

TAX FLASH NEWS

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Fees for supply management services are neither taxable as royalty nor as fees for technical services under the India-U.K. tax treaty

Background

Recently, the Authority for Advance Rulings (AAR) in the case of Cummins Limited¹ (the applicant) held that fees received by a foreign company for rendering supply management services to its Indian group company cannot be treated as Fees for Technical Services (FTS) under the India-U.K. tax treaty (the tax treaty) since the foreign company does not make available any technical knowledge, experience, know-how, etc.

The AAR also held that payment for supply management services cannot qualify as royalty under Article 13 of the tax treaty since it is not related to the use of, or the right to use any copyright, patent, trademark, design or model, plan, secret formula or process, etc.

Facts of the case

- The taxpayer, Cummins Limited, U.K. is a company incorporated in the U.K.
- Cummins Technologies India Limited (CTIL) is an Indian company engaged in the business of manufacture and sale of turbochargers.

- CTIL purchases turbocharger components directly from a third party in the U.K. and the U.S. and in relation to such purchases, the taxpayer, provides supply management services vide Material Suppliers Management Service Agreement (agreement).
- In terms of the agreement, CTIL pays supply management service fees calculated at 5 per cent of the base price of the suppliers. The applicant does not have a Permanent Establishment (PE) in India in respect of the supply management services as per the provisions of the tax treaty.
- As per the agreement the applicant is responsible for the following:
 - Finalisation of supplier prices from the U.K. and the U.S. suppliers and ensuring market-competitive pricing.
 - Ensuring that the approved suppliers have the necessary manufacturing capacities and infrastructure to provide for the raw material requirements.
 - Assisting in ensuring on-time delivery of components by the suppliers to Cummins India as well as the resolution of delivery performance issues with suppliers, if any.

¹ Cummins Limited (AAR No. 1152 of 2011) – Taxsutra.com

- Ensuring that suppliers maintain strict compliance with the standards, procedures and processes and support in obtaining a response from a supplier to any quality control violation issue; and
- Performance review of the supplier will be held by Cummins U.K. at least annually wherein it will perform regular product and process audits to check that the supplier process and controls meet the requirements.

Issue before the AAR

- Whether the supply management service fees are in the nature of FTS or royalty under Article 13 of the tax treaty? Whether such payments are taxable in India?

AAR ruling

Taxability of FTS

- On perusal of the agreement, it indicates that the CTIL is working with the applicant only to ensure market competitive pricing from the suppliers. The applicant maintains contract supply agreements with the suppliers after identifying the products availability, capacity to produce and competitive pricing.
- The applicant is not imparting its technical knowledge and expertise to the Indian company based on which the Indian company acquires such skill and will be able to make use of it in the future. Therefore, the 'make available' clause under the India-U.K. tax treaty is not satisfied. The AAR relied on the case of De Beers India Limited² by the Karnataka High Court.
- The concept of 'make available' was analysed in the case of Measurement Technologies Ltd.³ The AAR held that services in the nature of procurement can never be classified as technical or consulting in nature and are not making available any technical knowledge, experience, know-how, etc.

- It is also relevant to note that the services rendered in the present case are managerial in nature and managerial services were taken out of the ambit of FTS of the India-U.K. tax treaty with effect from 11 February 1994 and a clause relating to 'make available' was inserted. It indicates that the intention was to introduce such a clause and exclude managerial services. The AAR rulings relied on by the tax department are distinguishable on the facts of the present case.

Applicability of the anti-avoidance provisions

- The objection of the tax department that the agreement entered into by the applicant with CTIL is a scheme for tax avoidance is without any merits. The tax department's contention that the applicant has entered into a contract with the Indian company with the main purpose to take advantage of the India-U.K. tax treaty is factually incorrect.
- On perusal of the facts stated by the applicant in the application, it indicates that the applicant maintains Global Cummins contract supply agreements with suppliers and is responsible for finalisation of supplier prices to Cummins Turbo Technologies worldwide, including CTIL, from the U.K. and the U.S. suppliers.
- There is no mandate for CTIL to source the components from the approved suppliers only and if CTIL finds a better pricing from an alternate supplier, it shall be free to source the component from them. It is incorrect to say that such an arrangement has been done with the main purpose to avoid tax. Therefore, the objection of the tax department on this account is not correct.

Taxability of royalty

- With reference to services being royalty and covered under Article 13(3) of the tax treaty, it is held that the nature of services related to identification of products and competitive pricing cannot qualify as royalties under the provisions of Article 13 of the tax treaty because it is not related to the use of, or the right to use any copyright, patent, trademark, design or model, plan, secret formula or process, etc.

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

³ Measurement Technologies Ltd. (AAR No.966 of 2010)

Accordingly, it has been held that the supply management services fees received by the applicant are not in the nature of FTS or royalties under the India-U.K. tax treaty. In view of the fact that the applicant has no PE in India, the fees received are not taxable in India.

Our comments

In the instant case, the AAR held that fees received by the applicant for rendering supply management services to its Indian company cannot be treated as FTS since the applicant is not imparting its technical knowledge and expertise to the Indian company.

Based on a perusal of the terms of agreement and conditions with respect to the procurement of components from any supplier who offers a better price, it was held that the arrangement undertaken by the Indian company has not been done with the main purpose to avoid tax.



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