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TAX FLASH NEWS

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FTS is not taxable in India where services are for the purposes of making or earning any income from any source outside India

Recently, the Gujarat High Court in the case of Motif India Infotech Pvt Ltd[1] (the taxpayer) dealt with the issue with respect to taxability of Fees for Technical Services (FTS) vis-à-vis exclusion provided under Section 9(1)(vii)(b)[2] of the Income-tax Act, 1961 (the Act). The High Court held that FTS was paid by the taxpayer to a foreign company for the purpose of making or earning income from any source outside India. The source of income namely the taxpayer's customers were foreign-based companies. Therefore, even though services were in the nature of technical services, since the same were covered within the exclusion under Section 9(1)(vii)(b) of the Act, tax was not required to be deducted on payment of such FTS.

In the instant case, the taxpayer is engaged in the business of software development. It provides software-related services to its overseas clients. For providing services to its clients, the taxpayer had contracts for availing certain services with a Philippines based company. During Assessment Year (AY) 2009-10, the taxpayer made payments of FTS to the Philippines based company without deduction of tax at source. The Assessing Officer (AO) disallowed such payments on failure to deduct tax at source under the provisions of Section 195 of the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] held that the services were utilised outside India in a business or profession carried on outside India, or for the purpose of earning any income outside India. Therefore, even though services were in the nature of technical services, the same would be covered within the exclusion under Section 9(1)(vii)(b) of the Act. In the process, CIT(A) relied on a decision of Adani Enterprises[3] wherein in the context of interest payment to a non-resident investor, it was held that deduction of tax was not required if the interest payment was in respect of the amount borrowed outside India and used outside India for investment or business carried on outside India. The Tribunal upheld the order of the CIT(A).

The Gujarat High Court observed that the payments made by the taxpayer were for technical services provided by a non-resident. It was for providing services to be utilised for serving the taxpayer's foreign clients. Thus, FTS was paid by the taxpayer for the purpose of making or earning any income from any source outside India. Accordingly, the source of income namely the taxpayer's customers were the foreign-based companies[4]. Consequently, the tax was not required to be deducted on payment of such FTS.

Our comments

The issue with respect to the source rule exclusion for technical services under the Act has been a matter of litigation. The source rule exclusion lays down the principle that income of the recipient is chargeable in the country where the source of payment is located. The Supreme Court in the case of GVK Industries Ltd[5] while dealing with the exception under Section 9(1)(vii)(b) of the Act observed that such exception applies to a situation when fee is payable in respect of services utilised for business or profession carried out by an Indian payer outside India or for the purpose of making or earning of income from any source outside India.

The Tribunal[6] in various cases has applied this source rule exclusion and held that FTS was utilised in a business carried on by the taxpayer outside India or for earning any income from

[1] PCIT v. Motif India Infotech Pvt Ltd [2018-TII-60-HC-AHM-INTL]
[2] FTS shall not be deemed to accrue or arise in India where FTS is payable in respect of services utilised in a business or profession carried on outside India or for the purposes of making or earning any income from any source outside India
[3] ADIT v. Adani Enterprises Ltd [2013] 29 taxmann.com 99 (Ahd)

