IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI L BENCH, MUMBAI

Before Shri Pramod Kumar (Accountant Member),
and Shri R S Padvekar (Judicial Member)

ITA No. 3254/Mum/06
Assessment year 1998-99

Airlines Rotables Limited, UK ***…..……..….Appellant***
C/o B S R & Co, Chartered Accountants
KPMG House, Kamla Mills Compund,
Senapati Bapat Marg, Lower Parel
Mumbai 400 013

Vs.

Joint Director of Income Tax –
International Taxation, Range 1, Mumbai ***…….… Respondent***
Scindia House
Ballard Estate, Mumbai 400 020

Appellant by : Shri F V Irani
Respondent by : Shri Ajit K Sinha

O R D E R

Per Pramod Kumar:

1. By way of this appeal, the assessee appellant has called into question correctness of the order dated 28th February 2006 passed by the learned Commissioner of Income Tax (Appeals), in the matter of assessment under section 143(3) of the Income Tax Act, 1961, for the assessment year 1998-99.

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2. The appeal is time barred by three days, and the delay is said to have occurred as the appeal papers were required to be sent to United Kingdom for signatures, and as there were some complications regarding remittance of appeal fees. The assessee has moved a petition, duly supported by affidavit of one Naresh Makhijani, chartered accountant handling the taxation matters, in India, of the assessee. Having perused the petition, and having heard the parties on the same, we are inclined to condone the three days' delay in filing of appeal, and proceed to take up the matter for disposal on merits of the case. Delay condoned.

3. Grievances raised by the appellant, as set out in the memorandum of appeal, are as follows:

> *Based on the facts and circumstances of the case, and in law, the learned Commissioner of Income Tax (Appeals) XXXI Mumbai [hereinafter referred to as 'CIT(A)'] erred in upholding the assessment order {dated 30th March 2001 issued by the learned Deputy Commissioner of Income Tax, Circle 2(1), Mumbai (hereinafter referred to as 'the AO') under section 143(3) of the Income Tax Act, 1961 ('the Act') in relation to the assessment year 1998-99 in the case of Airline Rotables Limited – a company incorporated under the laws of United Kingdom and carrying on the business of providing spares and component support for*

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aircraft in India during the year ended 31st March 1998 ('hereinafter referred to as 'your appellant')} on certain grounds.

Your appellant's grounds of appeal against the order of the CIT(A) are specifically stated below :

1. ***Permanent Establishment (PE) in India***

   The CIT(A) erred in holding that your appellant had a permanent establishment in India.

   Your appellant prays that the AO be directed to hold that the appellant does not have a PE in India.

   <u>Without prejudice ground</u>

2. ***Quantification of income by applying 10% as rate of profit***

   The CIT(A) erred in applying an adhoc rate for determining the profits attributable to alleged PE in India.

   The CIT(A) erred in holding that the entire profits from Indian sales were attributable to the alleged PE in India, despite the fact that the operations were carried out outside India.

   Your appellant prays that the AO be directed to compute the total income of your appellant by applying the actual profit rates.

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4. The short issue that we are urged to adjudicate in this case thus is whether or not the assessee can be said to have a permanent establishment (PE) in India, and if the answer to this question is in affirmative, the next question that we will have to deal with is the manner in which profits attributable to the said PE are to be quantified. Learned counsel submits that the decision on these issues will govern the decision on core grievance i.e. against additions made by the Assessing Officer to the returned income, which have been sustained in appeal by the CIT(A).

