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TAX FLASH NEWS

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Management support services are not taxable as FTS under the India-Singapore tax treaty

Executive summary

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Inter-Continental Hotels Group (Asia Pacific) Pte. Ltd.[1] (the taxpayer) dealt with the issue of taxability of management support services provided to an Indian company under the India-Singapore tax treaty (tax treaty). The Tribunal held that receipt from management support services in terms of hotel management operations are not taxable as Fees for Technical Services (FTS) under the tax treaty since such services do not make available technical knowledge, experience, skill, know-how or processes, etc.

With respect to the reliance placed on the Memorandum of Understanding (MOU) of the India-US tax treaty, it has been observed that one can look into the Protocol attached to a treaty between two countries to find the meaning of an expression used in the tax treaty. However, reference to the tax treaty to which two countries are not parties, would not be appropriate. It can at the best has persuasive value.

Facts of the case

The taxpayer, a private company incorporated in Singapore, is a part of the Inter-Continental Hotels Group (IGH). The taxpayer is engaged in the business of franchise/license, operate and manage hotels operating under different hotel brands of IHG in the Asia Pacific region. The taxpayer being the regional headquarters for the Asia Pacific region of the IHG Group, is the economic and beneficial owner of various hotel brands including 'InterContinental', 'Holiday Inn' and 'Crowne Plaza'.

The taxpayer has centralised departments which provide services in the nature of operational support, accounting and legal support, information technology related services etc. to its subsidiaries/affiliates in the Asia-Pacific region for operational efficiency and consistency. The amount charged by the taxpayer to IHG India for such support services is determined based on certain allocation keys (fee charged) to be applied to 'total management pool costs'. During AY 2012-13, management support charges of an amount of INR 54.38 million has accrued to the taxpayer for providing such support services to IHG India. The taxpayer did not offer the aforesaid receipts to tax contending that the support services do not constitute FTS as envisaged under Article 12(4)[2] of the tax treaty.

The Assessing Officer (AO) observed that the services of the taxpayer were not merely support services but managerial consultancy services which fall in purview of consultancy services. It was observed that the term 'make available' is not defined in the India-Singapore tax treaty, and the taxpayer cannot take benefit of India-U.S. tax treaty where the term 'Fees for included Services' (FIS) has been defined.

The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO. The CIT(A) held that it was not merely a service but equipping of the resource of the recipient entity for their capacity building in order to manage the operations hotels owned by third parties. The CIT(A) held that the payment for management, support service is held to be FTS except for payment of Information Technology Services.

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[1] Inter-Continental Hotels Group (Asia Pacific) Pte. Ltd., v. ACIT (ITA No. 4524/Del/2017) – Taxsutra.com

[2] As per Article 12(4) of the tax treaty between India and Singapore, the term ' fees for technical services' means payments of any kind received as a consideration for services of a managerial, technical or consultancy nature if such services:
(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a
payment described in paragraph 3 is received; or
(b) make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the
services to apply the technology contained therein; or
(c) consist of the development and transfer of a technical plan or technical design, but excludes any service that does not
enable the person acquiring the service to apply the technology contained therein.

Tribunal's decision

The taxpayer started charging management support services from FY 2011-12. So, it is the first year when the management support services were provided to IHG India. As regards the reliance placed by the taxpayer to the meaning of 'make available' in the MOU of India-US tax treaty, it was observed that a Convention is a treaty entered into by two sovereign States relating to rights and duties of subjects or citizens of the respective States in one another's possession. No doubt one can look into the Protocol attached to a treaty between two countries to find the meaning of an expression used in the tax treaty, but to refer to a tax treaty to which two countries are not parties, would not be appropriate. It can at the best has persuasive value.

The expression 'make available' only means that the recipient of the service should be in a position to derive an enduring benefit and be in a position to utilise the knowledge or know-how in future on his own.

There was no dispute that IHG India has received the services[3] from the taxpayer in terms of management service agreement. As per the terms of agreement, the taxpayer provides highly technical services which were used by IHG India for taking managerial decision, budgeting & accounting decision, risk management decision, etc. The knowledge and expertise in the field of hotel operation and management & related areas which was accumulated through study, experience and experimentation with regard to management, budgeting, risk, etc. of the same business is nothing but a technical knowledge.

The Andhra Pradesh High Court in the case of G.V.K. Industries Ltd.[4] had held that the advice given by non-resident company in taking a financial decision either to procure loan or to strengthen the finance would be a technical or consultancy services. In reference to the said decision, it was observed that the advice given related to managerial including operational and financial aspects would be tantamount to delivery of managerial, consultancy or technical services.

