

# TAX FLASH NEWS

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## Payment received by a UK company under the management and administration services agreement is taxable as royalty under the Income-tax Act as well as the India-UK tax treaty

### Background

Recently, the Bangalore Bench of the Income-tax Appellate Tribunal (the Tribunal), in the case of TNT Express Worldwide (U.K.) Limited<sup>1</sup> (the taxpayer), held that the payment received by the U.K. resident from its Indian affiliate under a management and administrative services agreement is taxable as royalty under the Income-tax Act, 1961 (the Act) as well as the India-U.K. tax treaty (tax treaty).

The Tribunal observed that to bring the case within the definition of royalty, imparting of experience, information by the taxpayer to the Indian company is necessary. In the case of the taxpayer, it appears to be a composite agreement for providing various services, some of which are purely business/commercial services and others are in the nature of imparting the knowledge, and experience, which concern commercial or business experience. In such a situation, since the taxpayer has failed to produce the relevant information, which is necessary to segregate part of the payment which may not be falling under the purview of royalty, the entire consideration received by the taxpayer, would be treated as royalty.

### Facts of the case

- The taxpayer is a U.K. based company engaged in the business of international express distribution of freight, parcels and documents. The taxpayer entered into management and administration services (MAS) agreement with TNT (India) Pvt. (TNT India) under which the taxpayer provided services to TNT India.

- In terms of the MAS agreement, the taxpayer was rendering services such as business policy advice, management information and other automated system services, new process information, assistance in evaluation of the development in the international market, market research/analysis, evaluation of business opportunities, drawing up finance plans, assistance with strategic management, statistical evaluations, liaison with professional advisers, etc.
- The taxpayer invoiced TNT India for providing the services under the agreement. TNT India deducted tax at source under Section 195 of the Act, before making remittance of the said amount.
- Subsequently, the taxpayer filed its return of income declaring nil taxable income and claimed refund for the tax deducted at source. The taxpayer claimed that since it was not having any presence in India, income earned from the provision of MAS would not be taxable in India under Section 9(1) of the Act as well as under Article 13 of the tax treaty.
- The Assessing Officer (AO) held that services rendered by the taxpayer under the MAS agreement involved the provision of know-how, and such services would fall within the purview of royalty. The Dispute Resolution Panel (DRP) confirmed the order of the AO.

<sup>1</sup> TNT Express Worldwide (U.K.) Limited v. DDIT (IT(TP)A No.6/Bang/2011) – Taxsutra.com

## Taxpayer's contentions

- Information and advice provided by the taxpayer to TNT India in the course of rendering management and administrative support services do not amount to imparting know-how, experience or information concerning technical, industrial, commercial or scientific knowledge and consequently would not fall within the purview of royalty as defined under the Act as well as under the India-U.K. tax treaty.
- The amount accruing to the taxpayer under the MAS agreement is business income, and since the taxpayer does not have a PE in India, the said income will not be chargeable to tax in India in accordance with Article 7 of the India-U.K. tax treaty.
- Relying on the decision of Bombay High Court in the case of Diamond Services International (P) Ltd<sup>2</sup> it was contended that when there is no imparting of experience in favour of the client, but the clients receive reports prepared by the use of its commercial/technical knowledge, it cannot be said to be imparting of information by the person, who possess such information.

## Tax department's contentions

- When the knowledge or information provided by the taxpayer is not publicly available, and it is confidential and a secret, this is certainly a case of imparting knowledge or information to TNT India, which would fall under the purview of royalty.
- Economic benefit derived from the said information was the sole purpose, and therefore experience and knowledge of the taxpayer was parted with TNT India.
- Even general services may be a know-how for the other entity depending upon the nature of requirement and use of the services by the recipient.

## Tribunal's ruling

- As per the agreement, services provided by the taxpayer were broadly of two types i.e. one on which the taxpayer may incur direct costs and the other where there is no direct cost for providing the services and the consideration of providing such services is charged based on gross revenue.

- The services falling under the second category were not specifically developed or designed for the purpose of providing services to TNT India, but the same may be already in existence.
- Except for some clarification and meaning of certain terms in the 'royalty' definition under the Act, there is no difference in the meaning of 'royalty' provided under the Act as well as in the tax treaty.
- To bring the case within the definition of 'royalty', imparting of experience, information by the taxpayer to TNT India is necessary.
- It is not the nomenclature of the agreement, but the substance and contents and terms and conditions of the agreement which are material to ascertain the real intention of the parties and the nature of mutual obligations of the parties.
- As it was apparent from the list of services that some of the services were clearly for new process information including specification and application, evaluation of new opportunities, management information, and other automatic system services, which may be the taxpayer's own expertise and experience and acquired during the due course of time. Therefore, these services *prima facie* appear to be in existence and being provided in the form of information, which are definitely related to the commercial and business activity of the Indian entity.
- If the payment is received to supply existing information or reproduce the existing material, then it will constitute imparting of information so as to fall under the purview of royalty. The Mumbai Tribunal in the case of GECF Asia Ltd<sup>3</sup> has taken a similar view on this issue.
- In the case of the taxpayer, the MAS agreement appears to be a composite agreement for providing various services, some of which are purely business/commercial practice and contract services and others are in the nature of imparting the knowledge, and experience, which concern the commercial or business experience.

<sup>2</sup> GECF Asia Ltd. v. DDIT [2014] 34 ITR 303 (Mum)

<sup>2</sup> Diamond Service International Private Limited v. Union of India [2008]  
304 ITR 201 (Bom)

- In such a situation, where the taxpayer is unable to provide bifurcation of the payment relating to each kind of services then as per para 11.6 of the OECD Model Commentary<sup>4</sup>, where a reasonable apportionment is not possible, then the other part of the services could also be given the tax treatment as given to one part of the services provided, which constitute the principal purpose of the contract and falling under the purview of royalty.
- The taxpayer was asked to give the break-up of payments received from each of the services rendered. However, the taxpayer did not furnish information on the ground that no break-up is available as it is a composite contract. Further, information was not provided about the cost incurred by the taxpayer in rendering these services.
- Accordingly, the order of the lower authorities holding the entire consideration received by the taxpayer as royalty was upheld.

## Our comments

The Bangalore Tribunal held that the payment received by a foreign company from its Indian group company under the management and administrative services agreement was taxable as royalty under the Act as well as the India-U.K. tax treaty. In the instant case, the Tribunal noted that there was a composite agreement for providing various services, some of which are purely business/commercial practice and contract services, and others involve imparting knowledge, and experience.

So, while the Tribunal observed that not all services under the management and administrative agreement are taxable as royalty, its conclusion is based on peculiar facts where the taxpayer had failed to produce relevant details necessary to segregate that part of the payment which pertained to services which may not fall under the purview of royalty. In such a situation, the Tribunal, referring to para 11.6 of the OECD Model Commentary, observed that where a reasonable apportionment is not possible, the tax treatment as given to one part of the services provided, which constitutes the principal purpose of the contract, could be applied to the whole consideration. Therefore, the entire consideration received by the taxpayer was treated as royalty.

Further, it is to be noted that in this case, the issue before the Tribunal was only with respect to taxability of payments for management and administrative services as royalty, and the issue of whether the same are in the nature of fees for technical services was not an issue before the Tribunal.




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<sup>4</sup> Commentary on Article 12 – Concerning the taxation of royalties

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