



## Reimbursement of expenditure pursuant to training and technical agreement is not taxable as FTS as no profit element is embedded in such reimbursement

### Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Gemological Institute International Inc<sup>1</sup> (the taxpayer) held that the amount received by the taxpayer for reimbursement of travel expenditure, group health insurance and other incidental expenditure pursuant to training and technical service agreement is not taxable as Fees for Technical Services (FTS). The Tribunal observed that no profit element has been included in such reimbursement.

### Facts of the case

- The taxpayer is a non-resident company incorporated in USA. The taxpayer entered into a training and technical service agreement (TTA) with a group company (GIA India) to train the employees of GIA India and providing technical services for the implementation of grading policies, procedures and processes.
- In terms of the said agreement, the taxpayer provided technical services to GIA India. The taxpayer raised separate debit notes as 'fee for training and technical services' rendered by it to GIA India and also on account of 'reimbursement of travel expenses, group health insurance and other minor incidental expenses' incurred by it pertaining to the aforesaid assignment.

- The taxpayer filed a return of income declaring total income of INR106.18 million. The taxpayer excluded from its income, the amount received by way of reimbursement of expenditure for the reason that these constituted actual cost borne by the taxpayer, and therefore, these were not in the nature of income.
- The Assessing Officer (AO) held that the total amount received by the taxpayer from GIA India was liable to be included in the income of the taxpayer including the expenditure reimbursed by GIA India for the reason that these constituted part of FTS, and therefore, the AO made addition of the same in the assessment order.
- The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

### Tribunal's decision

- On perusal of the terms of the agreement, it indicates that the taxpayer was entitled to receive by way of fee only the amount incurred by way of cost to 'employ' the individuals plus mark-up of 6.5 per cent. The expression cost to 'employ' individuals is different from the expression cost incurred to 'depute' a person. The cost of employment would clearly mean and include only internal costs as are incurred by an organisation to employ an individual in the organisation.

<sup>1</sup> Gemological Institute International Inc v. DCIT (ITA No. 4659/Mum/2014) and (ITA No. 385/Mum/2016) – Taxsutra.com

- Any cost incurred over and above that to depute the individual for a particular assignment, which is not an internal assignment of the taxpayer, would be additional cost. Thus, costs and expenditure incurred by the taxpayer on travel and insurance, etc., on the persons deputed in India to provide training and technical services to GIA India was in the nature of cost incurred over and above the cost of employment. This interpretation is further reinforced as it was provided that GIA India shall reimburse to the taxpayer any expenses incurred on account of thirty party costs.
- The drafting of the agreement and the manner of placement of the clauses in the agreement clearly provides a case that FTS is different from the expenditure incurred on third party costs. Thus, there is a clear bifurcation in the agreement between the internal cost incurred by the taxpayer and external cost borne or paid by the taxpayer on behalf of GIA India.
- There is no dispute on the proposition that FTS has to be taxed on a gross basis. However, the issue that arises in this case is whether the expenditure incurred on a cost-to-cost basis is to be included in the amount of FTS. This controversy has been settled by the Supreme Court<sup>2</sup>. Therefore, it is clear that the amount received by the taxpayer on account of reimbursement received over and above the amount of FTS, cannot be included and taxed as part of FTS.
- Our attention has been drawn on the Transfer Pricing Study report and Transfer Pricing order passed in the case of GIA India from where it can be made out that no profit element has been included in the expenses reimbursed. Thus, taking into account the totality of facts and circumstances of the case, it has been held that the addition made by the AO is contrary to facts and therefore, is directed to be deleted.

## Our comments

The issue with respect to taxability of payments made to the foreign company towards reimbursement of expenditure has been a subject matter of litigation before the Courts/Tribunal. In some of the decisions, the Courts have held that the reimbursement is not taxable where no element of profit is embedded in such reimbursement<sup>3</sup>. However, in some of the decisions, it has been

held that services provided to group companies would be liable to tax as FTS, even if no profit element is involved<sup>4</sup>.

Recently, the Supreme Court<sup>5</sup> observed that no profit element was embedded in the payments made by Indian agents to the foreign company. The payments were in the nature of reimbursement of cost whereby the Indian agents paid their proportionate share of expenditure incurred on common systems. Further, no technical services were rendered by the foreign company to the Indian agents. Accordingly, such payments were not taxable as FTS.

The Mumbai Tribunal in the present case has also held that pure reimbursement of costs where element of profit has not been embedded, would not trigger the taxability.



<sup>2</sup> DIT v. A.P. Moller Maersk [2016] 392 ITR 186 (SC)

<sup>3</sup> CIT v. Dunlop Rubber Co. Ltd. [1983] 142 ITR 493 (Cal), Dampskibsselskabet v. ADIT [2011] 9 taxmann.com 165 (Mum)

<sup>4</sup> Timken India Ltd [2005] 273 ITR 67 (AAR), International Hotel Licensing Co [2007] 158 Taxman 231 (AAR)

<sup>5</sup> DIT v. A.P. Moller Maersk [2016] 392 ITR 186 (SC)

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