5. Let us first take a look at the relevant material facts, as culled out from the orders of the authorities below and the documents on record. The assessee before us, Airlines Rotables Limited (ARL), is a company incorporated under the laws of United Kingdom. It has its place of business at 6002 Taylors End, Stansted Airport, Stansted, Essex CM24 IRL, UK, and its main business is said to be providing spares and component support for aircraft to the aircraft operators. The assessee has entered into an agreement with Jet Airways Limited (hereinafter referred to as 'the airline'), an Indian company engaged in the business of air transportation, for providing certain support services in respect of Boeing 737 aircrafts. The basic arrangement is like this. When the airline discovers that an aircraft component becomes

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operationally unserviceable, i.e. when the component is not in a condition to be used or is not airworthy, the same is to be repaired or overhauled by the assessee and the assessee also has to ensure that airworthiness directives in respect of the same are to be complied with. However, it is not merely repairs and overhauling that the assessee has to do. The assessee also has to provide a replacement component which can be used by the airline during the period its original equipment is under repairs or overhauling by the assessee. Under the said agreement, the assessee is also responsible for providing replacement rotables, on exchange basis, required for an aircraft as a result of operational unserviceability . 'Rotable', for this purpose, is defined as "an item, with a manufacturer's serial number, that can be economically restored to a serviceable condition, and, in the normal course of operations rehabilitated to a fully serviceable condition over a period approximating the life of the flight equipment to which it is related". In order to ensure that the replacement components are readily available and the flight operations are not interrupted due to repairs and servicing of the components, the assessee company provides stock of such components, as agreed with the airlines, at the operating bases of the airlines. In addition to this, the assessee company also maintains a stock of components at its main depot in the United Kingdom from which the assessee company provides replacement components within time limits specified in the

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agreement, and which vary depending upon the urgency of requirements. In simple words, what the assessee does is to organize repairs or overhauls of the rotables , and ensure that during the period when the a rotable is under repairs or overhaul, the airline has a replacement rotable, on loan basis, so as to have uninterrupted operations. With a view to ensure adequate availability of necessary rotables, the assessee company maintains stock of such replacement rotables at operational bases of the airlines in India, as also at the assessee company's main depot in the United Kingdom. As regards the stock maintained at the United Kingdom, such stock is under direct control of the assessee company. However, since assessee company does not have any storage or support facilities in India, the stock in India are in the possession of the airlines itself – though as a bailee. The arrangement is like this. The assessee hands over the consignment stock to airlines and it is kept in the warehouse located at the operating base. This stock remains property of the assessee company at all times and the airline is forbidden from loaning, pledging, selling, exchanging or encumbering any items from the stock- except as permitted under the agreement itself. Whenever need arises i.e. a component is sent for repairs or overhauling, the airlines has a right to use replacement component from the said stock. It is maintenance of this consignment stock in India which is at the root of dispute before us. During the course of the assessment proceedings, the

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Assessing Officer noted that the claim of the assessee was that since the assessee did not have any permanent establishment in India, his business profits were not taxable in India. The Assessing Officer did not, however, accept the claim that the assessee did not have a permanent establishment in India. He took note of the facts, as set out in the preceding paragraph, and also noted that the stocks of the assessee company are kept separately under a bin card identification system, but in the control of the staff of the assessee company. He referred to the statement of one H N Kamath, Stores Executive of Jet Airways, which was recorded on 26th March 1998 during the course of survey proceedings, wherein it is *inter alia* stated that "to verify the delivery procedure from consignment stock is in conformity with their (assessee company's) business interest, they have been deputing their executives to satisfy themselves" and that "they always have been satisfied by our performance as their agent for delivery of parts from consignment stock". It is on this basis that the Assessing Officer inferred that the stores staff of Jet Airways has been acting as agents of the assessee company, and this relationship has resulted in a PE coming into existence. He relied upon Article 5.4 (b) which provides that "A person acting in a Contracting State for or on behalf of an enterprise of be other Contracting State other than an agent of an independent status in whom paragraph (5) of this Article applies shall be deemed, to be a permanent establishment of that enterprise in the first-mentioned State if……he habitually maintains in

