SATURDAY INTERNATIONAL TAX GYAN !!!

#taxmadeeasy

SITG No. 167

Aircon Beibars (FZE)
Vs
Deputy Director of Income Tax (IT)

Lease payment for an equipment which is not received cannot be covered under the definition of Royalty as per Treaty

19.08.2023

Jain Shrimal & co

[2023] 153 taxmann.com 41 (Delhi- Tribunal) [31-07-2023]

Facts of the Case

- The assessee is a non-resident entity incorporated in UAE, that is engaged in the business of leasing helicopters to clients across the world.

- Assessee had leased a helicopter to an Indian entity (Heligo) for a period of 3 years by virtue of a dry lease agreement. In a dry lease agreement, the owner of aircraft provides the aircraft to the lessee without a crew.

- As the lease terms were under dispute no actual payment was made for the lease by lessee to lessor.

- The assessee filed its ITR declaring a total income of Rs. 528,58,080 for the A.Y. 2015-16, however the assessee never had any PE in India, therefore such business income shall not be taxable in India.

- In Form 26AS, an amount was reflected as income credited to the assessee, since lessee deducted the TDS on said amount.

- During the assessment proceedings, the A.O. asked for the details regarding the lease transactions, and after examining the details submitted by the assessee, he issued a Show Cause Notice (SCN) to the assessee. The A.O. through such notice asked the assessee to explain, why the lease charges received from leasing of the helicopter should not be treated as royalty under Article 12 of India- UAE DTAA r.w.s., 9(1)(vi) of the Act.

- It is important to mention here that the Ld. Commissioner (Appeals) restricted the addition to Rs. 143,59,792 from Rs. 528,58,080 of the assessee.

Assessee's Contention

- The assessee contended that it has only given the lease of asset (helicopter, in the present case) to an Indian entity and not any license to use the Intellectual Property (IP) in the asset, and hence such lease rental can neither be taxed as per the provisions of the act nor as per the treaty.

- The Ld. Counsel argued that the word 'Equipment' is used in Section 9 of the act as well as in Article 12(3) of India- UAE DTAA, however the qualifying phrase used for the underlying word is given as follows- "the use or right to use industrial, commercial, and scientific'. Therefore, the expression 'Equipment' has to be read in context of the above mentioned qualifying words, along with the contents of sub- clauses of Explanation 2 of section 9(1)(vi).

- The Ld. Counsel draws the attention to the fact that the agreement of leasing the helicopters does not tantamount to transfer of any IP rights, brand rights or sharing of any secret formula. It is also held in various decisions regarding leasing of ships that any lease income received is not in the nature of royalty. Few case laws mentioned herewith in support of contention-
  a) ACIT v. Kin Ship Services (India) (P.) Ltd. [2009] 31 SOT
  b) Mathewsons Exports & Imports (P.) Ltd. v. ACIT, [2014] 50 taxmann.com 378 (Cochin- Trib.)

- The Ld. Counsel further argues that even if we assume that such lease rental is classified as royalty, even then the fact is that the assessee has not received any amount from the lessee. Therefore, no income arose to the assessee during the year through the said transaction, and as per India-UAE DTAA, the royalty income can only be taxed purely on receipt basis.

Revenue's Contention

Opposing the appeal and the arguments presented by the Ld. Counsel of the assessee, the counsel for the Revenue, submitted the following:

- The word 'Equipment' is neither defined under the act, nor in any DTAA, so he believes that the dictionary meaning of the underlying word has to be adopted. According to it, he concludes that the lease of helicopter would fall under the definition of royalty as per Section 9(1)(vii) of the act.

- **He cited India- Ireland and India- Netherlands DTAA where it specifically excludes the use of aircraft from the definition of royalty, whereas such exclusion of aircraft from being treated as equipment is not explicitly provided in India- UAE DTAA, and therefore he believes that such income is taxable in India as per Article 12(3) of the treaty.**

- With regards to assessee's claim that no lease income is received during the year, the Ld. A.O. believes that the royalty income can also be taxed on accrual basis.

