

TAX FLASH NEWS

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Plant design and drawing related services are not taxable as royalty but FTS. In the absence of FTS clause under the India-UAE tax treaty, it is taxable as business income and in the absence of PE, no taxability in India

Executive Summary

Taxability of Royalty and Fees for Technical Services (FTS) has been a controversial issue considering various types of services provided in this globalised era. The issue becomes vexed when a particular income (FTS) clause is absent in some of the Indian tax treaties. Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Kalpataru Power Transmission Ltd¹ (KPTL) dealt with the issue of deduction at tax source on the payment made by an Indian company to the UAE entity for the hydropower plant design, drawings and related services. The Tribunal held that the payment for such services were in the nature of FTS but not royalty. Further in the absence of FTS clause in the India-UAE tax treaty, such payments are taxable as business income. The UAE entity did not have a Permanent Establishment (PE) in India and thus income was not taxable as a business income. Accordingly, the Indian company was not required to deduct tax at source on the payments made to the UAE entity.

Facts of the case

- KPTL, is an Indian Company, engaged in the business of Engineering, Procurement and Construction (EPC) Contracts relating to infrastructure facilities.
- The EPC contract was awarded to the Chinese company by the Government of Uganda for the hydropower plant and its associated transmission lines. The Chinese company subcontracted the work of design, manufacture, testing and installation etc. to consortium between KPTL and another Chinese company.

- For this purpose, the branch office of KPTL situated at Uganda obtained services from the UAE entity. KPTL entered into service agreement with the UAE company for carrying out project specification study, preparation of tower designs, preparation of structural drawings of tower, preparation of tower test data documents, etc. For the said services, KPTL made payment to the UAE entity and did not deduct tax at source on the ground that such payment was not chargeable to tax in India.
- The TDS Officer held that such payment was in the nature of royalty under Section 9(l)(vi) and hence the taxpayer was liable to deduct tax at source.

Tribunal's decision

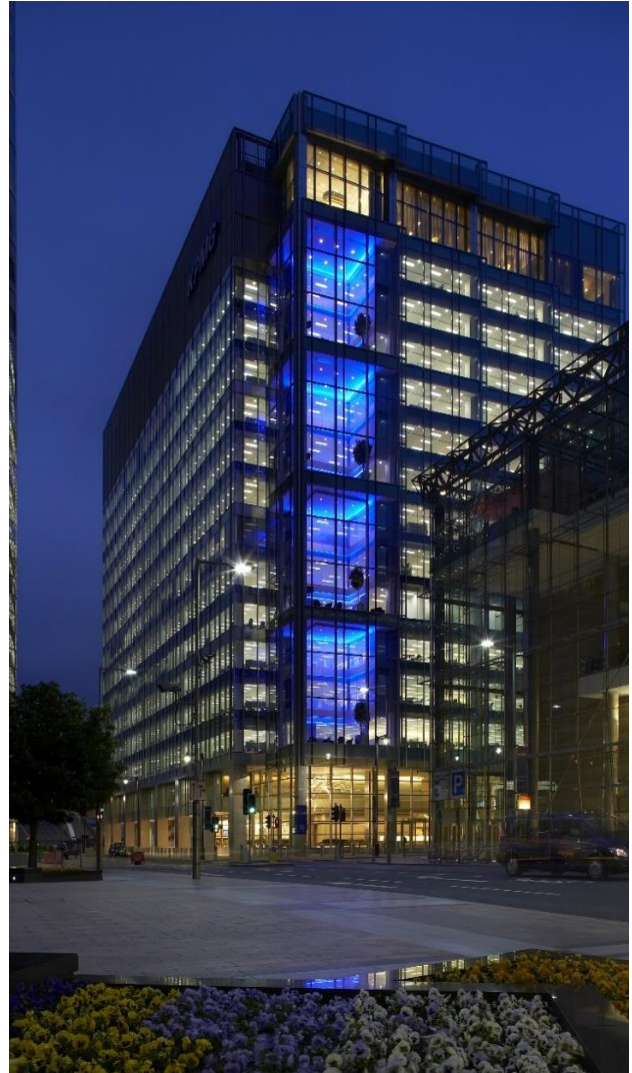
- There was no existing tower structure design or data which was supplied to KPTL by the UAE entity. The UAE entity was required to create a new design in the course rendering the service based on the specifications provided by KPTL.
- Payments were made to the UAE entity to carry out the services of project specification study, preparation of tower designs, preparation of structural drawings of tower, preparation of tower test data documents, etc. and various other services as mentioned in the service agreement. Therefore, such payments were in the nature of FTS and not Royalty.

¹ DCIT v. Kalpataru Power Transmission Ltd (ITA No. 35/Ahd/2021) – Taxsutra.com

- The FTS clause is missing in the India-UAE tax treaty. Relying on various decisions², it was held that in absence of FTS clause in the India-UAE tax treaty, payment for the services to the UAE entity could be taxed in India as business income subject to existence of a PE in India.
- The UAE entity did not have a PE in India and therefore such services were not taxable as business income.
- Accordingly, KPTL was not required to deduct tax at source on payments made to the UAE entity.

Our comments

While dealing with the taxability of technical services when FTS article is missing in the tax treaty, the Courts have treated such services to be taxable in different manner depending upon facts of each case and related jurisprudence. For example, in some of the cases such services have been taxed as business income whereas in a few cases they are taxed under 'other income' article. There are few cases where the taxability has been examined under the Income-tax Act, 1961 because of specific language of the 'other income' clause under some of the Indian tax treaties which provide for taxability under the domestic law of the contracting state. In the instant case, relying on various decisions, the Tribunal treated the income from technical services as a business income since the FTS article was missing in the India-UAE tax treaty. However, there was no taxability in India since the foreign company did not have a PE in India. This issue has not attained a finality till date, and one would need to wait for a detailed decision of the court considering all the relevant aspects.



² ABB FZ-LLC v. ITO [2016] 75 taxmann.com 83 (Bang), Paramina Earth Technologies Inc v. DCIT [2020] 116 taxmann.com 347 (Visakhapatnam), DCIT v. TVS Electronics Ltd. [2016] 22 taxmann.com 215 (Chennai)

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