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the first-mentioned Contracting State a stock of goods of merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise". He also noted that it was not necessary that the person who manages and controls the stock should be an employee of the foreign enterprise. In his view, the emphasis was on the fixed place of business, and given that the assessee's stocks are permanently kept at fixed places in India, with clear identification of each of stock item, the assessee has a fixed place of business in India. The Assessing Officer also noted that the exclusions clauses in Article 5(3) of the India UK tax treaty do not apply. He also observed that different pricing method, as in this case, did not really matter and that 'delivery to self is also a delivery so long as it results in a transfer'. He thus concluded that the assessee had a permanent establishment in India under Article 5 of the India UK tax treaty, and that, accordingly, the receipts will be taxable in India as business receipts. The Assessing Officer estimated 10% of gross receipts as its profits liable to be taxed in India. Accordingly, the Assessing Office proceeded to bring to tax Rs 2,41,26,040 as assessee's income from operations in India liable to be taxed in India. Aggrieved by the stand so taken by the Assessing Officer, assessee carried the matter in appeal before the CIT(A) but without any success. Learned CIT(A) held that the appellant has a fixed place of business within meanings of Article 5(1) and Article 5(4) since the assessee is having a fixed place of business in which goods are kept as stock for sale. The CIT(A) also observed that

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"the issue of sale has to be understood in its widest meaning in relation to business transactions" and added that "the appellant company is engaged in the business or providing repairs to the faulty components of Boeing 737 of JA". The CIT(A) thus justified sales as follows :

> **Faulty components are collected by the appellant company and after repairing they are sent to India. Stock of such goods and repaired parts/rotables is maintained in India from which delivery is to be made to JA as and when needed. Thus so far as the appellant is concerned, delivery of such repaired part amount to sales, since income is arising out of such delivery of goods and the repaired part. Thus benefit of clause (a) and clause (b) of Article 5(3) is not available to the appellant.**

6. The CIT(A) thus upheld the action of the Assessing Officer in holding that the assessee had a permanent establishment in India . The CIT(A) also upheld taxability @ 10% of gross revenues earned from India operations of the assessee company. The assessee is aggrieved and is in further appeal before us.

7. We have heard the rival contentions, perused the material on record and duly considered factual matrix of the case as also the applicable legal position.

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8. We may, at the outset, mention that in both the orders of the authorities below, there are frequent references to the order passed by the Assessing Officer (TDS) under Section 195 of the Act, when Jet Airways sought permission to remit the payment of bills to the assessee, as also the appellate order thereon by the CIT(A), but none of the parties could confirm whether the said matter travelled in appeal before this Tribunal, and if so, findings thereon, by the Tribunal. It has been stated at the bar that the matter rests with the appeal by the CIT(A) having been decided against the tax deductor. We have no reasons to doubt this statement, nor could we find anything to the contrary. It is in this backdrop that we have proceeded to decide this matter on merits and without reference to the proceedings under Section 195 in the hands of the tax deductor.

9. The first question that we need to decide is whether the assessee company had any permanent establishment in India. Article 5 of the India UK Double Taxation Avoidance Agreement (206 ITR Statute 235) defines 'permanent establishment' as follows :

Article 5

Permanent establishment

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1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term "permanent establishment" shall include especially :

(a) a place of management;

(b) a branch;

(c) an office;

(d) a factory;

(e) a workshop;

(f) premises used as a sales outlet or for receiving or soliciting orders;

(g) a warehouse in relation to a person providing storage facilities for others;

(h) a mine, an oil or gas well, quarry or other place of extraction of natural resources;

(i) an installation or structure used for the exploration or exploitation of natural resources:

(j) a building site or construction, installation or assembly project or supervisory activities in connection therewith,

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where such site project or supervisory activity continues for a period of more than six months, or where such project or supervisory activity being incidental to the sale of machinery or equipment continues for a period not exceeding six months and the charges payable for the project or supervisory activity exceed 10 per cent of the sale price of the machinery and equipment;

(k) the furnishing of services including managerial services, other than those taxable under Article 13 (Royalties and fees for technical services), within a Contracting State by an enterprise through employees or other personnel, but only if :

> (i) activities of that nature continue within that State for a period or periods aggregating more than 90 days within any twelve-month period; or
>
> (ii) services are performed within that State for an enterprise within the meaning of paragraph 1 of Article 10 (Associated enterprises) and continue for a period or periods aggregating more than 30 days within any twelve-month period :
>
> Provided that for the purposes of this paragraph an enterprise shall be deemed to have a permanent establishment in a Contracting State and to carry on business through that permanent establishment if it provides services or facilities in connection with, or supplies plant and machinery on hire used or to be

used in, the prospecting for, or extraction or production of, mineral oils in that State.

