* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

Reserved on: 22.12.2016
Pronounced on: 25.01.2017

\+ **ITA 627/2016**
DIRECTOR OF INCOME TAX ..... Appellant
versus
KLM ROYAL DUTCH AIRLINES ..... Respondent

\+ **ITA 610/2004**
DIRECTOR OF INCOME TAX INTERNATIONAL..... Appellant
versus
LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 337/2005**
DIRECTOR OF INCOME TAX DELHI ..... Appellant
versus
LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1017/2006**
DIRECTOR OF INCOME TAX INTERNATIONAL TAXATION
..... Appellant
versus
LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1024/2006**
DIRECTOR OF INCOME TAX INTERNATIONAL TAXATION
..... Appellant
versus
LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1026/2006**
DIRECTOR OF INCOME TAX INTERNATIONAL TAXATION
..... Appellant
versus
LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1031/2006**
DIRECTOR OF INCOME TAX INTERNATIONAL TAXATION

..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1241/2006**

DIRECTOR OF INCOME TAX INTERNATIONAL TAXATION

..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 856/2007**

DIRECTOR OF INCOME TAX INTERNATIONAL TAXATION

..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 195/2008**

DIRECTOR OF INCOME TAX ..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 765/2008**

DIRECTOR OF INCOME TAX ..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 862/2011**

DIRECTOR OF INCOME TAX ..... Appellant

versus

KLM ROYAL DUTCH AIRLINES ..... Respondent

\+ **ITA 877/2011**

DIRECTOR OF INCOME TAX ..... Appellant

versus

KLM ROYAL DUTCH AIRLINES ..... Respondent

\+ **ITA 1162/2011**

DIRECTOR OF INCOME TAX ..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 540/2016**

DIRECTOR OF INCOME TAX ..... Appellant

versus

KLM ROYAL DUTCH AIRLINES ..... Respondent

\+ **ITA 259/2007**

DIRECTOR OF INCOME TAX INTERNATIONAL..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 198/2008**

DIRECTOR OF INCOME TAX ..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1861/2010**

CIT ..... Appellant

versus

LUFTHANSA GERMAN AIRLINES ..... Respondent

\+ **ITA 1047/2011**

DIRECTOR OF INCOME TAX ..... Appellant

versus

KLM ROYAL DUTCH AIRLINES ..... Respondent

Through: Sh. Dileep Shivpuri, Sr. Standing Counsel, Sh. Sanjay Kumar, Jr. Standing Counsel and Sh. Vikrant. A. Maheshwari, Advocate, for Revenue in Item Nos. 2, 11 and 14.

Sh. Parag. P. Tripathi, Sr. Advocate with Ms. Neelam Rathore, Advocate, for Lufthansa German Airlines, in Item Nos. 2 to11, 14, 16, 17 & 18.

Sh. Salil Aggarwal, Sh. Anil Makhija and Sh. Madhur Aggarwal, Advocates, for KLM Airlines.

Sh. Asheesh Jain, Sr. Standing Counsel in Item Nos. 4 to 9, 12, 13, 16, 17, 18 & 19.

Sh. Ashok. K. Manchanda, Sr. Standing Counsel, for Revenue, in Item Nos. 3 & 10.
Sh. Puneet Rai, Jr. Standing Counsel, in Item Nos. 1 & 15.

CORAM:
HON'BLE MR. JUSTICE S. RAVINDRA BHAT
HON'BLE MR. JUSTICE NAJMI WAZIRI

MR. JUSTICE S. RAVINDRA BHAT

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1. The question of law, that arises from both the appeals, to be determined by the Court is:

> *"Whether profits of the assessees from providing technical services to other airlines is covered by Articles 8(1) and 8(4) of the Double Taxation Avoidance Agreement between India and Germany, and by Articles 8(1) and 8(3) of the Double Taxation Avoidance Agreement between India and Netherlands?"*

2. The facts in brief, in both the appeals are as follows: Both the assessees (hereafter referred to as "Lufthansa" and "KLM", and collectively, the "Assessees") are international airlines with headquarters and controlling offices in Cologne, Germany and Amsterdam, Netherlands respectively and branch offices in India. They operate aircraft in the international traffic business; these activities are also carried out in India inasmuch as they operate aircraft in international traffic from, and to, various Indian airports. Both the Assessees are members of the International Airlines Technical Pool ("IATP" or the "Pool"). As IATP members they extend minimal technical facilities (line maintenance facilities) to other International Air Transport Association ("IATA") member airlines at the New Delhi airport. The Assessees extend these facilities to various international airlines at Indian airports. Monies are not paid on account of these services but notional credits and debits are routed through the Pool's accounting mechanism i.e. IATA

clearing house. The facilities extended by the Assessees are in the nature of line maintenance facilities and these are predominantly with a view to assist other IATP member airlines as a means for collaboration among the air transport enterprises.

