



Flying High, Taxing Higher

In the intricate tapestry of modern economies, few industries hold as significant a role as the aviation sector. Beyond mere transportation of goods and passengers, airlines serve as vital conduits for global commerce, tourism, and connectivity. From facilitating trade to fostering cultural exchange, the importance of the airline sector reverberates across multiple facets of economic activity, contributing to growth, development, and prosperity. The Indian aviation market is estimated to be the world's third-largest.

With the myriad of activities being undertaken by this sector, the impact of taxes, both direct and indirect, attain significance. This article attempts to capture the intricacies of GST on the various activities and transactions involving the aviation sector.

The Dilemmas

• Cascading effect of Aviation Turbine Fuel (ATF)

The significant revenue generated by taxes on petroleum products has long been a cornerstone of state government finances. Anticipating a substantial decline in this crucial revenue stream, state governments staunchly opposed the inclusion of petroleum products within the GST framework.

Consequently, it was agreed to keep petroleum products out of the ambit of GST and they continue to be subject to the erstwhile Excise Duty and VAT, posing challenges for aviation industry, since ATF comprises of a critical cost component, estimated to be in the range of 30 to 40 per cent of the input costs. While GST largely eliminated the cascading effect of indirect taxes, keeping ATF outside the ambit of GST resulted in continued cascading effect as the input tax credits (ITC) claim of Excise Duty and VAT are not permissible. This raises cost of operations, and, of course, negatively impacts pricing decisions.

• Code sharing arrangements

Code-sharing is a widely adopted practice in the airline industry where a 'marketing airline' sells tickets under its own branding, even for routes operated by another airline which is the 'operating airline'. Such an arrangement requires contractual validity, so, a tripartite agreement is entered into between the two airlines and the customer. Code-sharing results in augmentation in passenger traffic, bolstering of revenues, expanding geographical coverage, enhancing service frequency and providing access to a broader array of destinations through streamlined operational collaboration. However, complexities galore, in such an arrangement. One, whether the marketing airline is required to obtain GST registration for all such places where the passenger

embarks on the journey, even though it is not involved in the transportation of that passenger, per se? It can be argued that since it is merely engaged in issue of tickets to be used in the code-sharing airline, the marketing airline does not have any place of business at the departure airport and would not require registration. But then, it is the powers-that-be, that will decide.

Another contention could be in respect of the nature of services being performed between the two airlines. Since the marketing airline issues tickets to be used on the operating airline, does the former become an agent? Or an intermediary? Maybe the marketing airline is merely sub-contracting the passenger transportation to the operating airline, and then, it is neither an agent nor an intermediary. Important to ascertain as it does impact the taxability and appropriate HSN usage.

• Tax Rates based on class of travel

GST rates vary as per the class of travel chosen by the passengers. For the economy class, the rate applicable is 5% with certain ITC restrictions, while non-economy classes are subject to 12% without ITC restrictions.

A passenger begins his journey from Delhi to London in business class. There is a layover in Dubai. On the Dubai-London leg, he had chosen economy class. For this continuous journey, a single ticket is issued. Based on prevalent practices, the GST rate applied is that of the initial leg of the journey, viz. 12%, even though a part of the journey is in economy class for which a lower tax rate is applicable. To make matters even more interesting, what if the passenger had booked Delhi-London in economy class, but while embarking to London from the layover country Dubai, he upgrades and pays for business class? Would he then be paying a higher rate only on the incremental fare? And how would ITC claims be segregated?

• Import of services from Head office

Most of the foreign airlines operate on a head office and branch office model in India. They set up a branch office in India with the permission of Reserve Bank

of India (RBI) and billing is done from said branch offices for passenger transportation services in India. The revenue collected from the Indian operations are repatriated to their respective head offices with authorization from RBI.

Now, the GST authorities, in their enthusiasm to augment revenue, rightly or wrongly, are claiming that the Indian offices have received various services from their head office located outside India viz. leasing and maintenance of aircraft, crew salary and more. Airlines, already operating on slim margins and being largely capital intensive, now face potential tax demands running into hundreds of crores, not to mention interest and penalties.

The Government did provide a clarification for related party transactions vide Circular No. 210/4/2024-GST dated June 26, 2024, stating that services rendered by an overseas related party to an Indian related party shall be deemed to have a NIL value when no invoice is issued and no consideration is paid by the Indian related party. But with a catch! This will be so if, and only if, the Indian related party is entitled to claim of full ITC. Because of this, the airline industry is unable to take shelter under the circular for such services by head office since certain services offered by the Indian offices of the airlines are exempt from tax and hence they are required to reverse common ITC in a certain mathematical ratio.

Conclusion

The airline industry is inherently complex and navigating its regulatory and tax environment can be particularly challenging. The burden of extensive tax compliance can further stifle growth and innovation within the sector. To foster a more conducive environment for the aviation industry, the government should prioritize measures to reduce the tax burden, not just in terms of tax, but also in terms of ease of procedures and eliminating ambiguity in tax regulations.

Authorised by

Sundeep Gupta
ASA

Lakshay Chhabra
ASA