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TAX FLASH NEWS

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Fees for executive search are not taxable as FTS or royalty under the India-Netherlands tax treaty

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (The Tribunal), in the case of Spencer Stuart International BV[1] (the taxpayer) dealt with the issue of taxability of fees for executive search services received by the taxpayer from an Indian entity. The Tribunal held that such executive search fees are distinct from the licence fees (which are taxed as royalty income) and it cannot be taxed as Fee for Technical Services (FTS) or royalty under the India-Netherlands tax treaty (tax treaty).

Facts of the case

The taxpayer, a non-resident company, had a wholly owned subsidiary in India. The taxpayer is engaged in the business of executive search services as well as providing Spencer Stuart Technology software and related services to its group concerns worldwide and third party franchisees. The taxpayer had two streams of income from India, namely, licence fee and executive search fee. The taxpayer entered into a 'licence agreement' with its subsidiary in terms of which subsidiary had been granted licence to use trademark, trade name, logos and the right to use the software owned by the taxpayer and certain other support services. In terms of the agreement, the taxpayer was entitled to receive a licence fee which was offered as royalty under the Act as well as under the tax treaty. The taxpayer had also entered into a service agreement in terms of which the subsidiary agreed to provide, on principal to principal basis, support services to each other in relation to executive search assignments. In terms of the said arrangement, the taxpayer received consideration which was treated as business income. The taxpayer claimed that the said income was not taxable as FTS under Article 12(5) of the tax treaty since the said services neither 'made available' any technical knowledge, experience, skill, know-how or process nor did it constitute development and transfer of a technical plan or technical design. The taxpayer contended that income by way of executive search services were not for services which were ancillary or subsidiary to the property rights for which licence fees was paid.

There was no dispute about the taxability of licence fee received by the taxpayer. However, with respect to executive search fee, the Assessing Officer (AO) observed that it was to be treated as FTS in terms of Explanation 2 to Section 9(1)(vi) of the Income-tax Act (the Act). Further, such fee was for services which are ancillary and for the application or enjoyment of the right, property or information for which the 'licence agreement' was entered into and, therefore, though it was in terms of a separate 'service agreement' yet it constituted FTS in terms of Article 12(5)(a) of the tax treaty. The AO held that the amount of the executive search fee received by the taxpayer was in the nature of FTS under Article 12(5)(a) as well as under Article 12(5)(b) of the tax treaty. Alternatively, the AO held that it was to be treated as royalty under Article 12(4) of the tax treaty read with clause (iv) of Explanation 2 to Section 9(1)(vi) of the Act. The Dispute Resolution Panel (DRP) upheld the order of the AO.

Tribunal decision

The Tribunal relied on the taxpayer's own case of earlier year where it was held that:

- The licence agreement which resulted in earning of royalty income (which has been offered to tax) and the service agreement (which resulted in earning executive search fee) were separate and distinct agreements constituting different sources of income.

[1] Spencer Stuart International BV v. DCIT (ITA No. 6666/Mum/2017) - Taxsutra.com

- The principal business of the Indian subsidiary was to carry out or execute the mandate of executive searches and thus the executive search fee generating activities cannot be treated as ancillary or subsidiary to the licence agreement.

- The licence fee payable in terms of the licence agreement was a percentage of search fee, which was earned by the Indian subsidiary from the execution of executive search mandate during a particular year. Thus, the executive search fee was not taxable as FTS in terms of Article 12(5)(a) or (b) of the tax treaty.