3. The nature of the services/facilities provided by Lufthansa and KLM are:

(i) communications, including compiling, dispatch and receiving all messages in connection with the services performed by the handling company, using the carrier's originator code or double signature procedure, as applicable; (ii) maintenance of a message file containing all above-mentioned messages for each flight, for ninety days; (iii) provision of headsets; (iv) providing ramp to light deck communications during tow in and/or under push back and providing ramp during engine starting; (v) fuel and oil (vi) liaising with fuel suppliers; (vii) supervise fuelling/defuelling operations (viii) drain water from aircraft fuel tanks and fuel/defuel the aircraft with quantities of products requested by carrier's designated representatives; (ix) check and verify the delivered fuel quality; (x) deliver the completed fuel order(s) to the carrier's designated representative; (xi) aircraft line maintenance (xii) perform line inspection in accordance with the carrier's current instructions. (xiii) enter the aircraft log and sign for the performance of the line inspection; (xiv) enter remarks in the aircraft log regarding defects observed during the inspection; (xv) Perform pre-departure inspection immediately before aircraft departure, according to carrier's instructions; (xvi) Perform ice-check immediately before aircraft departure according to carrier's instructions; (xvii) rectify defects entered in the aircraft

log as reported by the crew or revealed during the inspection, to the extent requested by the carrier. However, major repairs are excluded; (xviii) enter the aircraft log and sign for the action taken; (xix) report technical irregularities and action taken to the carrier's maintenance base in accordance with the carrier's instructions and (xx) provide engineering facilities, tools and special equipment to the extent available.

4. The Assessees filed their returns of income and claimed that the amounts received from various IATP member airlines for the above services rendered in India were not taxable in India. However, the Assessing Officer ("AO") in their cases held that such amounts received by them in India were taxable, holding that these activities were not covered under the term "Air Transport Services"; the services were given to other airlines by the Assessees, the receipt from which was not recovered from their passengers and was not part of the face value of the ticket. The AO held that these services were incidental to the Assessees for their own flights, but when rendered to other airlines they were not air transport operation; the assessees' business would not be affected if they did not render them to other airlines. The AO also relied on the Organization for Economic Co-operation and Development's ("OECD") commentary to hold that separate business activities are not covered under air transport operation. In view of these findings, the AO concluded that the Assessees rendered such services to other airlines by exploiting their manpower when idle at the time when there were no flights, and could not, therefore, be termed as "air transport operation".

5. The Assessing Officer also held that the Assessees' income had to be

computed as business income in terms of provisions of the DTAA. He held that the Assessees' branch offices in India constituted permanent establishments and, therefore, the income relating to the engineering and traffic handling was taxable in India, as the same was not covered under Article 7 of DTAA. The AO also held observed that for these operations, the airlines entered into separate agreements and the charges were based on per flight basis. Most of the work was visual inspection based, by the engineers; any replacement of defective components was replaced at IATP and, therefore, there was no extra cost of consumables by the Assessees. For earning income, the Assessees did not incur any additional expenditure. The earning of the Assessees were by exploiting their existing resources. The AO allowed deduction on account of amounts paid to engineers and mechanics out of the total engineering receipts and brought to tax the remaining amounts. The AO's orders were challenged before the CIT (A) who ruled that the profit derived from exploitation of excess capacity by rendering services to other airlines was taxable in India and that deduction of expenditure which the AO allowed was quite reasonable and did not interfere with it. The order of the CIT(A) was challenged before the ITAT, which reversed those findings.

6. The Revenue argued that the ITAT's previous decision in the case of ***British Airways Plc. vs. Dy. CIT*** **(2001) 73 TTJ (Del) 519 Ed** in a similar factual background, was a relevant precedent, and that, since the language of the Indo-UK, the Indo-German and Indo-Dutch DTAAs was similar, that precedent had to be followed. The ITAT disagreed and held as follows:

"36. It is this sub-clause (4) of Article 8 which is the matter of

dispute. There is no dispute that if any profit has arisen due to participation in a pool, a joint business, then it will not be liable to tax in India. The ITAT in the case of British Airways has held that income in that case had arisen due to permanent establishment in India. As mentioned earlier in the DTAA between India and Germany, the word "PE" finds place only in relation to business. The word "PE" has not been used in relation to profits from operation of ships or aircrafts in international traffic. The word "International Traffic" has also been defined in Article 3(1)(i) of the DTAA which reads as under:

"The term 'international traffic'; means any transport by a ship or aircraft operated by an enterprise which has its place of effective management in a contracting state except when the ship or aircraft is operated solely between places in the other contracting state."

37. We have therefore examine as to whether the profits of the appellant was due to participation in a pool. Admittedly, if it was so then the profits will not be liable to tax in India. The aims and objectives of participation in IATP have been mentioned earlier. We find that the appellant has rendered services/facilities to three airlines and has availed the services of one airline. On extending services to the other airlines, the appellant has received a sum of Rs. 49.64 lakhs and on availing the services, it has paid the sum of Rs. 45.50 lakhs. Thus, there was reciprocity between the members of the pool. But in the case of British Airways, we find that it has rendered services to more than 16 airlines and has not availed services from any other airlines in India. It was only one way traffic. Thus, there was no reciprocity between the British Airlines and the other airlines and, therefore, the ITAT has held that in the case of British Airways, there was no reciprocity and, therefore, it could not be said to be participation in a pool.

