasing revenues earned in foreign exchange were 100%, 99.79% and 99.86% for the Financial Years 1997-98, 1998-99 and 1999-2000, respectively. This chart also gives the figures of direct operational expenses in foreign exchange on actual payment basis as culled out from the Annual Accounts of the company for three years (at pps. 122, 132, 143 of the Paper Book). As per the annual accounts, the direct expenses are mainly on account of lease rent, travelling and training, foreign office expenses, maintenance, interest on aircrafts acquired under hire-purchase, and depreciation. The aggregate of the direct expenditure incurred outside India works out to 55%, 81% and 67% of the total expenses debited to Profit & Loss Account of each of the three years. It is submitted that remaining indirect expenditure was on account of Head Office expenses in India and expenditure on the ground staff, overnight stay of crew and airport charges etc. When the aircrafts landed in Indian airports for delivering and picking up cargo.

52. The Ld. CIT DR relied on the order the Assessing Officer and contended that the assessee's business was controlled from India and therefore it cannot be said that the business was carried on outside India.

53. We have carefully considered the rival submissions and we have also gone through the annual accounts of the assessee for the Financial Years ended 31.3.98, 31.3.99 and 31.3.2000 respectively, filed in the Paper Book. The question whether a business is carried on in India or outside India cannot be decided by the situs of the Head Office or the place of control of the business. The assessee, being an Indian company, would have the Head Office or the place of control in India. We agree that the assessee's business of wet-leasing of aircrafts have been predominantly carried on outside India. The assessee's business of wet-leasing of aircrafts is composed of a number of operations such as acquisition of aircrafts, wet-leasing, maintenance of crew and engineering personnel, aircrafts maintenance and establishment, etc. It is settled law that profits of a business cannot be said to accrue only in the place where sales take place or the revenue is earned, but they are embedded in each distinct operation of the business, both on the revenue and the expenditure side. For this legal proposition, we are supported by the decision of the Supreme court in the case of *Anglo French Textile Company Ltd. v. CIT* (1954) 25 IRT 27, where relying on an earlier judgment of the larger bench in the case of *CIT v. Ahmed Bhai Umar Bhai and Co.* (18 ITR 472) the Apex Court explained the legal position in following words:-

'In the case of a composite business, i.e., in the case of a person who is carrying on a number of businesses, it is always difficult to decide as to the place of the accrual of profits and their apportionment inter se. For instance, where a person carries on manufacture, sale, export and import, it is not possible to say that the place where the profits accrue to him is the place of sale. The profits received relate firstly to his business as a manufacturer, secondly to his trading operations, and thirdly to his business of import and export. Profit or loss has to be apportioned between these business in a business like manner and according to well established principles of accountancy in such cases it will be doing no violence to the meaning of the words

"accrue" or "arise" if the profits attributable to the manufacturing business are said to arise or accrue at the place where the manufacture is being done and the profits which arise by reason of the sale are said to arise at the place where the sales are made and the profits in respect of the import and export business are said to arise at the place where the business is conducted...."

The above passage is also sufficient in our opinion to establish that the apportionment of income, profits or gain between those arising from business operation carried on in the taxable territories and those arising from business operations carried on without the taxable territories is based not on the applicability of Section 42(3) of the Act but on general principles of apportionment of income, profits or gains. That was really the ratio of the judgment of the majority in Commissioner of Income-tax, Bombay v. Ahmedbhai Umarbhai and Co., Bombay (1) and any attempt to distinguish that case from the present one by having resort to the statutory provisions of the Excess profits Tax Act is really futile." (Emphasis supplied)

54. The Ld. Counsel for the assessee fairly states that he has no objection to the apportionment on the basis of the above-quoted decision. He, however, submits that virtually 100% of the Revenues were earned outside India and the aggregate direct expenditure incurred outside India is about 71%, and another 10% should atleast be attributed to the business outside India on account of Head Office expenses incurred in India.

55. Normally, we would have referred the matter to the Assessing Officer to verify the figures and work out the apportionment on a reasonable basis. However, we need not go into this arithmetical exercise because we have already held that the payments made to Technik and other foreign companies for maintenance repairs are not in the nature of fees for technical services as defined in Explanation-2 to Section 9(1) (vii)(b). Further, in any event these payments are not taxable for the reason that they have been made for earning income from sources outside India and therefore fall within exclusionary clause of Section 9(1) (vii)(b).

56. In view of our decision allowing the main ground relating to chargeability of tax, the alternate grounds have become academic. We therefore do not propose to go into them though considerable arguments were advanced on the alternate grounds.

57. We now take up the appeals filed by the Revenue.

57.1 The grievance of the Revenue is that the CIT (A) was not correct in holding that as per the provisions of DTAA with USA & UK, the payment for repairs made to the residents of those countries cannot be considered to be fees for included/technical services as defined in Article 12.4(b) of the US treaty and Article 13.4(c) of the UK treaty, respectively. The Ld. DR relies on the order of the Assessing Officer; whereas, according to the Ld. Counsel for the assessee, the issue is squarely covered in the assessee's favour by the decision of the ITAT, Bombay Bench 'C', in the case of Raymond Ltd. (2003 80 TTJ (Mumbai) 120). We however do not propose to go into this

controversy in view of our decision that the impugned payments to non-residents for repairs of components are not chargeable to tax under the Act, and therefore the assessee was not liable to deduct tax Under Section 195 of the Act. In this view of the matter, the Revenue's appeals fail.

58. We now take the appeals filed by assessee relating to penalty Under Section 271C for assessment years 1997-98, 1998-99 and 1999-2000.

58.1 We have already allowed the appeals of the assessee on quantum, i.e., against order Under Section 201/201 (1A). Therefore, these appeals have to be allowed because the basis on which the penalties Under Section 271C were imposed have already quashed. Therefore, these appeals of assessee in regard to penalty levied and confirmed Under Section 271C are hereby allowed by deleting the penalties for all the years here before us.

59. In the result, the appeals filed by the assessee succeed and the appeals filed by the Department are dismissed.