3. The term "permanent establishment" shall not be deemed to include :

(a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise ;

(b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display;

(c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(e) the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information or for scientific research, being activities solely of a preparatory or auxiliary character in the trade of business of the enterprise. However, this provision shall not be applicable where the enterprise maintains any other fixed place of business in the other Contracting State for any purpose or purposes other than the purposes specified in this paragraph ;

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(f) the maintenance of a fixed place of business solely for any combination of activities mentioned in sub-paragraphs (a) to (e) of this paragraph, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

4. A person acting in a Contracting State for or on behalf of an enterprise of be other Contracting State other than an agent of an independent status in whom paragraph (5) of this Article applies shall be deemed, to be a permanent establishment of that enterprise in the first-mentioned State if :

(a) he has and habitually exercises in that State, an authority to negotiate and, enter into contracts for or on behalf of the enterprise, unless his activities are limited to the purpose of goods or merchandise for the enterprise; or

(b) he habitually maintains in the first-mentioned Contracting State a stock of goods of merchandise from which he regularly delivers goods or merchandise for or on behalf of the enterprise; or

(c) he habitually secures orders in the first-mentioned State wholly or almost wholly for the enterprise itself or for the enterprise and other enterprises controlling, controlled by, or subject to the same common control, as that enterprise.

5. An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely

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because it carries on business in that other State through a broker, general commission agent or any other agent of an independent status, where such persons are acting in the ordinary course of their business. However, if the activities of such an agent are carried out wholly or almost wholly for the enterprise (or for the enterprise and other enterprises which are controlled by it or have a controlling interest in it or are subject to same common control) he shall not be considered to be an agent of an independent status for the purposes of this paragraph.

6. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

7. For the purposes of this Article the term "control" in relation to a company, means the ability to exercise control over the company's affairs by means of the direct or indirect holding of the greater part of the issued share capital or voting power in the company.

10. In terms of the provisions of Article 5(1), i.e. the basic rule, a permanent establishment is said to exists in the other contracting state when an enterprise of one of the contracting states has a fixed place of business, in that other contracting state, through which business is carried out – wholly or partly. There are three criterions

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embedded in this definition – physical criterion i.e. existence of physical location, subjective criterion i.e. right to use that place, functionality criterion i.e. carrying out of business though that place. It is only when these three conditions are satisfied, a PE under the basic rule can be said to have come into existence.

11. As observed by a coordinate bench in the case of Western Union Financial Services Inc Vs Additional Director of Income Tax (104 ITD 34), "**a permanent establishment should project in the foreign enterprises in India** *(the other contracting state)*" . In the case of CIT Vs Vishakhapatnam Port Trust (144 ITR 146), Hon'ble Andhra Pradesh High Court has, after an elaborate survey of world wide judicial precedents and technical literature on this issue, has observed that, "**in our opinion, the words 'permanent establishment' postulate the existence of substantial element of enduring or permanent nature of a foreign enterprise in another country which can be attributed to a fixed place of business in that country**". Their Lordships further added that "**it should be of such a nature that it would amount to a virtual projection of foreign enterprise of one country into the soil of another country**". Incidentally, the treaty definition of 'permanent establishment' basic clause, which came up for consideration of Their Lordships, was exactly the same as in the case before us.