38. We also find that in the case of British Airways, the ITAT has held that the services rendered by that airline was in the nature of commercial activities and, therefore, was in the

nature of business activities. For coming to this conclusion, the ITAT had noted that the British Airlines had employed excess staff for such purposes. Volume of receipts which is in crores for providing services also suggested that the providing of services by British Airways was a commercial activity. But in the case of the appellant, it has not been proved by the revenue that the extra staff was employed for providing services to other airlines. We have also noted that the services rendered and availed were as per IATP manual and, therefore, the profit was not taxable in India in view of Article 8(4) of DTAA.

39. We also find that Article 8(3) of DTAA between India and UK, provided that the term "operation of aircrafts shall include.....Charter of Aircrafts including the sale of tickets for such transportation.....". Such activity is not provided in the IATP manual. The IATP manual has provided the precise services, which could be rendered/availed by its members, which has been enumerated earlier. Therefore, it was clear that in the case of British Airways, the facilities provided to other airlines were beyond the scope of IATP objects and, therefore, the profit from rendering such services cannot be termed as profits from participation in a pool. But in the case of the appellant, the services to be rendered to the members airlines were as per IATP manual and the handling charges were also as per IATP manual.

39A. We have also noted that as per Article 8(4) of DTAA between India and Germany, the profit from the participation "in a pool" will not be taxable in India. But Article 8(2) of DTAA between India and UK talks of "participation in pool of any kind by enterprises engaged in air transport". The use of the word "pools" envisages that there could be several pools or understanding i.e. more than one. Here the word "pool" does not indicate a pool which is internationally recognized. The use of the word "pools any kind" clearly indicates that it was in the nature of commercially understood meaning. But in the international aviation industry, there is only one pool i.e. IATP. Certainly, in the case of British Airways, it was not a case of participation in a pool. In the appellant's case, it is

participation in IATP only. This was the reason that the ITAT has to find out the meaning of the word "pool" in the case of British Airways. Moreover, in the case of British Airways, it was "pools of any kind" but in the case of the appellant, it was not a pool of any kind but only IATP. Thus, the facts in the case of British Airways were altogether different then the facts of the appellant's case and the view taken by the ITAT in the case of British Airways is not applicable in the case of appellant as the facts are entirely different. We have also noted that British Airways has rendered services to Atlas Air Corporation, which is not a member of IATP. The services rendered to that airline could not be bound by IATP manual.

40. Looking to the above distinguishing features, we hold that the appellant's profit due to participation in a pool was covered under Article 8(4) of the DTAA between India and Germany and such profit cannot be brought to tax in India. We, therefore, allow the ground of appeal and delete the addition sustained by the CIT(A)."

7. M/s Dileep Shivpuri, Ashok Manchanda and Asheesh Jain, learned counsel for the Revenue relied on the case of *British Airways* (*supra*) and urged that under the similar circumstances, the ITAT had negated the claim of British Airways. Counsel for the Revenue stated that it was Article 5(1) of DTAA, which was applicable in the assessees' case. Counsel emphasized that the term "pool" is undefined in the DTAA and, therefore, the IATP cannot be said to be the concerned pool referred to in the two DTAAs. The Revenue's counsel stressed that, exemption under the DTAA is based on reciprocity between two members of the pool for extending/obtaining the facilities. Such reciprocity should be direct. The facilities, therefore, should be extended to a particular airlines and the facility should be acquired from that particular airline. The services were extended to different parties, quite apart from those given by an entirely different set of parties. Furthermore, the concept

of a pool meant that there had to be a unified management structure, shared by all, which administered the pool and in the running of which members had to show some participation. In the absence of a common structure or common administration, the mere extending of services by more than one party, based on certain minimum rates did not imply that they were participants of a pool.

8. Learned counsel stressed that the term "pool" involved an idea of bringing together the assets or the personnel of various airlines with the intention to carry on joint business and to share profits from the pool. It was submitted that the services rendered under IATP agreements did not constitute services on reciprocal basis as it could happen that the assesses could receive services from another airline, but may not render any services to that airline. In other words, there was no reciprocity in the nature of services rendered as between one airline and another. Nothing on record established that availing one kind of service by an airline entailed providing similar services to such airline. It was highlighted that the ground handling services provided on commercial terms were only with a view to generate revenues from spare capacity and there was no existence of any pool regarding ground handling services since neither the assets and nor the personnel of the various airlines were brought together at any international airport.

9. Counsel for the Revenue argued that the position would have been different if IATP had come to India, pooled the resources of various airlines at the airports, rendered services to willing airlines and thereafter distributed profits to the participants. The crux of the matter, according to the Revenue,

therefore was, not that separate agreements could be entered into amongst the various airlines in respect of facilities at one airport belonging to one airline and fixing the price of the service, but the bringing together of the infrastructure of various airlines together at one place with a view to render services and share profits from the pooled assets.

