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Services relating to review of designs and drawings do not make available technical knowledge, skill or experience and therefore not taxable as fees for technical services under India-Finland tax treaty

Background

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Nokia India Private Limited[1] (the taxpayer) held that mere provision of technical/consultancy services comprising of review of design, construction plans, etc. would not fall within the ambit of 'fees for technical services' (FTS) under the India-Finland tax treaty (the tax treaty), since the service provider has not 'made available' any technical knowledge, skill or experience to the taxpayer.

Facts of the case

- The taxpayer is a wholly owned subsidiary of Nokia Corporation. During the year under consideration i.e. Assessment Year (AY) 2006-07, the taxpayer, in the process of setting up a manufacturing facility at Chennai, had entered into a contract with Leighton Contractors India Private Limited (LCIPL) for the designing, manufacturing and completion of the manufacturing facilities.
- In order to ensure that the designs, construction plans, etc. prepared by LCIPL are in line with Nokia's global standards, the taxpayer entered into a contract with 'Olof Granlund Oy' (OG), a Finland based company, to review the same.
- In relation to the payment made against the aforesaid services, the taxpayer did not withhold taxes on such payments on the ground that the said services availed from OG, Finland did not fall within the ambit of FTS, as defined under the tax treaty and hence was not liable to tax in India under the provisions of the Income-tax Act, 1961 (the Act) read with tax treaty.
- Subsequently, the TDS officer has initiated proceedings under Section 195 of the Act and asked the taxpayer to show cause as to why the taxpayer should not be treated as an 'assessee in default' under Section 201(1) and 201(1A) of the Act for want of non-deduction of tax.
- The taxpayer submitted that the services rendered by OG, Finland are towards the review of design and other related services and that no technical knowledge was made available to the taxpayer in this regard, and hence the same does not qualify as FTS under Article 13(4)(c) of the tax treaty. Further, in the absence of a definition of 'make available' in the tax treaty, the taxpayer has placed reliance on the 'Memorandum of Understanding (MoU), concerning Fees for Included Services as per Article 12 of the India–U.S. tax treaty.
- The taxpayer also contended that the said services would not be taxed under Article 7 read with Article 5 of the tax treaty in the absence of a Permanent Establishment (PE) of OG, Finland in India.
- However, the TDS officer, by placing reliance on the ruling of the Supreme Court in the case of Transmission Corporation of AP[2], held the taxpayer as an assessee in default under Section 201(1) of the Act.

[1] ITO v. Nokia India Private Limited (ITA No. 1941/Del/2012) – Taxsutra.com

[2] Transmission Corporation of AP Limited v. CIT (1999) 239 ITR 587 (SC)

- Aggrieved by the order of the TDS officer, the Company filed an appeal before the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) affirmed the view taken by the taxpayer. A few takeaways from the order of the CIT(A) are outlined below:
  - The services provided by the non-resident are technical in nature as per the provisions of Section 9(1)(vii) of the Act.
  - Article 13(4)(c) of the tax treaty consists of two limbs, and there is a word 'or' between the two limbs. The services should fall under either of the two limbs before these could be termed as technical services.
  - As per the first limb of Article 13(4)(c) of the tax treaty, the words 'make available' qualify the technical services and unless this qualification is satisfied, the services which are otherwise technical in nature cannot be termed as technical services under the said article of the tax treaty.
  - As per the contract, the services provided are in the nature of review of designs and technical plan and hence the nature of services provided do not fall in the second limb either i.e. the development and transfer of a technical plan or technical design.
- In view of the above, and adding to the fact that OG, Finland does not have a PE in India, the CIT(A) held that the provisions of Section 195 of the Act are not triggered and hence the taxpayer cannot be deemed as an assessee in default.

