

# TAX FLASH NEWS

21 October 2021

## IT support services provided by foreign entities are standard automated services, not taxable as FTS under the Income-tax Act

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case Hitachi Metglas (India) Pvt. Ltd.<sup>1</sup> (the taxpayer) dealt with the issue of taxability of IT support services provided by non-resident entities for standard connectivity and networking services. The Tribunal held that standard automated services received over internet are not taxable as Fees for Technical Services (FTS) since there was no human intervention in the supply of such services. Where the entire process resulting in provisioning of service is fully automated process, charges paid for provision of such services cannot be classified as FTS under the Income-tax Act, 1961 (the Act).

### Facts of the case

During the assessment year 2011-12, the taxpayer, an Indian company, paid for support and analysis system provided by three AEs located in U.S.A., Singapore and Japan respectively. With this support system and analysis, the taxpayer was producing certain articles or things in India.

The Assessing Officer (AO), with regard to FTS, held that the services rendered require expertise and knowledge in the specific area of work and such expertise cannot be developed overnight but it is the result of long period of work in this line of activities coupled with accumulated experience of operations. Hence, the payments made by the taxpayer to the AEs partakes the character of FTS under the Act. The Commissioner of Income-tax (Appeals) [CIT(A)] confirmed the action of the AO.

### Tribunal's decision

The Tribunal observed that the services provided by a non-resident AEs to the taxpayer were standard automated services. Those services were provided to enable the taxpayer to send and receive data through the broadband network over the intranet and internet. All companies of the taxpayer's group were provided with network services to exchange information through intranet and regulate the use of internet through its proxy servers or provide remote access to log-on to the company's network. It is a settled law that standard/common services cannot partake the character of FTS under the Act.

The Madras High Court in the case of Skycell Communications Ltd.<sup>2</sup> held that call charges received from telecom operators from firms and companies subscribing to cellular mobile services provided by them do not fall within the definition of technical services under Section 194J read with Section 9(1)(vii) as it was a mere collection of fees for use of a standard facility.

Further, reliance was placed on the decision of the Supreme Court in the case of Kotak Securities Ltd.<sup>3</sup> where it was held that common or standard services provided to every member who wants to trade on the stock exchange cannot be termed as FTS under Explanation 2 to Section 9(1)(vii) of the Act. Further, reference was also made to various decisions<sup>4</sup>.

<sup>1</sup> Hitachi Metglas (India) Pvt. Ltd. v. DCIT (ITA No. 3694/Del/2016) – Taxsutra.com

<sup>2</sup> Skycell Communications Ltd. v. DCIT [2001] 251 ITR 53 (Mad)

<sup>3</sup> CIT v. Kotak Securities Ltd. [2016] 383 ITR 1 (SC)

<sup>4</sup> CIT v. Media Worldwide (P.) Ltd. [2020] 275 Taxman 272 (Cal), CIT v. ESTEL Communication (P.) Ltd. [2000] 318 ITR 185 (Del)

Payment of network charges does not take the character of FTS due to absence of human intervention. Hence, the services received by the taxpayer can be said to be not in the nature of FTS as defined under Explanation 2 to Section 9(1)(vii) of the Act. To treat any consideration as FTS, such consideration must be paid for rendering of managerial, technical or consultancy services.

The extracts of the agreement relied on by lower authorities do not indicate that the IT support services were provided through human intervention. By their very nature and inherent characteristics, networking services over internet and intranet including mail services cannot be provided by human activities and intervention. The extract of the agreement does not demonstrate in any manner that human intervention was required for rendering such IT support services.

The obligation to share information, confidentiality and other obligations were standard obligations that were provided in any services agreement and do not deal with the manner of provisioning of services but with ancillary obligations of the parties. Reference was made to the decision of the Delhi High Court in the case of Bharti Cellular Ltd.<sup>5</sup>

Accordingly, the Tribunal held that the foreign AE (service provider) had neither employed any technical or skilled person to provide managerial or technical service nor there was direct interaction between the taxpayer and the foreign AE. Thus, where the entire process resulting in provisioning of service was fully automated process with no human intervention, charges paid for provision of such services cannot be classified as FTS for the purpose of the Act.