10. The Revenue also argues that since Article 8 (4) of the Indo-German DTAA and Article 8 (3) of the Indo Dutch DTAA (hereafter referred to as the "pool provisions") are amplifications of Article 8(1), they should be construed in such a manner as to be consonant with the main object of the provision, i.e. that the joint pool or international enterprise should be relatable or proximate to the air transport operations. Since there is no such nexus, inasmuch as the international pool operations do not relate to its work the exception in the pool provisions do not apply. Learned counsel elaborates this argument, by saying that Article 8 (1) spells out the rule which is that the carrier would be subject to tax, in its state of residence *in respect of air transport operations,* but for the pool provisions, the activities covered in that provision would not be deemed part of air transport operations. The pool provisions, therefore, should relate to the assessees' business, jointly with pool operations relating to participation in an international pool and joint operations.

11. Learned senior counsel for the Assessees, Shri Parag Tripathi, and Shri Salil Agarwal, learned counsel argued that the Assessees are concededly international air carriers, who operate aircrafts in international traffic. They are members of the IATP, and participate in the pool sharing aircraft components, spare parts, aircraft tools, ground handling equipment and

manpower across the world. The DTAAs in both cases, by Article 8(1) provide that profits from the operation of ships or aircrafts in international traffic shall be taxable only in the contracting state in which the place of effective management of the enterprises is situated. Indisputably, effective management of the Assessees are situated in Netherlands and Germany. The pool provisions in both the DTAAs provide that the provisions of Article 8(1) shall also apply to the profits from the participation in pool joint business of an international operating agency. Therefore, profits derived from participation in a pool are taxable in the country of effective management. It was claimed that under the international traffic, there is no pool other than the IATP. Counsel argued that the participation in IATP meant that various services/facilities are provided by the participants and availed by the participating members. Learned counsel submitted that the Revenue's contention that there is no reciprocating arrangement by members is factually unfounded.

12. The participation in the pool, results in the Assessees entering into separate agreements with IATP members for extending and availing the services to the airlines members participating in the pool. Such agreements were entered on the IATP Form-53 and the handling charges were as per the IATP manual. The Assessees entered into agreements and extended services to various other airlines, such as Malaysian Airlines, Austrian Airlines, Aeroflot, Virgin Atlantic, Air Canada, Alitalia, in airports in India. The Assessee airlines also received similar services in other Indian airports from other participating members. No consideration was paid on account of these services; only notional credits and debits were given through the pool

accounting mechanism i.e. IATA clearing house. The services and facilities,which the assessees provide, are in the nature of line maintenance facilities with a predominant objective of assisting other IATP member airlines for collaboration among the air transport enterprises. Such technical facilities are mandatory and non-derogable from the point of view of flight safety requirements, which cannot wait till aircrafts returns to their base, such as the place where the airline concerned has its own in-house facility. In other words, the technical facilities extended by the Assessees to other airlines are not routine technical services but are the minimal technical facilities required to be extended at the transit airport.

13. Countering the Revenue's contentions, learned counsels submit that the facts of these cases are different from those in *British Airways (supra)*. The difference in terminology in Article 8 (2) of the Indo-UK DTAA as compared to the pool provisions of the Indo-German and Indo-Dutch DTAA between India and Germany, and Netherlands, respectively, was highlighted. Counsel submitted that in *British Airways (supra)* the facts disclosed a one-way traffic, because the Assessees rendered services to many airlines in India but did not avail services in India from any other airline. It was also stressed that the Assessees did not have any additional manpower to handle these facilities in India, but rather, provided facilities most of the times each week in India to other airlines and likewise availed services. But British Airways rendered services for which it was remunerated but has not availed services from any of the airlines. The counsel also stated that the expression "pool" emphasized in the *British Airways (supra)* cannot be read in isolation and should be construed together with "international". The said phrase meant

an arrangement such as IATP; in the absence of the Revenue showing any other international pool, the Revenue cannot dictate what according to it, alone constitutes a pool. In the context in which the expression is used, it means simply sharing resources through a common pool; the management of the pool is incidental; it can be merely through co-ordination, to achieve efficient sharing of essential resources. Learned counsel also submitted that the IATP manual is voluminous and it was the only pool recognized all over the world. Counsel further argued that the Assessee (Lufthansa) had received ₹ 49.64 lakhs for rendering services and facilities and in turn had paid a sum of ₹ 45.50 lakhs for availing the services/facilities. These payments were fixed and regulated by IATP clearance. In *British Airways (supra)*, the assessee only received amounts and did not incur expenses; therefore, profit motive was proved. In *British Airways (supra)*, the facts justified a conclusion that the work was a planned commercial activity as the establishment was only meant for rendering the services to other airlines. The entire extra or idle staff was deployed for rendering the services. Thus, in the case of British Airways, it was an organized activity of rendering services. In the case of the assessee, there was no question of any additional deployment or permanent establishment.

14. Counsel urged that IATP provides Form No. 53 as the format agreement between two participating airlines; the British Airways did not conform to the pool rules and, therefore, it did not enter into agreement using those formats. Therefore, the agreements entered into by British Airways and other airlines were not covered under IATP rules, whereas the Assessees were covered by the IATP. Article 8(4), besides covered income not only by

way of profit in participation of the pool, but also the joint business. But in the Indo-UK DTAA, exemption was not available to joint business. Importantly, British Airways did not work under any umbrella arrangement, whereas the Assessees were working under the international umbrella of IATP. For these reasons, *British Airways (supra)* was not an apt authority, as correctly deduced by the ITAT.