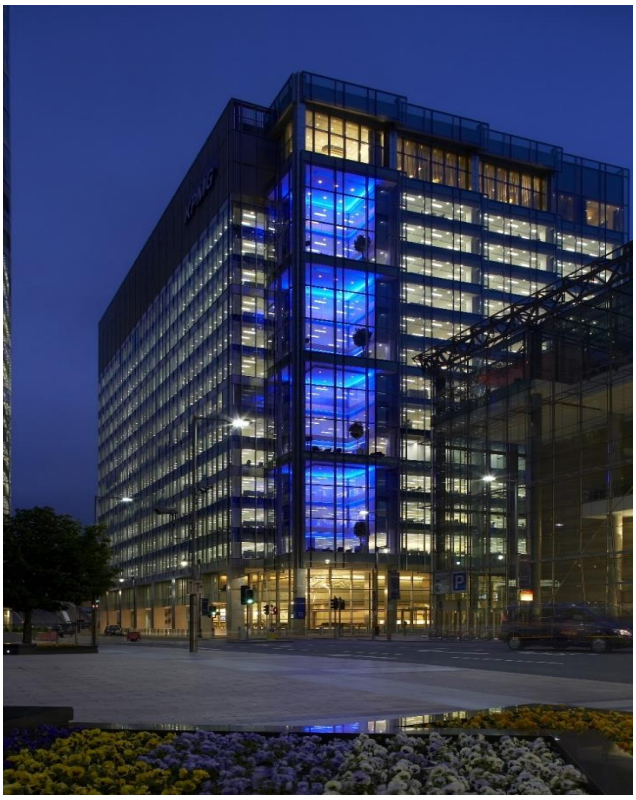
The Tribunal on reference to the Advance Pricing Agreement (APA) entered into by the subsidiary observed that the 'licence agreement' and the 'service agreement' between the taxpayer and the subsidiary are separate and distinct of each other. Further, in the context of the arm's length price (ALP) of the transactions, the APA makes a distinction between the payment of licence fee and executive search fee. There was a complete dichotomy between the nature and characterisation of transactions accepted in the APA in the context of Indian subsidiary vis-à-vis the tax authority in the present case. Ostensibly, it does not need any more emphasis that the nature and characterisation of the amount in the present case has correspond to what has been accepted by the tax authorities in the case of the payer of the same.

If the tax department was to contend that the executive search fee was nothing but licence fee, then even in the APA proceedings, the tax authority should have re-characterised such executive search fee as 'licence fee' to tax it as royalty under the APA. The Tribunal observed that considering the executive search fee as 'royalty' would make the APA redundant. Therefore, the executive search fee cannot be treated as FTS under Article 12(5)(a) as well as 12(5)(b) of the tax treaty. Further, it cannot be taxed as royalty under Article 12(4) of the tax treaty read with clause (iv) of explanation 2 to Section 9(1)(vi) of the Act.

Our comments

In the instant case, the taxpayer relied on APA during the appeal proceedings. Various Courts/Tribunal[2] have also relied on APA during the appellate proceedings and held the decision in favour of the taxpayer. Similarly, in the present case, the Tribunal made reference to APA and observed that the 'licence agreement' and the 'service agreement' between the taxpayer and the subsidiary are separate and distinct of each other. If the tax department was to contend that the executive search fee was nothing but licence fee, then even in the APA proceedings, the tax authority should have re-characterised such executive search fee as 'licence fee' to tax it as royalty under the APA. The Tribunal observed that considering executive search fee as royalty would make the APA redundant.

Thus, on the basis of APA and its earlier decision in the taxpayer's case, the Tribunal held that the executive search fees cannot be taxed as FTS or royalty under the India-Netherlands tax treaty.



[2] Spencer Stuart International BV v. ACIT [2018] 94 taxmann.com 380 (Mum), Ranbaxy Laboratories Ltd. v. ACIT [2016] 68 taxmann.com 322 (Del), PCIT v. Ameriprise India Pvt Ltd (ITA 206/2016), AXA Technologies Shared Services Pvt Ltd v. DCIT [2016] 76 taxmann.com 102 (Bang), Warburg Pincus India Pvt. Ltd. v. ACIT [2017] 78 taxmann.com 273 (Mum), 3i India Private Limited v. DCIT (ITA No. 581/Mum/2015)

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