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12. The physical test, i.e. place of business test, requires that there should be a physical location at which the business is carried out. However, mere existence of a physical location is not enough. This location should also be at the disposal of the foreign enterprise and it must be used for the business of foreign enterprise as well. A place of business should be at the disposal of the foreign enterprise for the purpose of its own business activities. This place has to be owned, rented or otherwise at the disposal of the assessee, and a mere occasional factual use of place does not suffice. As observed by a Special Bench of this Tribunal in the case of Motorola Inc Vs DCIT (95 ITD 269 SB) has upheld this school of thought, and, inter alia, observed as follows:

> **………..The OECD Commentary on Double Taxation Conventions refers to a fixed place as a link between the place of business and a specific geographical point. It has to have certain degree of permanence. It is emphasized that to constitute a 'fixed place of business', the foreign enterprise must have at its disposal certain premises or part thereof. Philip Baker, in his commentary on Double Taxation Conventions (Third Edition), states that the fixed place is very much that of a physical location, i.e., one must be able to pinpoint to a physical location <u>at the disposal of the enterprise</u>** (*emphasis supplied by us now*) **through which the business is carried on. On the other hand, possession of a mailing address in a State without an office, telephone listing or bank account – has**

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been held not to constitute a PE. Further the fixed place of business need not be owned or leased by the enterprise provided <u>it is at the disposal of the enterprise in the sense of having some right to use the premises for the purposes of its business and not solely for the purpose of project undertaken on behalf of the owner of the premises</u> (*emphasis supplied by us now*).

13. It is thus necessary that, in order to give a positive finding about existence of the PE, not only that there should be a physical location through which the business of the foreign enterprise is carried out, but also such a place should be at the disposal of the foreign enterprise in the sense that foreign enterprise should have some sort of a right to use the said physical location for its own business.

14. The third and final test for existence of PE under the basic rule is the functionality test i.e. the fixed place of business should be used for the purposes of business of the foreign enterprise. As observed by the Special Bench of this Tribunal in the case of Motorola Inc (supra), such a use should not be confined to mere doing the work for owner of the enterprise owning that physical location and must extend to carrying on of the business of the foreign enterprise. The business carried out at that place should be such as to amount to, as was observed by Hon'ble Andhra Pradesh High Court in the case of

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Vishakhapatnam Port Trust (supra), "**virtual projection of enterprise of one country into soil of another country**". The PE must project the foreign enterprise of which it is claimed to be permanent establishment. It is in this sense that the business must be carried on at the physical location in the other country. It is also important to bear in mind that when such a physical location has come into play as an end result of business having been carried out, such as a barge in territorial waters of the other country upon having given such barges on hire to a resident of the other country – in the case of a person who is engaged in the business of giving barges on hire, the business cannot be said to have been carried out on such place qua that business activity. It was so held by a coordinate bench in the case of ADIT Vs Valentine Maritime (Mauritius) Limited (2010-TIOL-195-ITAT-MUM) wherein it was held that that "**by no stretch of logic, when an assessee is in the business of hiring out the barges, a barge so hired out cannot be viewed as a place of carrying on its business, which, as we understand, is limited to, *qua* that barge, the barge having been so hired out**".

15. In the light of the above discussions, let us revert to the facts of this case. Can we say that on the facts of this case, the assessee had a fixed place of business though which he was carrying out his business ? Undoubtedly, the consignment stock of the assessee was

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stored at specific physical locations but this storage was under control of the airlines and the assessee did not have any place at his disposal in the sense that he could carry out his business from that place. It is also important to understand that the consideration for the services rendered by the assessee was divided into two segments – one segment as a consideration for repairing and overhauling of rotables, and the other segment as consideration for use, or right to use, of the replacement equipments. As for the consideration for repairs and overhauling of equipments, no part of the profits thereon could be taxed in India for the elementary reason that the repairs and overhauling work is done outside India, and, even if there is a PE, only such profits as attributable to PE can be taxed in India under Article 7(1). PE or no PE, since entire repairs and overhauling is carried outside India, the profits arising to the assessee from such repairs or overhauling can be taxed in India. The existence of PE in a country cannot warrant or justify taxation of all the profits arising to a foreign enterprise in that country. Even if there is a PE, one cannot infer application of the force of attraction principle and proceed to bring to tax all the profits of the foreign enterprise whether or not they relate to the PE. As far as the consideration for use or right to use the replacement equipments are concerned, the location of such equipments so given for use or right to use cannot be viewed as a place of carrying on its business, which, as we understand, is limited to, *qua*