The Tribunal referred to various decisions<sup>6</sup> and held that the taxpayer was not liable to deduct tax on such expenditures. Accordingly, the disallowance made by the lower authorities was deleted.

## Our comments

FTS is defined in Explanation 2 to Section 9(1)(vii) of the Act to provide that any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services including the provision of services of technical or other personnel, subject to certain exceptions. To determine whether services are FTS in nature or not, 'human intervention' is one of the important factors.

<sup>5</sup> CIT v. Bharti Cellular Ltd. [2009] 319 ITR 139 (Del)

<sup>6</sup> Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT [2021] 281 Taxman 19 (SC), CIT v. Kotak Securities Ltd. [2016] 239 Taxman 139 (SC), CIT v. Bharti Cellular Ltd. [2011] 330 ITR 239 (SC)

Courts in various cases<sup>7</sup> have held that payments made for use of standard facility provided by the service provider, even where it involves use of sophisticated equipment and trained personnel by the service provider, cannot be construed as FTS under the Act. Further services in which human intervention is not required are not covered within the scope of Section 9(1)(vii) of the Act.

The Kolkata Tribunal in the case of Right Florists Pvt. Ltd.<sup>8</sup> held that there was no human touch involved in the entire process of online advertisement on search engines of Google and Yahoo. Therefore, even if such services are technical in nature it cannot be taxed as FTS.

MOU to the India-U.S. tax treaty provides that a 'technical' service means a service requiring expertise in technology. Further, OECD TAG Report provides that the word 'technical' involves special skills or knowledge related to a technical field. Use of technology in providing a service is not determinative and delivery of a service via technological means does not make the service technical.

The Tribunal in the present case has held that standard automated services received over internet are not taxable as FTS since there was no human intervention in the supply of services.

It is important to note that Equalisation Levy (EL) provisions will not apply if consideration is taxable as Royalty/FTS under the Act read with tax treaty. However, if the services are not taxable as Royalty/FTS under the Act read with tax treaty, it would be important to carefully examine the EL provisions.

<sup>7</sup> CIT v. Bharati Cellular Ltd [2008] 175 Taxman 573 (Del), Pacific Internet India Pvt. Ltd., [2009] 318 ITR 179 (Mum), Skycell Communications Ltd. v. DCIT [2001] 251 ITR 53 (Mad), Vodafone Digilink Ltd. v. CIT [2017] 87 taxmann.com 315 (Del), Vodafone East Ltd. v. ACIT [2015] 61 taxmann.com 263 (Kol), Metro & Metro v. ACIT [2014] 20 ITR(T) 772 (Agra), CIT v. Siemens Ltd. [2013] 23 ITR(T) 86 (Mum), Atos Information Technology HK Ltd v. DCIT [2017] 79 taxmann.com 26 (Mum), Lufthansa Cargo India (P.) Limited v. DCIT [2004] 91 ITD 133 (Del)

<sup>8</sup> ITO v. Right Florists Pvt. Ltd. [2013] 32 taxmann.com 99 (Kol)

## KPMG in India addresses:

### Ahmedabad

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

### Bengaluru

Embassy Golf Links Business Park,  
Pebble Beach, 'B' Block,  
1st & 2nd Floor,  
Off Intermediate Ring Road, Bengaluru –  
560071  
Tel: +91 80 6833 5000

### 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

2nd Floor, Block T2 (B Wing),  
Lodha Excelus, Apollo Mills  
Compound, N M Joshi Marg,  
Mahalaxmi, Mumbai- 400011  
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

[home.kpmg/in](http://home.kpmg/in)



[home.kpmg/in/socialmedia](http://home.kpmg/in/socialmedia)



The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011  
Phone: +91 22 3989 6000, Fax: +91 22 3983 6000

© 2021 KPMG Assurance and Consulting Services LLP, an Indian Limited Liability Partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved.

The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

This document is meant for e-communication only.