15. The counsel for the Assessees refuted the Revenue's stand that the Assessees did not furnish the figures of expenses incurred by it. It was stressed that that no additional cost was incurred for rendering the concerned services. However, the amount received by the Assessees for rendering the services and the amount spent by them was already on record of the Assessing Officer.

16. The Articles 8(1) and 8(4) of the DTAA between India and Germany read as under:

> *"(1) Profits from the operation of ships or aircraft in international traffic shall be taxable only in the Contracting State in which the place of effective management of the enterprise is situated;*
>
> *(2) ...*
>
> *(3) ...*
>
> *(4) The provisions of paragraph-I shall also apply to the profits from the participation in a pool, a joint business or an international operating agency."*

17. Articles 8 (1) and 8 (3) of the Indo-Dutch DTAA read as follows:

> *"ARTICLE 8 –Air transport-*
> *1. Profits from the operation of aircraft in international traffic*

shall be taxable only in the State in which the place of effective management of the enterprise is situated.
2. For the purpose of this Article:
(a) profits from the operation in international traffic of aircraft include profits derived from the rental on a bareboat basis of aircraft if operated in international traffic if such rental profits are incidental to the profits described in paragraph 1;
(b) interest on funds connected with the operation of aircraft in international traffic shall be regarded as profits derived from the operation of such aircraft and the provisions of Article 11 shall not apply in relation to such interest.
3. The provisions of paragraph 1 shall also apply to profits from the participation in a pool, a joint business or an international operating agency."

18. A plain reading of the above provisions reveals that income is exempt in respect of two activities, namely:

(a) profits from operation of aircrafts in international traffic and,

(b) profits from participation in a pool, joint business or an international operating agency.

19. In *British Airways (supra)*, the findings that the ITAT upheld were:

"The IATP agreement does not envisage bringing together of the assets or personnel under joint command, nor it envisages apportioning of receipts or profits. Therefore, it cannot be said that the impugned agreements constitute pools of any kind notwithstanding the nomenclature used in the agreements. Thus, the true position which emerges from this discussion is that there should first of all be a pool, in fact, in the sense that the assets or personnel are brought together for some kind of joint venture, whose profits are shared in some manner by the participants. That is not the case here. From experience, it was found that certain airlines had accumulated excess capacity in respect of ground handling services at some stations, while some other airlines did not have such facilities on some of the airports. It would have been quite difficulty for each airline to

have ground facilities at each line station. Maintenance of such facilities would have involved considerable lay out making some of the airlines unprofitable. Therefore, a mechanism was formed through IATP under which airlines, which did not have ground facilities at some line stations, could use the existing facilities of another airline. But that did not bring either the personnel or the equipment of the airlines under a joint command. That also did not mean that the profits from such activities were shared by the participants. In fact, separate agreements were entered into by each providing airline with the availing airline for rendering and receiving services. It would have been a totally different matter if IATP would have brought these facilities under a common umbrella. That would have amounted to a pool, in fact. But that is not the case. Each airline, including the appellant, continues to own and manage its manpower and equipment at each station. As these facilities were found to be idle for considerable period of time, it was found profitable to use them to render services to other airlines with a view to generate revenues. It is no doubt true that the price for a service is fixed by the IATP. But, fixation of price is not the sine qua non of the existence of a pool. Besides this, it is quite contradictory first to say that the establishments were part and parcel of the appellant's business, which could not be served as separate establishments, and then to say that an unserved part was pooled with other establishments. In view of this, it is held that it cannot be said that the income of the appellant from the said activities is not taxable in India. It is further held that the revenues so generated represent the income of the appellant from the PE in India and, therefore, the same are taxable in India."

20. At the outset, it is necessary to notice that the Indo-UK DTAA is significantly different. Whilst Article 8 (1) is similar in its language with the Indo-German and Indo-Dutch DTAAs, the phraseology used in the other provisions is a departure –in the Indo-UK DTAA. Article 8(2) of DTAA between India and UK provides that Article 8 (1) shall likewise apply in

respect of participation in pools of any kind. The words "pools of any kind" was interpreted by the ITAT by taking the dictionary meaning of the word "pools". Article 8(3) of DTAA between India and UK provided *"...3. For the purposes of this article the term "operation of aircraft" shall include transportation by air of persons, live-stock, goods or mail, carried on by the owners or lessees or charterers of aircraft, including the sale of tickets for such transportation on behalf of other enterprise, the incidental lease of aircraft on a charter basis and any other activity directly connected with such transportation..."* The Revenue urges that this difference is not material for deciding the present appeals and that the expression "pools" is to be interpreted in line with the *British Airways (supra)*.

