TAX FLASH NEWS

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Support services are taxable as FTS under the India-UK tax treaty. However, consultancy services which are merely advisory in nature are not taxable as FTS

Recently the Authority of Advance Ruling (AAR) in the case of Aircom International Ltd.[1] (the applicant) dealt with the issue of taxability of support services provided under the Management Service Agreement (MSA). The AAR held that the payment made by the Indian entity to the applicant for the services with respect to the direct technical advice, support and management including implementation service relating to Information Technology (IT) are taxable as Fees for Technical Services (FTS) as such services were satisfying the 'make available' condition under Article 13(4) of the India-UK tax treaty (tax treaty).

The consultancy services which are merely advisory in nature and which merely involve discussion and advice of routine nature or exchange of information, do not fulfil the requirement of 'make available' condition and cannot be treated as FTS under Article 13(4)[2] the tax treaty.

The payment under the MSA was in respect of actual rendering of the services and not towards right to use the Intellectual Property Rights (IPRs). Further the AAR held that the amount received by the applicant towards the services rendered under the MSA would not be in the nature of royalty.

Facts of the case

The taxpayer is a non-resident entity engaged in business of software solutions and consultancy business in the area of telecommunications. The taxpayer entered into a MSA with its subsidiaries including Indian subsidiary wherein it provides management support services with a view to rationalise and standardise the business conducted by Indian subsidiary in accordance with the international best practices. The services as per the MSA includes establishment and set-up advice and services, general management advice and services, group bulk purchasing arrangement, group-led sales, marketing and business development services, general treasury and financial management advice and services and legal, human resource, IT services, etc. The taxpayer filed an application before the AAR to determine taxability in connection with this MSA.

AAR ruling

FTS – ancillary and subsidiary to the services rendered for which royalty paid

On reference to the terms of the agreement it indicates that the parent i.e. the applicant is the beneficial owner of the IPRs subsisting in and associated with the services and their provisions. In terms of MSA, the applicant agreed that for the provision of various services to the subsidiaries and the clause regarding IPR merely entitled the subsidiaries to enjoy the benefit of the services without violation of IPR rights of the applicant. The payment under the MSA was in respect of actual rendering of the services and not towards right to use the IPR. If no service was rendered to any subsidiary nothing was payable by it.

In order to include FTS under Article 13(4)(a)[3] or 13(4)(b)[4] of the tax treaty, there has to be payment of royalty and the services have to be ancillary and subsidiary to the services for which royalty is being paid.

In the present case, there was no consideration for the use of, or the right to use, any industrial, commercial or scientific equipment. Therefore, Article 13(4)(b) of the tax treaty was not attracted. There was payment on account of consideration for the use of, or the right to use, technology under software license, maintenance and technical support services agreement (SLA) but

[1] Aircom International Ltd. (AAR No. 1329/2012) – Taxsutra.com
[2] Article 13(4) of India-UK tax treaty defines FTS as payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including the provisions of services of technical or other personnel) which fulfills the specified conditions
[3] The services will qualify as FTS only if they are ancillary and subsidiary to the services rendered for which royalty referred to Article 13(3)(a) is being paid
[4] The services will qualify as FTS only if they are ancillary and subsidiary to the enjoyment of property for which royalty as referred Article 13(3)(b) is being paid

there was no royalty payment as per the agreement. The taxpayer stated that only the costs incurred for these services along with a mark-up and there was no stipulation of payment of any royalty. Further, the sub-licensed softwares were being traded by the Indian entity and the taxpayer was getting only a part of the turnover. In the absence of any royalty payment, Article 13(4)(a) of the tax treaty would not get attracted.

FTS – technical, consultancy services vis-à-vis managerial services

On an analysis of Article 13(4)(c)[5] of the tax treaty, there are two limbs to this Article, firstly, it is required to be established whether the consideration is for rendering of technical/consultancy services and secondly, whether those services 'make available' the technology to the recipient. The applicant contended that the services rendered as per the MSA were not technical or consultancy services but were managerial in nature. However, it has not been demonstrated as to how the services rendered were managerial and not technical or consultancy services.

The meaning and the scope of the term technical and consultancy services was considered by the AAR in the case of Intertek Trading Services India (P) Ltd.[6] Where it was held that the expression 'technical services' cannot be construed in a narrow sense. It has been observed that the term 'technical' ought not to be confined only to technology relating to engineering, manufacturing or other applied sciences. Professional service imbued with expertise could be regarded as technical service. Applying the above ruling in the present case, these services giving knowledge and experience of the telecommunication industry to Indian subsidiary is not found to be managerial but rather mostly technical in nature. On reference to MSA it was clarified that the applicant did not render services related to the pricing of software consultancy services which are rendered by Indian subsidiary to its third-party customers.

Obtaining the entire e-mail correspondence, which are not connected with the services rendered, will have no relevance as the AAR have to only examine the correspondence pertaining to the services rendered. The services rendered in setting-up and maintaining strategic management support, target setting, direct customer negotiation, business review and consultation, sales, marketing and business development services including vendor management, sales presentations, general treasury and financial management advice and services, legal services including contract management, contract negotiations and advice, legal compliance assistance, consulting including advice on pricing, customer negotiations, customer management etc., human resource services, information technology (IT) and solution services including network sharing development and strategic development, advice on sales presentations, training of IT engineers/employees etc. are all technical services which cannot be provided without the domain knowledge of the relevant field. Thus, the majority of the services are technical in nature and the remaining one are in the area of consultancy. Therefore, AAR did not agree with the submission that they were only managerial in nature and not in the nature of technical or consultancy services.