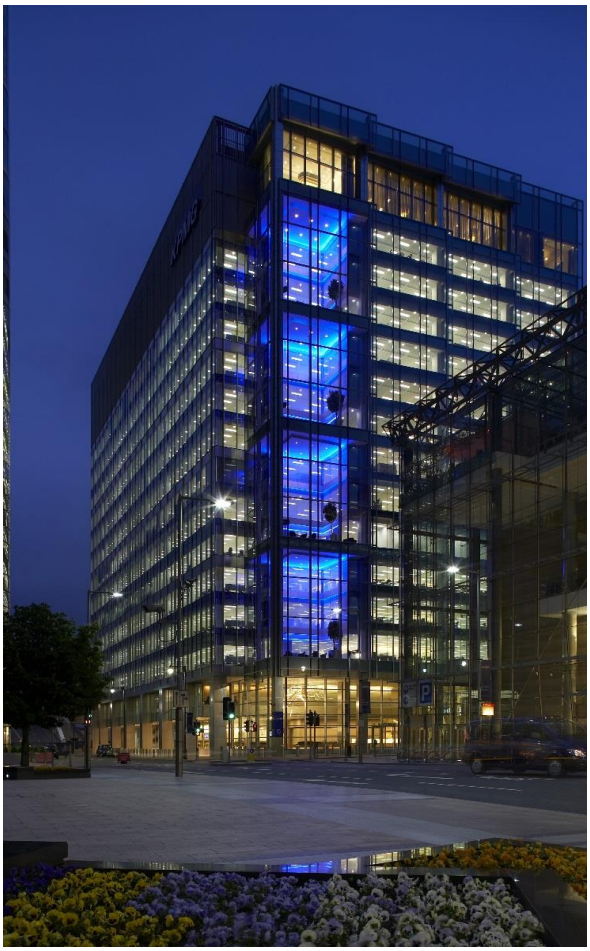
[4] The High Court relied on the decision in the case of CIT v. ITC Hotels Limited [2015] 233 Taxmann 302 (Kar)
[5] GVK Industries Ltd. v. ITO [2015] 371 ITR 453 (SC)
[6] Aqua Omega Services (P.) Ltd. v. ACIT [2013] 31 taxmann.com 179 (Chen), ADIT v. DQ Entertainment (International) P. Ltd. [2014] 164 TTJ 84 (Hyd), Nissan Motor India (P.) Ltd. v. DCIT [2018] 92 taxmann.com 127 (Chen)

any source outside India. Accordingly, the FTS shall not be deemed to accrue or arise in India in the hands of a non-resident. However, the Delhi Tribunal in the case of International Management Group (U.K.) Ltd.[7] held that payment was taxable as FTS under the Act as the services provided by the foreign taxpayer were utilised by the Indian entity for carrying on business in India and the source of income of the Indian entity was in India. Accordingly, the services did not fall under the source rule exclusion applicable to FTS under the Act.

While dealing with the taxability of testing and certification services paid to a U.S. company for the export of a product to the U.S., the Delhi Tribunal in the case of Havells India Ltd[8] held that the services have been rendered outside India and have been utilised for the purpose of making or earning any income from any source outside India. Accordingly, such payments to the U.S. would fall outside the purview of Section 9(1)(vii) of the Act and will not be deemed to accrue or arise in India. However, the Delhi High Court[9] overruled the Tribunal's decision and observed that it was not the payer of income but the location of the manufacturing activity and conclusion of the export contract from India that will determine the source of income. The High Court held that the taxpayer's case does not fall within the exception provided in Section 9(1)(vii)(b) of the Act and the FTS paid was taxable under the Act.

Subsequently, the Chennai Tribunal in the case of Alstom T & D India Ltd[10] observed that the source of income was created at the moment when the export contracts were concluded in India. Even though the importer of the taxpayer's products is situated outside India, he was only the source of the monies received and he cannot be regarded as a source of income. In order to fall within the exception provided in Section 9(1)(vii)(b), the source of the income, and not the receipt should be situated outside India and this condition was not satisfied in the taxpayer's case.

On a different note the Mumbai Tribunal in the case of Kotak Mahindra Bank Ltd.[11] held that the source rule exclusion under the Act was not restricted to a case where FTS was incurred for the purpose of earning overseas income only when there was an existing source of income, but even if the payment was for the creation of a new source of income, it was covered by the source rule exclusion. Since the payments to a foreign entity were made for earning a new source of income or earning income from business outside India, by way of acquisition of a banking company or setting up of a branch outside India, such payments were covered by the source rule exclusion under the Act.



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[7] International Management Group (UK) Ltd. v. ACIT [2016] 162 ITD 219 (Del)
[8] Havells India Ltd v. ACIT [2011] 140 TTJ 283 (Del)
[9] CIT v. Havells India Ltd [2013] 352 ITR 376 (Del)
[10] DCIT v. Alstom T & D India Ltd [2016] 68 taxmann.com 336 (Chen)
[11] Kotak Mahindra Bank Ltd v. ITO [2016] 161 ITD 304 (Mum)

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