21. The decision in *British Airways (supra)* was by a two-member bench; both agreed on the concept of pooling- however, there were separate opinions. The presiding member, after considering the dictionary meaning of the expression "pool" stated that:

> *"63. Article 8(2) in our opinion speaks of the same type of activity giving rise to profits earned by the enterprise participating in a pool for earning the profits derived from international traffic. In other words, what is done by an enterprise singly in Article 1 is done by the same enterprise jointly with others by participating in a pool. We have in the earlier part of this order discussed at length the concept of "Pools" and nothing more is tobe said so we move on to Article 8(3).*
>
> *64. Article 8(3) expands the meaning of the term "operation of aircraft" to include transportation by air of (1) persons (2) livestock goods or mail carried on by the owners or lessees or charterers of aircraft (3) sale of tickets for such transportation*

on behalf of other enterprises (4) incidental lease of aircraft on a charter basis (5) any other activity directly connected with such transportation.

65. Both the parties are agreed that this clause is both activity based as also enterprise based, but "transportation" by aircraft of human beings and specified goods and even the term "any other activity" has to be considered with reference to such "transportation" as aiding it supporting it and incidental thereto. The tax authorities have referred to three such activities, namely :—

> *"(i) the operation of a bus service connecting a town with its airport*
> *(ii) transportation of goods by truck connecting a depot with the airport and*
> *(iii) maintenance and running of a hotel by the airlines strictly for the use of its passengers for night accommodation and if the cost thereof is included in the price of the ticket and the hotel does not cater to any other category of persons."*

66. The above examples in our opinion do aptly qualify for inclusion in the category of "any other activity directly connected with such transportation" and by no stretch of imagination would it include the engineering/ground handling services provided by the assessee to other airlines.
67. It is clear from the discussion of the various clauses that the activities, which are tax exempt in India are specified and determined and there is no scope for an interpretation which could bring something more into the fold."

22. Internationally, the only pool known to the aviation industry is IATP. The Revenue does not talk of or refer to any other internationally recognized pool in this regard. Its contention, rather is that a pool means not mere sharing of resources, but a structure or managing entity that administers the pool, which the participants are members of and that such centralized entity

should facilitate the services. This Court is of the opinion that a "pool" cannot be stereotyped as the Revenue advocates. The international airlines business is a mammoth one; its size is assessed through operations of international airlines in several ways: fleet; cargo handled; passengers handled; countries served; scheduled freight tonne- kilometers (millions) served; profits; market capitalization and employees serving.[1] The IATP describes itself in the following terms[2]:

> "***IATP Mission***
> *The IATP is a convention of Airlines sharing Technical Resources to generate economic savings and support on time dispatch reliability and operational safety.*
>
> ***IATP Organization Definition***
> *The IATP is a non-profit, independent, non-political global organization based on a democratic culture with equal opportunities for all member Airlines and their delegates.*
>
> ***Technical Resources Definition***
> *Technical Resources includes, but not limited to, aircraft spare parts, line maintenance, ground handling equipment, aircraft recovery kits and technical training."*

23. During the course of hearing, counsel for the assessees had relied upon extracts of the IATP manual issued in 1996. The manual states that from 24 members in 1962, IATP membership had grown from 24 to 121 (96

[1]Available at:
http://www.forbes.com/global2000/list/#header:revenue_sortreverse:true_industry:Airline;last visited on: 16.01.2017and
World Air Transport Statistics 58th Edition.IATA; available at:
https://web.archive.org/web/20150102034843/http://www.iata.org/publications/pages/wats-passenger-carried.aspx, last visited on: 16.01.2017

[2]IATP Mission Statement, available at:
https://www.iatp.com//P_Home/About_IatpMission_Statement.aspx, last visited on: 16.01.2017

members and 25 guests). The IATP manual states that it is an organization of airlines formed for the purpose of providing reciprocal technical support and line stations throughout the world. This technical support includes aircraft spare parts, ground and ramp handling equipment and manpower. The primary goal of IATP is to generate economic setting savings to participant airlines by minimizing investments otherwise required for purchase of equipment and spare parts, for positioning at various stations in support of aircraft operations. The IATP Articles of Association was also relied upon. Article 11 (1) states that the IATP membership would be to those airlines, which execute a counterpart of the agreement. The subscribing or applying airlines (which wish to be a member of IATP) should be "*fit, willing and able to act as provider at not less than one station in respect of each group in which it wishes to participate"*. It is thus, apparent from the eligibility conditions and the general description of the IATP that the arrangement is primarily meant to optimize resources.

24. If one looks at the airlines industry which is cost intensive in terms of capital assets such as aircraft spares equipment etc., and one visualizes the compulsions of each airline to ensure compliance with air safety standards *vis-à-vis* both passenger and cargo traffic, the economic advantages for sharing resources become obvious. But for a pooling arrangement of the kind which IATP provides, every airline – irrespective of its size of operation or capital deployed, would be compelled to maintain ground handling services including the repairs, maintenance etc. in different continents, in several countries. This in turn would sap its capital and telephone its profitability. This adverse impact would mean that smaller airlines would be economically unfeasible. Even larger airlines would be driven to increase their costs which

would impact adversely the end products and services, which would inevitably result in increase of passenger airline ticket fare and cargo or freight fare. The optimization of resources and to an extent services, not only makes economic sense but, in fact is a compulsion if the airlines industry is to continue and grow the way it is today. The shape of the airlines industry would have been entirely different in the absence of resource pooling and sharing – perhaps one would not have seen as much air traffic as one sees today. Probably the size of the airlines transport sector in the global economy would have been smaller, if the costs were driven up in the absence of a pool like the IATP. It is for this reason that pool provisions like the one the Court is concerned with today, find place in almost every DTAA entered into by a multitude of nations. In fact an examination of the OECD Model Convention bears out this surmise because, right from 1976 the model has been that of providing tax treatment uniformly in the place of residence of the airline i.e. where it is principally incorporated and headquartered; equally the concept of ensuring pooling provisions along with joint businesses has been consistently followed in all later OECD model DTAA conventions.