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that consignment, the consignment so having been given for use or right to use. The business with regard to that consignment is over when that consignment is given for standby purposes to the airline. It is thus clear that not only that the assessee did not have any right to use the location of consignment stock, such a location was also not used for the purposes of assessee's business. There is also no projection of the assessee at this physical location in the sense that the business of the assessee is not carried out, or sought to be carried out or even projected, from these locations. When the physical locations at which consignment stock is kept donot project the assessee, it cannot be said that these locations constitute permanent establishments of the assessee.

16. We have also noticed that the revenue has made efforts to demonstrate that the assessee is storing the goods and using the place for securing the orders, and for this reason, the physical location of storing the consignment stock should be treated as a permanent establishment. We are unable to see any substance in this line of reasoning. Unless it is a warehouse and the storage of goods is for outsiders, which is certainly not the case before us, storage of goods cannot lead to a permanent establishment. That apart, it is not the case of storage of goods even, since the consignment stock is handed over to the airlines for use as standby replacement components. There is something more than storage simplicitor involved in this exercise, and that is the right to use the stock

for Jet Airways operational requirements on as and when required basis. As regards using the place of storage as a location to securing the sale orders, the components stored are for standby use of the airline and it is not even the business of the assessee to sell those components. The authorities below have also observed that the assessee constitutes a dependent agent permanent establishment under Article 5(4)(b). It is necessary to understand the conceptual framework for Dependent Agency Permanent Establishment first. The rationale for dependent agent permanent establishment is simple. A foreign enterprise may chose between business activity itself , or having it done through a domestic agent. In case this domestic agent acts in the normal course of business, and is not wholly or almost wholly dependent on the foreign enterprise, the PE situation is out of reckoning because it is business of the agent, rather than business of the foreign principal, that the agent is mainly carrying out. In case of a dependent agent, the PE situation arises because when the foreign enterprise prefers to perform the business activity through a domestic agent, he does not need to depend on having a right to use a fixed place of business as the business is carried through the dependent agent. However, taxation would infringe neutrality vis-à-vis the choice of manner in which business is carried out , in the event tax position of a foreign enterprise is to depend on whether business is carried out by the foreign principal directly or through the a dependent agent – who, being a dependent agent, is integrated into principal's

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business to a substantial extent. In case the tax position is to be based on whether or not the business activities are carried out directly or through the agent, it would be a bit too easy to circumvent the PE taxation if no PE taxation is applied on business through the dependent agent permanent establishment. This is the unmistakable underlying principle behind the DAPE clause in tax treaties. It is thus clear that DAPE can come into existence only when business is carried out through the dependent agent. In the situation before us, no business is carried out through the agent, even if there be an agent in keeping the consignment stock, because this consignment stock with the airlines is the end result of assessee's business and not an intermediate step to get business. What the assessee is paid for, vis-à-vis the consignment stock, is consideration for so placing the consignment stock at the disposal of the airlines. The only other part of the consideration received by the assessee is for repairs and overhauling of aircraft rotables – a work which is entirely carried out outside India and no part of profit thereon could be taxed in India as attributable to PE. It is also difficult to understand how can Jet Airways Limited can be construed as a dependent agent of the assessee before us. It would be absurd to contend that Jet Airways is dependent agent of its supplier for the purposes of giving out replacement component. Nothing has been elaborated in the orders of the authorities below except for making a reference to Article 5(4). There is no material whatsoever to establish, or even indicate, that Jet Airways or its staff

