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cutting through complexity

16 July 2015

Business development and marketing related services do not make available technical knowledge, skills, etc., and hence it is not taxable as 'fees for included services' under the India-USA tax treaty

Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of ABB Inc.[1] (the taxpayer) held that business development, market services and other support services do not make available technical knowledge, skills, etc. Therefore, it is not taxable as Fees for Included Service (FIS) under Article 12(4)(b) of the India-USA tax treaty (tax treaty).

The Tribunal held that the taxpayer's Permanent Establishment (PE) in India was in respect of the trading transactions only and hence no part of the earning from rendering of services to the Associated Enterprises (AEs) can be related to the nature of the PE activities. Therefore, consideration for these services cannot be brought to tax in India.

Facts of the case

- The taxpayer is incorporated in the United States of America. It is engaged in providing business development, market services and other support services to its AEs in India.
- During the year under consideration, the taxpayer had earned fees from providing these support services. In the income tax return, the entire income was claimed to be taxable exclusively in the U.S.A. and not in India under Article 12(4)(b) of the tax treaty.
- The Assessing Officer (AO) held that the services rendered by the taxpayer were mostly consultancy services. The AO also observed that the taxpayer was providing technical services to its AEs and also made available technical knowledge to the service recipients. Therefore, it was held that services provided were in the nature of FIS under the Income-tax Act, 1961 (the Act) and under the tax treaty.
- The Dispute Resolution Panel (DRP) not only confirmed the AO's order on the taxability of FIS, but also held that the taxpayer has a DAPE in India. The Indian AEs of the taxpayer act as an agent of the taxpayer in purchasing the products of the taxpayer and distribute the same to various companies. Accordingly, the DRP held that a part of the consideration was taxable as business profits in India.

Tribunal's ruling

Fees for Included Services

- The law is settled so far as the connotations of 'make available' clause in the definition of FIS under the tax treaties are concerned. The main condition for invoking the 'make available' clause is that the services should enable the person acquiring the services to apply technology contained therein. The Karnataka High Court in the case of De Beers India (P.) Ltd.[2] has approved the same.
- Unless there is a transfer of technology involved in technical services extended by the USA-based company, the 'make available' clause is not satisfied. Accordingly, the consideration for such services cannot be taxed under Article 12(4)(b) of the tax treaty.

[1] ABB Inc. v. DDIT (IT(TP) A No. 1613/Bang/12) –Taxsutra.com

[2] CIT v. De Beers India (P.) Ltd. [2012] 346 ITR 467 (Kar)

- The AO held that the services were technical in nature. However, the decisive factor for determining the taxability of consideration under the tax treaty is not the training services per se, but the training services being of such a nature that it results in the transfer of technology. However, that was not the case before the Tribunal.
- It was not even by the suggestion of the AO that there was a transfer of technology in the present case so as to bring the services within the ambit of services which 'make available' technical knowledge, experience, skill, know-how, etc.
- The lower authorities have been persuaded by normal connotations of the expression 'make available'. However, this expression has specific legal connotations, as held by the Karnataka High Court in the case of De Beers. In the light of the law so laid down by the Karnataka High Court, the consideration for these services cannot be brought to tax under Article 12(4)(b) of the tax treaty as these services do not enable the recipient of the services to utilise the knowledge or know-how on his own in future without the aid of the service provider.

Permanent Establishment

- The DAPE exists in India on the grounds that its Indian affiliates, to which the services were rendered, were involved in purchase and sale of similar kind of products of the taxpayer but the taxability was held to be in respect of the FIS rendered to these entities.
- Even if a PE exists and the taxpayer carries on business through the PE, under Article 7(1) of the tax treaty the profits of the taxpayer may be taxed in the source jurisdiction, but only so much of them that are attributable to (i) PE (ii) sales in the other state of goods or merchandise of the same or similar kind as those sold through that PE (iii) other business activities carried on in the other state of the same or similar kind as those effected through that PE.
- In the present case, the PE was in respect of the trading transactions only and hence no part of the earning from rendering of services to the AEs can be related to the nature of the PE activities. Therefore, consideration for these services cannot be brought to tax in India.
- Relying on the decision of SET Satellite (Singapore) Pte Ltd[3] it was held that even if there is a DAPE in India, it will have no taxable profits to be taxed in the hands of the taxpayer in the absence of the finding that the DAPE has been paid remuneration less than arm's length remuneration. Accordingly, there was no need to examine the aspect regarding the existence of the DAPE.
- Accordingly, additions made with respect to income under Article 12(4)(a) as FIS and with respect to business income under Article 7(1) of the tax treaty were deleted.

Our comments

This is a welcome ruling of the Bangalore Tribunal where it was held that since fees for business development, market services and other support services do not make available technical knowledge, skills, etc., such fees are not taxable as FIS under the tax treaty. The Tribunal held that the taxpayer had a Permanent Establishment (PE) in India only in respect of trading transactions. Therefore, no part of earning from rendering services to the Associated Enterprises AEs can be brought to tax in India applying Article 7 of the tax treaty.

The Authority for Advance Rulings (AAR) in the case of Mersen India Private Limited[4] held that services provided by the taxpayer in respect of advice and assistance on business strategy, general management, marketing, commercial matters, etc., were made available knowledge and know-how to the recipient. Accordingly, it was held that such services were taxable as fees for technical services under India-France tax treaty.

Similarly, the Cochin Tribunal in the case of U.S. Technology Resources Pvt. Ltd.[5] held that financial, sales and risk management services provided by the U.S. company are technical in nature. Such services 'make available' technical knowledge, experience, skills, etc. to the taxpayer. Therefore, it is taxable as FIS under the India-USA tax treaty.

[3] SET Satellite (Singapore) Pte Ltd v. DDIT [2009] 307 ITR 205 (Bom)

[4] Mersen India Private Limited [2013] 353 ITR 628 (AAR)
[5] US Technology Resources Pvt. Ltd. v. ACIT [2013] 39 taxmann.com 23 (Cochin)

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