25. Though not in any manner binding, the OECD commentary on Article 8 (1) reflects this intention:

> *"4. The profits covered consist in the first place of the profits directly obtained by the enterprise from the transportation of passengers or cargo by ships or aircraft (whether owned, leased or otherwise at the disposal of the enterprise) that it operates in international traffic. However as international transport has evolved, shipping and air transport enterprises invariably carry on a large variety of activities to permit, facilitate or support their international traffic operations. The paragraph also covers profits from activities directly connected with such operations as well as profits from the activities,*

which are not directly connected with the operation of the Enterprises ships or aircraft in international traffic as long as they are ancillary to such operation.

4.1 If the activity carried on is primarily in connection with the transportation amount by the enterprise of passengers or cargo by ships or aircraft that it operates in international traffic should be considered to be directly connected with such transportation.

4.2 Activities that the enterprise does not need to carry on for the purposes of its own operations of ships or aircraft in international traffic but which make a minor contribution relative to such operation and are so closely related to such operation that debtor should not be regarded as a separate business or source of income of the Enterprises should be considered to be ancillary to the operation of ships and aircraft in international traffic.

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23. Various forms of international cooperation exist in shipping or air transport. In this field international cooperation is secured through pooling agreements or other conventions of a similar kind, which lay down certain rules for up apportioning of the receipts, or profits from the joint business.

24 In order to clarify the taxation position of the participant in a pool, joint business or an international operating agency and to cope with any difficulties which may arise the contracting states may bilaterally add the following if the find necessary but only so much of the profits so derived as is attributable to the participant in proportion to its share in the joint operation."

26. The OECD 2008 version states that:

> *"10. An enterprise that has assets or personnel in a foreign country for purposes of operating its ships or aircraft in international traffic may derive income from providing goods or services in that country to other transport enterprises. This would include (for example) the provision of goods and services by engineers, ground and equipment- maintenance staff, cargo handlers, catering staff and customer services personnel. Where the enterprise provides such goods to, or performs services for, other enterprises and such activities are directly connected or ancillary to the enterprise's operation of ships or aircraft in international traffic, the profits from the provision of such goods or services to other enterprises will fall under the paragraph.*
>
> *10.1 For example, enterprises engaged in international transport may enter into pooling arrangements for the purposes of reducing the costs of maintaining facilities needed for the operation of their ships or aircraft in other countries. For instance, where an airline enterprise agrees, under an International Airlines Technical Pool agreement, to provide spare parts or maintenance services to other airlines landing at a particular location (which allows it to benefit from these services at other locations), activities carried on pursuant to that agreement will be ancillary to the operation of aircraft in international traffic."*

27. From the above discussion it is quite clear that the airline business requires not only huge capital deployment in acquisition of assets but also a continued maintenance and operations regime that is cost intensive. Like in any other industry, these costs are absorbed in the operation and are effectively factored in. That an airline carries on these activities as a part of its airline operation is not disputed and is rather considered a given by the Revenue. However, its argument essentially is that participation in a pool means that the activities that an airline performs on behalf of other airlines constitutes a business which is not an airline operation and is not ancillary or

incidental to its business and consequently, has to be taxed where the income arises.

28. In furthering this argument it states that the international pool or joint enterprise model conceived of in the pooling provision and in the relevant articles of the DTAA between India and Germany on the one hand, and between India and Netherlands on the other, envision a pool whereby there is a joint control in terms of deployment of capital resources as well as minimum management control by both airlines and a separate profit centre. This Court is of the opinion that the Revenue cannot ordain the manner by which industries set up or organize their business. The Court, too cannot resort to the dictionary meaning or seek recourse to other external aids such as DTAAs between one State and another in the interpretation of such convention with third-party states. In this endeavour the Court's primary focus is the meaning that the contracting states intended to give to the expression in the provisions,which they agree to. That one of the contracting parties or states might have contracted with another state party, which may contain a similar provision but with slight modification would be entirely extraneous. In this respect the Court must be conscious of the fact that it is interpreting an international convention between sovereign nations. The Vienna Convention on the Law of Treaties under Article 31 guides the interpretation, which international agencies primarily have to follow. Article 31 reads as follows:

> *"Article 31, GENERAL RULE OF INTERPRETATION*
>
> *1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.*

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

1. *(a) Any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;*
2. *(b) Any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.*

3. There shall be taken into account, together with the context:

1. *(a) Any subsequent agreement between the parties regarding the interpretation of*

   the treaty or the application of its provisions;