Tribunal's ruling

- The Tribunal held that to determine whether the payments fall under Article 13(4)(c) of the tax treaty, it is imperative to determine whether the services 'make available' any technical knowledge, experience, skill, etc. to the recipient of the service or if it involves the development and transfer of a technical plan or design to the recipient of the services.
- The tax treaty does not specifically define the term 'make available'. In the absence of the same, a reference can be drawn from the MoU to India – U.S tax treaty, in line with the principle of parallel treaty interpretation. Previously, various courts[3] have held that parallel treaty interpretation is permissible where the language of two treaties is similarly worded and where one treaty clarifies the meaning of the terms used.
- The MoU seeks to clarify that the services are considered to be made available only where it leads to a transfer/impart of technical knowledge, experience, skill, know-how or process to the recipient, which enables the recipient to apply the same on its own.
- The services rendered by OG, Finland are merely to ensure that the design and construction plans to be installed at the taxpayer's factory in Chennai are of the right design and quality and in line with Nokia's global standards, and are neither geared to nor do they 'make available' any technical knowledge, skill or experience to the taxpayer.
- Further, in absence of a PE of OG, Finland in India under the provision of Article 5 of the tax treaty during the subject period, the same would not be taxed as 'Business Profits' under Article 7(1) of the tax treaty.
- With respect to the other issue of applying and seeking a certificate for lower withholding tax order for such payments, the Tribunal by placing reliance on the decision of the Supreme Court in the case of GE India Technology Centre P. Ltd[4] held that there is no requirement of seeking such lower/nil withholding tax certificate if the whole of such payment is not chargeable to tax in India.
- Based on the above, the Tribunal held that the payments made by Nokia India to OG, Finland towards reviewing design/drawings to ensure that they are of the right quality, are not in the nature of FTS as per Article 13(4)(c) of the tax treaty since OG, Finland has not 'made available' any technical knowledge or experience that could in turn enable Nokia India to use it independently in its business without recourse to OG, Finland.

Our comments

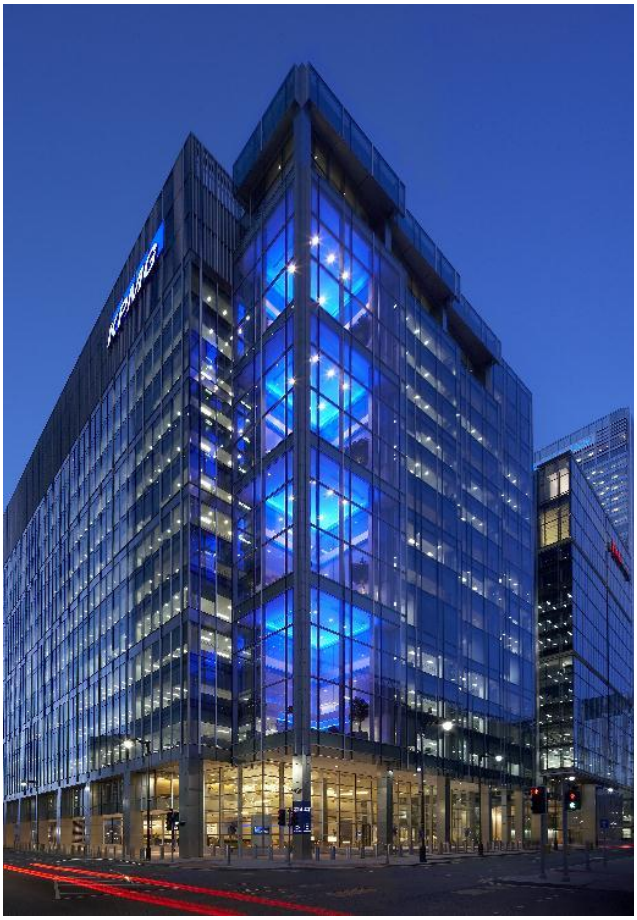
The taxation of FTS under the tax treaties have been a matter of debate before various courts. The present decision deals specifically with the meaning of the term 'make available' in the FTS clause under the erstwhile India-Finland tax treaty.

The Delhi Tribunal, in the present case, has reiterated the usage of the principle of parallel treaty interpretation, in cases where the language of the two treaties is similarly worded. In such cases, in the absence of the definition of any specific term in one treaty, an inference can be drawn from the other treaty which has similar terms.

[3] National Organic Chemical Industries Ltd v. DCIT [2005] 96 TTJ 765 (Mum), CESC v. CIT [2003] 80 TTJ 806 (Cal), DDIT v. Prenoy A.G. [2010] 39 SOT 187 (Mum), Intertek Testing Services India (P) Ltd., In re [2008] 307 ITR 418 (AAR)

[4] GE India Technology Centre P. Ltd (Civil Appeal Nos.7541-7542 of 2010)

A new treaty has been executed between India and Finland with effect from 1 April 2011, wherein the concept of ‘make available’ has been done away with in Article 12, which dealt with taxation of Royalties and Fees for Technical Services. The new tax treaty contains the most favoured nation (MFN) clause where it is provided that if after the India-Finland tax treaty has entered into force, any tax treaty between India and OECD country provides for lower rate or scope with respect to dividend, interest, royalty or FTS, the same will apply to India-Finland tax treaty. However, this MFN clause is subject to a notification to be issued by the Indian competent authorities.



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