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constitute dependent agent of the assessee company. A statement given by an employee where 'agent' word is used, clearly in its lose sense and not in its legal sense, in the statement cannot even be conclusive of whether the assessee has an agent, in legal connotations of that expression, in India, and by no stretch of logic it even suggests that the agent is a dependent agent. Even if one assumes that Jet Airways can be treated as an agent of the assessee company for this purpose, Jet Airways will at best be an independent agent and custodian of the consignment stock, covered by the first limb of Article 5(5). Unless second limb of Article 5(5) is satisfied, taxability as a DAPE will not arise. In the case of Morgan Stanley & Co International Limited In Re (272 ITR 416), Hon'ble Authority for Advance Ruling has held that the brokers, custodians and bankers who are "acting in the ordinary course of business and their activities are not devoted wholly or almost wholly on behalf of applicant (i.e. enterprise of the other contracting state) or on behalf of the applicant and other enterprise controlling, controlled by or subject to the same control as the applicant" and "therefore they donot fall within the mischief of (second limb of) Article 5(5) of the treaty". It is thus clear that unless it is established that Jet Airways Limited is a dependent agent of the assessee company, Jet Airways Limited can not be treated as a permanent establishment of the assessee. There is nothing on record to suggest even that claim. The consignment stock is maintained by Jet Airways Limited only for standby use and not its delivery for or on

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behalf of the enterprise. The conditions of Article 5(4)(b) are thus clearly not satisfied. The CIT(A) has also erred in observing that the delivery of repaired part amounts to sales because the assessee is being paid for repairing the component owned by the airline. It is difficult to understand how can one sell something to a person who already owns that thing. The delivery is for standby use of equipment and not for its sales. As a matter of fact, there is no sales involved in this transaction, and as such there is no question of delivery for sale. In view of these discussions, it is clear that the revenue authorities have not been able to establish that the assessee had a permanent establishment in India. It is a settled position of law, as noted by the Special Bench of this Tribunal in the case of Motorla Inc (supra), that the onus is on the revenue to demonstrate that a permanent establishment of the foreign enterprise exists in India. That onus is not discharged. Having said that, we may also add that, in our considered view, the business model of the assessee company is such that in the above arrangements, a PE in the source location does not come into existence.

17. In view of the above discussions, we are of the considered opinion that the assessee company did not have any PE in India, and, accordingly, the entire income attributable to the India operations could not have been taxed in India. The grievances raised against quantification of income attributable to the PE , under Article 7(1), are thus rendered

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infructuous. To that extent, we uphold the grievance of the assessee and vacate the orders of the authorities below.

18. We may, however, add that while the consideration for use or right to use the consignment stock of equipments is taxable under Article 7(1) read with Article 13(6), in a situation when the assessee has a PE in the other contracting state, even when the assessee does not have a PE , its taxability is still required to be considered in the light of Article 13(3)(b) on gross basis. Therefore, our finding that the assessee did not have a PE in India, by itself, would not take the assessee out of ambit of taxability in India. Having held that the assessee had a PE in India, the authorities below were not required to give a finding on that aspect of the matter because even if a part of receipts of the assessee company was found to be for use of , or right to use of, any "industrial, scientific or commercial equipment" covered by Article 13(3)(b), in a situation in which PE can be said to exist, such consideration was taxable, on net basis, under Article 7 – as was done in the present case. We may, in this regard, refer to the following provisions contained in Article 13 of the India UK tax treaty:

> ***Article 13***
> ***Royalties and fees for technical services***
>
> *1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.*

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2. However, such royalties and fees for technical service may also be taxed in the Contracting State in which they arise and according to the law of that State; but if the beneficial owner of the royalties or fees for technical services is a resident of the other Contracting State, the tax so charged shall not exceed;

(a) in the case of royalties within paragraph 3(a) of this Article, and fees for technical services within paragraph 4(a) and (c) of this Article;

(i) during the first five years for which this Convention has effect ;

> *(aa) 15 per cent of the gross amount of such royalties or fees for technical services when the payer of the royalties or fees for technical services is the Government of the first-mentioned Contracting State or a political subdivision of that State, and*
>
> *(bb) 20 per cent of the gross amount of such royalties or fees for technical services in all other cases; and*

(ii) during subsequent years, 15 per cent of the gross amount of such royalties or fees for technical services; and

(b) in the case of royalties within paragraph 3(b) of this Article and fees for technical services defined in paragraph 4(b) of this Article, 10 per cent of the gross amount of such royalties and fees for technical services.