2. *(b) Any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;*
3. *(c) Any relevant rules of international law applicable in the relations between the parties.*

4. A special meaning shall be given to a term if it is established that the parties so intended."

29. Thus, while interpreting tax treaties and conventions, the emphasis is upon the context- in the instrument itself, and *"any subsequent agreement between the parties"* as to the interpretation of the treaty or the application of its provisions. The expression *"profit from the operation of ship or air-craft in international traffic"* has not been defined in the Indo-Dutch DTAA, or in the Indo-German DTAA. In Article 8(3) of the DTAA between India and UK, it is explained. This is a significant distinction between these three sets of DTAA. The position in the Indo-German DTAA and Indo-Dutch DTAA

on the one hand is similar, whereas,in the case of the Indo-UK DTAA, there is a difference. The ITAT while explaining the meaning of profit from the operation of ships or aircraft in international traffic- in both Lufthansa and the KLM cases took into consideration the bye- laws of IATP, because this organization authorized its members to share aircrafts, aircrafts pooling, ground handling equipment and manpower all over the world. The ITAT also considered the relevant clauses of the IATP manual and held that any receipt by the assessee due to participation in the IATP pool as provided in its manual and dealt with in Article 8(4) of Indo-German DTAA will not be taxable in India under Article 8(1); a similar finding was rendered in the case of KLM too.

30. The Assessees participated in the IATP pool and earned certain revenues from such activities and also incurred expenditure. There is, in the opinion of the Court, clear reciprocity as to the extension of services; IATP membership is premised upon each participating member being able to provide facilities for which it was formed (line services, OMR services, etc.) of a required mandated standard. As there was reciprocity in the rendering and availing of services, there was clearly participation in the pool; in terms of the two DTAAs (Indo-German and India-Netherlands) the profits from such participation were not taxable in India.

31. The terms of the India-UK DTAA as contrasted with the DTAA between India and Germany are dissimilar in some significant ways. The *British Airways (supra)* decision was based on the following facts- as held by the ITAT:

(i) British Airways provided engineering and ground handling services at IGI Airport, New Delhi to 11 other airlines, at Chennai to 5 other airlines and certain other airlines at Mumbai. It has not availed any services/facilities from any airlines in India. Thus, there was no reciprocity in the agreement entered into between British Airways and other airlines;

(ii) British Airways had a separate establishment and separate office set up to monitor ground handling services and different establishment at International Airports New Delhi did not form part and parcel of the operation of British Airways pertaining to the operation of aircrafts in international traffic. There is no such finding in the present appeals.

(iii) British Airways' services and facilities in India to the other airlines was a commercial activity. The excess/idle capacity was provided to various airlines at a price. The services provided in terms of the IATP manual are not based on any consideration paid or received; a system of credits has been created for IATP members.

(iv) British Airways has a branch office in India, which constituted a Permanent Establishment ("PE") in India, and, therefore, the income derived from PE in India was taxable as the same was not covered under DTAA.

(v) Article 8(2) of DTAA between India and UK provided that paragraph 1 of Article 8 shall likewise apply in respect of participation in pools of any kind. The words *"pools of any kind"* was interpreted by the ITAT by taking the dictionary meaning of the word *"pool"*.These are missing in the two DTAAs in question.

(vi) Article 8(3) of DTAA between India and UK provided that the terms "operation of aircraft" shall include *"..3. For the purposes of this article the term "operation of aircraft" shall include transportation by air of persons, live-stock, goods or mail, carried on by the owners or lessees or charterers of aircraft, including the sale of tickets for such transportation on behalf of other enterprise, the incidental lease of aircraft on a charter basis and any other activity directly connected with such transportation....."* These terms are not present in the two DTAAs in the present set of appeals.

(vii) After meeting the requirement of its own flights, the services of employees were required for handling other airlines' operation for generating income.

32. Having regard to these facts, this Court is of opinion that the amplification of the term *"operation of aircraft"* in Article 8 (1) through Article 8 (3), i.e. *"...3. For the purposes of this article the term "operation of aircraft" shall include transportation by air of persons, live-stock, goods or mail, carried on by the owners or lessees or charterers of aircraft, including the sale of tickets for such transportation on behalf of other enterprise, the incidental lease of aircraft on a charter basis and any other activity directly connected with such transportation..."* had the effect of limiting the nature of activities that could be comprehended in the pool envisioned in Article 8 (2): in other words, the expanded meaning of operation of aircraft included those activities in Article 8(3) through the extended definition and no more. On the other hand, there is no such limitation in the DTAAs in question, in these cases. This constituted the most significant difference between the two sets of cases on the one hand, and *British Airways (supra)* on the other. For these

reasons, this Court rejects the Revenue's contentions.

33. For the foregoing reasons, this Court answers the questions of law, framed in both sets of appeals, against the Revenue and in favour of the assessees; there is no infirmity in the impugned orders of the ITAT, which are affirmed. The appeals fail and are dismissed.

S. RAVINDRA BHAT
(JUDGE)

NAJMI WAZIRI
(JUDGE)

JANUARY 25, 2017