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TAX FLASH NEWS

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Consultancy services do not satisfy 'make available' conditions and hence are not taxable as FTS under the India-US tax treaty

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Hero Motocorp Ltd[1] (the taxpayer) dealt with the issue of taxability of consultancy services in relation to scenario planning exercise initiated by the taxpayer for two-wheeler industry. The Tribunal held that the consultancy services in relation to scenario planning exercise are not taxable as Fees for Technical Services (FTS) within the meaning of Article 12(4) of India-US tax treaty (the tax treaty) as it did not 'make available' any technology or technical knowledge to the taxpayer. Therefore, the payment was not liable for deduction of tax at source under Section 195 of the Income-tax Act, 1961.

Further, the Tribunal held that expenditure does not result in enduring benefit to the taxpayer. The expenditure was part and parcel of the existing business, incurred to gain some insight of the future outlook of the two-wheeler industry. Thus, the expenditure in nature of consultancy charges was not capital in nature.

Facts of the case

During the Assessment Year 2005-06, the taxpayer made payment to a professor from Harvard University, a US resident, towards the consultancy charges for the services rendered in relation to scenario planning exercise for two-wheeler industry initiated by the taxpayer. The planning exercise was aimed at identifying the key variables impacting the two-wheeler industry and establishing the early warning signal. After studying the two-wheeler industry, the advice was given to the taxpayer relating to future prospects. The taxpayer paid the consultancy fees without deducting tax at source (TDS).

The Assessing Officer (AO) observed that the payment was taxable as FTS under Section 9(1)(vii) and disallowed the same under the provisions of Section 40(a)(i). Alternatively, the AO held that the aforesaid expenditure resulted in enduring benefit to the taxpayer through the study conducted by the vendor and, therefore, the expenditure was a capital expenditure, which was not allowable as a revenue expenditure under Section 37(1).

The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the disallowance made by the AO and also held that the foreign service provider had 'made available' advice to the taxpayer and thus services were taxable as FTS.

Tribunal's decision

The Tribunal observed that the foreign national had only made available its findings of the scenario planning exercises conducted by him as a professional, but did not make available his knowledge, which was used for conducting the aforesaid exercise. The Tribunal relied on the decision of Delhi High Court in the case of Guy Carpenter & Co Ltd[2] to support its case. The Tribunal held that the payment did not 'make available' technical know-how/knowledge of the foreign national to the taxpayer in India and thus, the payment was not taxable in India. Accordingly, the taxpayer was not required to deduct tax at source on such payments.

The Tribunal rejected the alternate contention of the AO to treat the payment as capital expenditure. The Tribunal observed that the taxpayer is a large sized company already existing in the business of manufacturing two wheelers since past several years. The specified expenditure constitutes a miniscule part of the total expenditure incurred by the taxpayer. The aforesaid expenditure did not result in providing any benefit of enduring nature. The expenditure was part and parcel of the existing business, incurred to gain some insight of the future outlook of the two-wheeler industry. Thus, the Tribunal held that the aforesaid expenditure was not capital in nature.

Accordingly, the Tribunal held that the disallowance made by the AO was wrong in law.

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[1] Hero Motocorp Ltd. v. ACIT (ITA No. 6282 & 6302/Del/2015) – Taxsutra.com Note – The Tribunal in this decision has dealt with several issues. However, this flash news deals with the taxability of FTS.

[2] DIT v. Guy Carpenter & Co Ltd [2012] 346 ITR 504 (Del)

Our comments

Normally, where services rendered are simply in the nature of 'consultancy services', it do not 'make available' any technical knowledge, skill or know-how. Merely because consultancy services have technical inputs, these services do not become technical services and simply because the recipient of a technical consultancy services learns something with each consultancy, there is no transfer of technology.

The Ahmedabad Tribunal in the case of Sun Pharmaceutical Laboratories Ltd.[3] held that consultancy services are inherently of such nature that these cannot be said to be covered by 'make available clause' in the tax treaties for the reason that while these services, may require technical inputs, mere rendition of these services does not, by itself, result in transfer of such technical knowledge, skills or experience.

An incidental benefit, by way of enrichment of experience, to the recipient of a consultancy service may not amount to make available technical knowledge, skills or experience. The important factor is there should be transfer of service provider's specific knowledge to the recipient. In this regard, the Ahmedabad Tribunal in the case of Bio Tech Vision Care (P.) Ltd.[4] held that since consultancy services do not result into transfer of technology, technical knowledge, skills, etc., such services do not make available the technology.