Fees for technical services – make available conditions

The AAR in the present case observed that the nature of services were such that the technical knowledge, skills etc. was not passed on or did not remain with the recipient of the service, except in the case of 'direct technical advice, support and management' which is part of IT services. The training provided by the taxpayer was found to be in respect of technical aspect of new launch of various software programmes and was meant for sales personnel. Such training cannot be said to have made available any technical knowledge based on which such new software modules could be developed by Indian subsidiary independently.

Similarly, in the legal and financial services some input from the other party is necessary to provide the service. In the case of contract management/negotiations, financial management, etc. advice has to be given on the basis of the relevant facts and there has to be two-way communication. Therefore, even if the taxpayer has sought certain clarifications or given options to Indian subsidiary while rendering such services it does not mean that the inherent legal or financial competence of the taxpayer was passed on to Indian subsidiary. The consultancy services which are merely advisory in nature and which merely involve discussion and advice of routine nature or exchange of information, do not fulfil the requirement of make available.

However, such competence is made available when a 'Direct Technical Advice and Support' was given under IT services. The taxpayer was rendering specific services under IT services i.e. wide area network, server management, exchange system, help desk, and direct technical advice, support and management including implementation. All functions were general in nature but the 'Direct Technical Advice and Support' was in respect of specific technical issue. The technical advice in respect of the problem faced by the clients was rendered through the employee of Indian subsidiary only. Thus, the services in the nature of direct technical advice, support and management including implementation were not only technical in nature but were also made available to Indian subsidiary.

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[5] The term 'fees for technical services' means payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design.

[6] Intertek Trading Services India (P) Ltd. [2008] 307 ITR 418 (AAR)

Such advice was not in respect of any outage on the Aircom network or troubleshooting of malfunctions in the IT infrastructure, rather it was in respect of the specific technical problem faced by the clients of Indian subsidiary, which was flagged to the taxpayer for resolution and the solution of which was provided through the employees of Indian subsidiary. Therefore, this service was not only technical in nature but was also made available. Accordingly, the AAR held that the payment received for various services in terms of the MSA was not managerial but technical in nature. However, only 'direct technical advice, support and management including implementation' service provided under Information Technology (IT) service meets the requirement of 'make available' under Article 13(4) of the tax treaty.

Royalty

The scope of MSA states that the applicant has to provide information on various business and commercial matters, guidelines, templates, best practices and strategies that could be adopted by the Aircom Group and is aimed at providing uniformity and seamless quality in business dealings of the participating network entities. By no stretch of logic, it could be said that payment for these services under MSA was for the supply of any knowledge or information. The passing on of applicant's experience in network planning, optimization, open source software and consultancy for mobile networks etc. to Indian subsidiary was not in the scope of MSA. These core activities were not part of MSA and were not rendered by the applicant under MSA.

The payment under the MSA was in respect of actual rendering of the services and not towards right to use the IPR. It was also held that only because the transfer pricing under the SLA was excluded from the 'total gross trading revenue' for the purpose of calculating the service fee payable under MSA, it did not establish that the services provided under MSA were ancillary and subsidiary to the services under SLA. Therefore, the AAR held that the amount received by the applicant towards the services rendered under the MSA would not be in the nature of 'Royalty'. The decision of Oncology Services India Pvt. Ltd.[7] relied on by the tax department is distinguishable on facts of the present case.

Business income

In order to constitute a Service PE in India the services including managerial services must be furnished by the taxpayer for a period or periods aggregating more than 30 days within any 12-month period in the case of an associated enterprise. A mere stay of an employee doesn't establish that he had rendered the service all the time. In order to attract the Service PE provision there has to be concrete evidence to establish that the service was rendered through an employee for 30 days or more. In the absence of such, the AAR held that there cannot be said that any service PE was created in the present case. The services under MSA is found to be covered under Article 13 of the tax treaty, it does not have a PE in India. As no business was carried out in India and in the absence of any PE, the payment for the services rendered under MSA cannot be considered as business income.

Our comments

The issue with respect to the taxability of FTS / royalty has been a subject matter of debate before the Courts/Tribunal.

The Mumbai Tribunal in the case of Shell Information Technology International BV[8] held that the payment for restricted software/network access and related IT support services to Indian entities could not be treated as royalty. Further technical and advisory services to various clients under MSA by the taxpayer, a Netherland based company engaged in business of providing information technology support services could not be said as FTS as the services did not make available any technical knowledge, skill, experience etc. to service recipients and thus, said services would not be liable to tax in India.

However, the Mumbai Tribunal in the case of Aktiebolaget SKF[9] held that IT services rendered by the taxpayer are subservient to the royalty agreement and are ancillary and subsidiary to the main frame royalty agreement entered into by both the parties. Since, the taxpayer has already a royalty agreement under which it transfers its knowledge in relation with the products covered under the royalty agreement, it would be taxable as FTS under the India-Sweden tax treaty. Such services make available technical knowledge, skill, process etc.

The AAR in the present case has held that the payment made by the Indian entity to the applicant would be characterised as FTS under Article 13(4) of the tax treaty only in respect of direct technical advice, support and management including implementation service provided under IT service as such services were satisfying the 'make available' condition. However, consultancy services which are merely advisory in nature are not taxable as FTS.

[7] Oncology Services India Pvt Ltd [TS-209-ITAT-2017(Ahd)]

[8] Shell Information Technology International BV v. DCIT [2020] 182 ITD 294 (Mum)

[9] Aktiebolaget SKF v. DCIT [2020] 181 ITD 695 (Mum)

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