KPMG

#KPMG josh

TAX FLASH NEWS

8 June 2019

Income from testing and other services is taxable as FTS under the India-Finland tax treaty

Recently, the Kolkata Bench of the Income-tax Appellate Tribunal (the Tribunal) in case of Outotec (Finland) Oy[1] (the taxpayer) held that the income from testing and other services is taxable in India even if technical services of testing were performed outside the country. The Tribunal observed that though the process of testing was conducted outside India, the payment in question was not for the process but was for the results of testing which were used in India. Therefore, the services provided by the taxpayer are taxable Fees for Technical Services (FTS) under Article 12(5)[2] of the India-Finland tax treaty (tax treaty).

Further the Tribunal held that income from the sale of designs and drawings is not taxable as royalty or as FTS. The income had to be considered as business income, and as the taxpayer did not have Permanent Establishment (PE) in India, it cannot be brought to tax in India.

Facts of the case

The taxpayer, a Finland based entity, is a worldwide leader in providing innovative and environmentally sound solutions for a wide range of customers in metal processing industries. During the Assessment Year (AY) 2015-16, the taxpayer earned four types of revenue, i.e., technical services, royalty income, design and drawings, testing and other services. The taxpayer offered to tax income from the rendition of technical services and income from royalty (licence fees) but did not offer to tax income received from the sale of designs and drawings and income from testing and other services. The taxpayer contended that income from the sale of designs and drawings was a business income and since the taxpayer did not have Permanent Establishment (PE) in India, the business profit was not taxable in India. On the issue of income from rendering of testing and other services, the taxpayer relied on Article 12(5) of the tax treaty and as the services had been rendered outside India, it claimed that the same was not taxable in India. The Assessing Officer (AO) held that income earned from the sale of designs and drawings was taxable in India as the same was in nature of royalty under the tax treaty and under the Income-tax Act, 1961 (the Act). On the issue of taxability of income from rendering of testing and other services, the AO held that the same is taxable as royalty/FTS, both under the Act as well as under the tax treaty. The Dispute Resolution Panel (DRP) upheld the order of the AO. Aggrieved, the taxpayer filed an appeal before the Tribunal.

Tribunal's decision

Taxability of income from the sale of design and drawings

On a perusal of agreements for sale of drawings and designs, it indicates that the designs and drawings in question were not embedded in the plant and machinery. They were separate items which were sold by the taxpayer. The fact that these were sold outside India was not disputed. The Tribunal relied on various cases[3] wherein it was held that income earned from the sale of designs and drawings was treated as business income and it was not liable to tax in India under the Act as well as under the tax treaty. The sale was made outside India, and the consideration was also received outside India in foreign currency. Accordingly, it has been held that income from the sale of designs and drawings cannot be classified

[1] Outotec (Finland) Oy v. DCIT (ITA No. 2601/Kol/2018) – Taxsutra.com

[2] Article 12(5) of the tax treaty - Royalties or FTS shall be deemed to arise in a Contracting State when the payer is that State itself, a political sub-division, a local authority or a resident of that State. Where, however, the right or property for which the royalties are paid is used within a Contracting State, or the fees for technical services related to services performed, within a Contracting State, then such royalties or FTS shall be deemed to arise in the State in which the right or property is used, or the services are performed.

[3] Outotec Gmbh v. DCIT [2015] 172 ITJ 337 (Kol), Outotec Gmbh v. DCIT (ITA No. 160 & 193/Kol/2016)

either as royalty or as FTS. The income had to be considered as business income, and as the taxpayer did not have PE in India, it cannot be brought to tax in India.

Taxability of income from testing and other services

It is an undisputed fact that testing and other services were rendered outside the country, i.e., in Finland. On a perusal of Article 12(5) of the tax treaty, it indicates that the royalties or FTS shall be deemed to arise in a state where the payer is located. In cases where the right of property, for which royalty was paid is used within a state or a case where the FTS relate to services were performed within a state, then the income shall be deemed to arise in the state in which the right of property is used or the state in which the services were performed.

The taxpayer contended that the technical services of testing were performed outside the country, i.e., in Finland and hence cannot be taxed in India in view of the exception carved out to Article 12(5) of the tax treaty. The exception in question was when the fee is paid for technical services which are performed within a state, then the income therefrom is deemed to accrue or arise within the state in which the services were performed. The Tribunal observed that this clause does not apply as the payment in question was made for the test results which were used within the state i.e. India. It may be true that the process of testing may have been conducted outside India. However, the payment in question was not for the process but was for the results of testing which were used in India. Accordingly, it has been held that income from testing and other services is taxable as FTS in India under the tax treaty.

Our comments

The issue with respect to the taxability of testing and other services has been a subject matter of debate before the Courts/Tribunal.

Article 12(5) of the tax treaty provides that the royalties or FTS shall be deemed to arise in a state where the payer is located. In cases where the right of property, for which royalty was paid is used within a state or a case where the FTS relates to services performed within a state, then the income shall be deemed to arise in the state in which the right of property is used or the state in which the services are performed.

The Kolkata Tribunal held that income from testing and other services is taxable in India even if technical services of testing were performed outside the country. The Tribunal observed that though the process of testing was conducted outside India, the payment in question was not for the process but was for the results of testing which were used in India. Therefore, the services provided by the taxpayer are taxable under Article 12(5) of the tax treaty.

It is pertinent to note that the India-Finland tax treaty has been amended with effect from 1 April 2011, where the concept of ‘make available’ has been removed. Further 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 an exemption from tax or a lower rate with respect to dividend, interest, royalty or FTS, the same will apply to India-Finland tax treaty. It is important to note that the MFN clause is subject to a notification to be issued by the Indian competent authorities and it only deals with the benefit of exemption from tax or lower tax rate.

home.kpmg/in

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000