Legal Provisions

According to **Section 9(1)(vi)** of Income Tax Act, 1961,

income by way of royalty payable by—

(a) the Government; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of 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; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property, or information used or services utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

***Provided** that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April 1976, and the agreement is approved by the Central Government :*

***Provided further** that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a license) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development, and Training, 1986 of the Government of India*

Legal Provisions

Explanation 2 to Section 9(1)(vi) of Income Tax Act, 1961 suggests that

Explanation 2.—For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property ;

(iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(iva) the use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB;

(v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting; or

(vi) the rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v)

Legal Provisions

According to **Article 12(2) and (3)** of India- UAE DTAA,

2. However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the recipient is the beneficial owner of the royalties ***the tax so charged shall not exceed 10 per cent of the gross amount of such royalties****.*

3. The term ***"royalties"*** *as used in this Article* ***means payment of any kind received as a consideration*** *for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematography films, or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience but do not include royalties or other payments in respect of the operation of mines or quarries or exploitation of petroleum or other natural resources.*

Ruling

- During the course of proceedings Hon'ble Tribunal provided the judgement on one fact that no payment was made by lessee to lessor and discussed as under:

- The Hon'ble Tribunal states that based on the facts it can not be said with certainty that the assessee has received any royalty income. Therefore, in their concerned opinion, the expression 'received' stated in Article 12(3) of the treaty needs to be read with Article 12(1) and 12(2) of the treaty, which would conclude that such expression 'received' would mean 'actual receipt' of royalty and not at all mean receipt on accrual or on deemed basis.

- Therefore, when the admitted factual position is that the assessee has not even received any amount against those 4 invoices raised during the year, therefore, the royalty income can not be taxed on notional basis. Therefore, the Hon'ble Tribunal directs the A.O. to delete the addition and demand.

Our Comments

- The Hon'ble Tribunal decided the matter in favor of the assessee only on the pretext that the assessee didn't receive the income during the year and the A.O. can't tax the royalty income on the accrual basis as per Article 12(3) of the treaty. However, the Hon'ble Tribunal kept the issue open of whether such lease rental can even be treated as royalty income, or in fact whether it falls under the definition of 'Equipment Royalty'.

- In our humble opinion when we read any definition under the domestic law it talks about scientific equipment and not any equipment which is leased to another person. Further, the word scientific equipment is not defined anywhere but as per the general parlance leasing a helicopter is more of a vehicle rather than a scientific equipment and according leasing of helicopter should not be covered under the definition of royalty as per explanation 2.

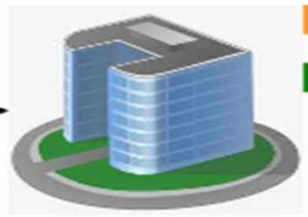
- *"(iva) the use or right to use any industrial, commercial or **scientific equipment** but not including the amounts referred to in section 44BB;"*

- In common parlance, term royalty is used for a transaction where one person charges fees for transferring or allowing use of any of its exclusive intellectual property to another person but the definition of royalty as per income tax act is much more wide than that and covers a lot more items.

#taxinpic

Aircon Beibars
(FZE)
[The assessee]

The assessee leased out the helicopter to an Indian entity through a dry lease agreement for 3 years, against which 4 invoices were raised, for which no payments received



Heligo Charter
Pvt. Ltd.
[The Lessee]

The A.O. issued a Show Cause Notice (SCN) to the assessee, as the A.O. believed that such lease income shall constitute Royalty income and also shall be subjected to tax on the accrual basis.

A.O.

Jain Shrimal & Co.

The Hon'ble Tribunal states that the expression 'received' in Article 12(3) would mean 'actual receipt' of royalty, and not any receipt on accrual or on deemed basis, however, the hon'ble tribunal kept the issue open regarding such income shall be considered as royalty income or not

Section/Article	Section 9(1)(vi)- Explanation 2 of the act, Article 12(3) of DTAA
DTAA/Country	India- UAE DTAA
Court	Delhi Tribunal
Date of decision	31.07.2023

Disclaimer

- This presentation has been prepared on the basis of information available in the public domain and is intended for guidance purposes only.
- Jain Shrimal & Co. has taken reasonable care to ensure that the information in this presentation is accurate. It however accepts no legal responsibility for any consequential incidents that may arise from errors or omissions contained in this presentation.
- This presentation is based on the information available to us at the time of preparing the same, all of which are subject to changes which may, directly or indirectly impact the information and statements given in this presentation.
- Neither Jain Shrimal & co. nor any person associated with us will be responsible for any loss however sustained by any person or entity who relies on this presentation. Interested parties are strongly advised to examine their precise requirements for themselves, form their own judgments, and seek appropriate professional advice.