In the instant case also, the Tribunal observed that the taxpayer was only made available its finding and not his knowledge.

Thus while analysing whether the services are satisfying 'make available' conditions, it is important to consider following principles:

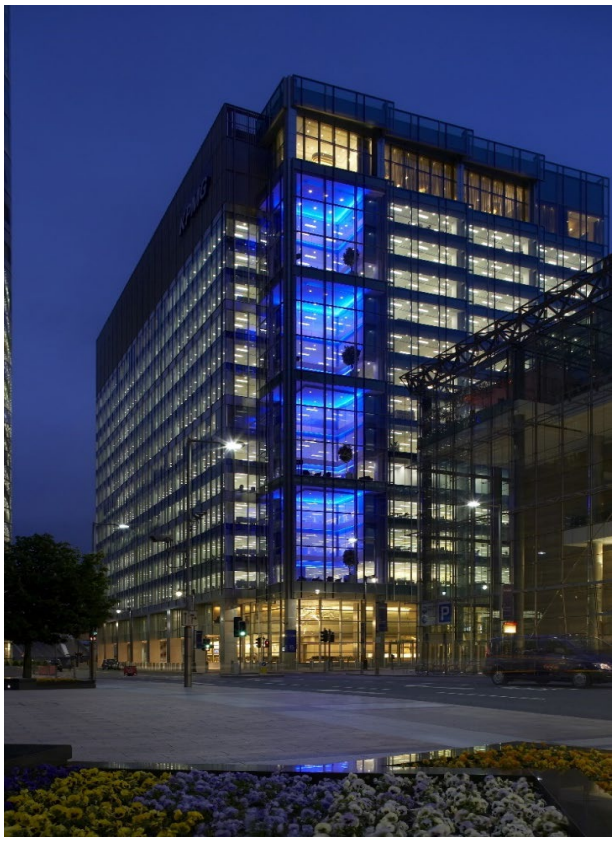
- Technology is considered 'made available' when the service recipient is enabled to absorb and apply technology/skills/knowledge provided by the services provider.[5]
- The service recipient is able to make use of technical knowledge by himself without recourse to the service provider in future.[6]

While specifically dealing with the consultancy services[7], the Court/Tribunal dealt with the above principles and observed that technical knowledge, experience, skill continued to remain with the taxpayer even after conclusion of the services. Therefore, services were not made available by the taxpayer for future use or utilization.

However, the Bangalore Tribunal in the case of Nilgiri Dairy Farm (P.) Ltd.[8] on applying the above principles observed that the taxpayer would be able to use consultancy services for its enduring benefit in the succeeding years without any assistance of the consultant. Therefore, provision of such consultancy services satisfied 'make available' conditions and they were taxable as FTS.

Thus it is important to examine the agreement between the service provider and the service recipient, nature of services, etc. to determine whether 'consultancy services' satisfy the 'make available' conditions.

In this decision consultancy services are provided by an individual consultant (a professor from foreign University). Thus such services could be tested under Independent Personal Services (IPS) Article under the India-US tax treaty. There is a thin line of distinction between IPS and FTS. Generally, if services are covered under both, i.e. FTS and IPS, then IPS being a specific provision would be considered over FTS being a general provision and taxed accordingly. The taxability of services under IPS Article in the source state depend upon the satisfaction of period of stay in India and availability of fixed base in India. Also, FTS clause in certain tax treaties like the India-US tax treaty in the instant case, specifically provides that the income covered in IPS clause would be excluded from the FTS clause.



[3] DCIT v. Sun Pharmaceutical Laboratories Ltd [2018] 96 taxmann.com 105 (Ahd)
[4] DCIT v. Bio Tech Vision Care (P.) Ltd. [2018] 93 taxmann.com 20 (Ahd)
[5] MOU to India-US tax treaty, Dell International Services India (P.) Ltd. [2008] 305 ITR 37 (AAR)
[6] CIT v. De Beers India (P.) Ltd [2012] 346 ITR 467 (Kar), Raymond Ltd v. DCIT [2003] 86 ITD 791 (Mum), , ITO v. Skill Infrastructure Ltd [2015] 70 SOT 186 (Mum)
[7] DDIT v. Preroy A.G. [2010] 39 SOT 187 (Mum), DCIT v. Andaman Sea Food (P.) Ltd [2012] 52 SOT 562 (Kol), Endemol India (P.) Ltd [2014] 361 ITR 340 (AAR)

[8] Nilgiri Dairy Farm (P.) Ltd. v. ITO [2017] 162 ITD 109 (Bang)

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