Further, in the case of Obreroi Hotels (India) Pvt. Ltd.[5], the Supreme Court echoed the fact that management support involves great deal of expertise, skill and technical knowledge. Accordingly, there was no doubt that the services rendered by the taxpayer were in the nature of managerial/technical/consultancy services.

The Tribunal referred the agreement and the TP study report of the IHG India with regard to the services provided and observed that the operational support such as providing advice, information and competitive expertise to local general CMH Hotel management on the operation of hotels is in accordance with brand standards for maintaining the qualification available with regard to the international hotel business. Taxpayer's management techniques, managerial plan and actions, advising local general management on trends and changes in the hotel business in general and advice on the production of operating and capital budgets are consistent with the strategic plan. Therefore, it can at best be the managerial consultancy service but not the services made available so that the recipient can use or replicate such services received from the taxpayer.

With regard to accounting support, the Tribunal posed a pertinent question as to why not the accounting support given be treated as the technical knowledge 'made available'. It was held that the accounting support given was in relation to the preparation of balance sheet and modalities and to advice production of reports regarding the budgets from time to time and the services are rendered repetitively based on the requirements of the clients and hence it cannot be treated as a service which was 'made available' to be applied independently and in times to come. The Tribunal agreed with the contentions raised by the taxpayer.

Similarly, the services rendered in connection with training & recruitment and manpower specification, it was observed that there was neither technology transfer, knowledge transfer nor transfer of any skill or know-how. Hence, it was held that the provisions of the Article 12(4) could not be applied to the services rendered by the taxpayer in the strict sense of the provisions of the tax treaty.

Services provided by the taxpayer did not 'make available' technology, skill, know-how, etc. Therefore, such services cannot be taxed as FTS under the tax treaty.

Our comments

The term 'fees for technical services' is defined in Explanation 2 to Section 9(1)(vii) of the Income-tax Act, 1961 (the Act). The said term is also defined in various Indian tax treaties. The normal definition of FTS is more or less on similar lines under the Act as well as in the tax treaties. However, certain tax treaties (e.g., UK, USA, Singapore, etc.) depart from the normal definition. The key difference is that as against reference to 'rendering of' technical services, the stress is on 'make available' technical knowledge, experience, skill, know-how or process etc.

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[3] Operational support, Analytical and accounting support, legal advice, Information Technology, Purchasing, Personnel and Training, etc.
[4] G.V.K. Industries Ltd. v. ITO [1997] 228 ITR 564 (AP)
[5] CBDT v. Obreroi Hotels (India) Pvt. Ltd. [1998] 97 Taxman 453 (SC)

In the case of CESC Ltd.[6] the Kolkata Tribunal considered the meaning of 'make available' in the context of FTS as appearing in the India-UK tax treaty. The provisions of India-UK tax treaty are in pari-materia with the definition of the said term in India-US tax treaty. Therefore, the Tribunal held that the Explanation given in India-US tax treaty will also apply to India-UK tax treaty. Similar view has been taken by the various benches of Tribunal, and AAR in a various cases[7].

However, the AAR in the case of Perfetti[8] has taken a different view. The AAR, with reference to the Netherlands tax treaty, observed that the expression 'made available' used in India-Netherlands tax treaty cannot be interpreted in the same manner as the term has been interpreted in Indo-US tax treaty. The AAR comprising a two-member bench effectively differed from its own ruling given by the three-member bench in Intertek Testing Services India P Ltd[9] without assigning any cogent reasoning.

The Tribunal in the present case with respect to the reliance placed on the MOU of India-US tax treaty observed that one can look into the Protocol attached to a treaty between two countries to find the meaning of an expression used in the tax treaty. However, reference to the tax treaty to which two countries are not parties, would not be appropriate. It can at the best has persuasive value.

The Tribunal analysed the services provided by the taxpayer and held that receipt from management support services provided to the Indian entity in terms of hotel management operations are not taxable as FTS under the tax treaty since such services do not make available technical knowledge, experience, skill, know-how or processes, etc.

[6] CESC Ltd. v. CIT [2003] 275 ITR 15 (Kol)
[7] DCIT v. Boston Consulting Group P Ltd. [2005] 280 ITR 681 (Mum), McKinsey & Co. Inc. (Philippines) [2006] 99 ITD 549 (Mum), Raymond Ltd. [2003] 80 TTJ 120] (Mum), NQA Quality Systems Registrar Ltd. v. DCIT [2004] 2 SOT 249 (Del), CESC Ltd v. DCIT [2003] 275 ITR 15 (Kol) and National Organic Chemical Industries Ltd. [2005] 96 TTJ 765] (Mum)
[8] Perfetti Van Melle Holding B.V. [AAR No 869 of 2010, dated 9 December 2011]
[9] Intertek Testing Services India P Ltd [2008] 307 ITR 418 (AAR)

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