3. For the purposes of this Article, the term "royalties means :

(a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic or scientific work, including cinematograph films or work on films, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trademark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience; and

(b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial or scientific equipment, other than income derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic.

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4. For the purposes of paragraph (2) of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provision of services of technical or other personnel) which :

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this Article is received; or

(b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received; or

(c) make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

5. The definitions of fees for technical services in paragraph 4 of this Article shall not include amounts paid :

(a) for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property, other than property described in paragraph 3(a) of this Article;

(b) for services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with, the operation of ships, or aircraft in international traffic;

(c) for teaching in or by educational institutions;

(d) for services for the private use of tile individual or individuals making the payment; or

(e) to an employee of the person making the payments or to any individual or partnership for professional services as defined in Article 15 (Independent personal services) of this Convention.

6. The provisional of paragraphs 1 and 2 of this Article shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contradicting State in which the royalties or fees for technical services arise through a permanent establishment situated therein, or performs in that other State independent personal services from a

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fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business profits) or Article 15 (Independent personal services) of this Convention, as the case may be, shall apply.

7. Royalties and fees for technical services shall be deemed to arise in a Contracting State where the payer is that State itself, a political subdivision, a local authority or a resident of a Contracting State or not, has in a Contracting Stats a permanent establishment or a fixed base in connection with which the obligation to make payments was incurred and the payments are borne by that permanent establishment or fixed base then the royalties or fees for technical services shall be deemed to arise in the Contracting State in which the permanent establishment or fixed base is situated.

8. Where, owing to a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services paid exceed for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

9. The provisions of this Article shall not apply if it was the main purpose or one of the main purpose of any person concerned with the creation of assignment of the rights in respect of which the royalties or fees for technical services are paid to take advantage of this Article by means of that creation or assignment.

19. When a PE exists, even such a consideration, which may otherwise be taxable in the source country under Article 13, is taxable on net basis under Article 7. Therefore, merely because an amount is not taxable under Article 7 in the source country, it is not end of the road so far taxability for that item in the source country is

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concerned. In the case before us, as evident from a plain reading of the consideration clause in the agreement between the parties, consideration for use of replacement components is distinct and separate and the same can perhaps be neatly segregated from the overall receipts. In this view of the matter, non taxability under Article 7 will still mean that application of Article 13 is to be considered and adjudicated upon. However, since the above aspect of the matter has not been heard by any the authorities below, we deem it fit and proper to remit the matter to file of the CIT(A) for limited adjudication on this aspect of the matter.

20. For the reasons set out above, we are not inclined to uphold the orders of the authorities below on the issue of existence of the permanent establishment and for quantification of taxable income. The matter is, however, remitted to the file of the CIT(A) for adjudication on the question of taxability, if any, of consideration for use, or right to use, of industrial, scientific or commercial equipment contained in the payments made by the airlines to the assessee company. We make it clear that our above observations should not influence the decision of the CIT(A) on merits of this issue, and that the CIT(A) will decide the matter in accordance with the law, by way of a speaking order and after giving due and fair opportunity of hearing to the parties. We direct so.

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21. In the result, the appeal is allowed for statistical purposes in the manner and in the terms indicated above. Pronounced in the open court today on 21st day of May, 2010.

Sd/xx	***Sd/xx***
(R S Padvekar)	**(Pramod Kumar)**
Judicial Member	**Accountant Member**

Mumbai; 21st day of May, 2010.

Copy forwarded to :

1. *The appellant*
2. *The respondent*
3. *Director of Income Tax (International Taxation), Mumbai*
4. *Commissioner (Appeals) , Mumbai*
5. *Departmental Representative, L bench, ITAT, Mumbai*
6. *Guard File*

True Copy

By Order

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai

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