

Seminar on International Taxation for Beginners – WIRC

Royalty and Fees for Technical Services



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07 January 2017



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Basic Concepts



Royalty/ FTS under the ITA

Section 5 –Scope of Total Income for Non Residents

- Income received / deemed to be received in India
- Income accruing / arising in India or deemed to accrue or arise in India

Section 9 –Income deemed to accrue or arise in India

- Royalty/FTS provisions introduced - AY 1977-78
- Royalty -S 9(1) (vi) / Explanation 2
- FTS –S 9(1) (vii) / Explanation 2

Taxation of Royalty / FTS

- S 115A / 44DA

Where does Royalty/ FTS arise - ITA?

Section 9(1) (vi) / (vii) of the Act

Income by way of Royalty/ FTS shall be deemed to accrue or arise in India if payable by

Government

Resident

Non resident

EXCEPT

Business/ Profession outside India

OR

Source of Income outside India

WHERE

Business/ Profession in India

OR

Source of Income in India



Royalty



What is Royalty?

Book-seller selling a book to a student



Receipt of sale price

Mr. XYZ allowing publisher to print book



Receipt of license fee
(Based on percentage sale price or goods manufactured)

Royalty - Use of copyright, literary, artistic or scientific work

What is Royalty?

A R Rehman allowing HMV to draw on his all-time hits to make CDs



Mr. X buying HMV CDs for gifting as mementos to speakers



Money for use of

IPR ?

or

IPR backed product?

Royalty - Use of copyright, literary, artistic or scientific work

What is Royalty?

Microsoft allowing resellers to duplicate Windows OS and sell in market



X Ltd. buying Windows OS for office use by employees



Money for use of

IPR ?

or

IPR backed product?

Royalty - Use of copyright, patent, invention, model, design, trademark, secret formula or process

Product v/s Underlying IPR?

Underlying product	Embedded IPR content	What does Licensee of IPR expect?	What does Purchaser of product get?
Medicines	Patent	License to manufacture	Ownership of drugs
Books	Copyright	Publishing house wants right of reproduction	Ownership of book
Packaged drinking water	Trademark	Franchisee wants right to manufacture and sell under trademark	Ownership of product
Washing machine	Know-how / experience	License to manufacture and sell.	Ownership of process, skill,

Receipt constitutes Royalty

Receipt constitutes price

Definition of Royalty as per Income-Tax Act, 1961

Explanation 2 to section 9(1)(vi) of the Income-tax Act, 1961 defines Royalty as under:

For the purposes of this clause," royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head" Capital gains") for-

- (i) the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (ii) the imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iii) the use of any patent, invention, model, design, secret formula or process or trade mark or similar property;
- (iv) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;
- (v) the transfer of all or any rights (including the granting of a licence) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but not including consideration for the sale, distribution or exhibition of cinematographic films; or
- (vi) the rendering of any services in connection with the activities referred to in sub- clauses (i) to (v)

Explanations to section 9(1)(vi) of the Income-tax Act, 1961

Explanation 4.— For the purpose of this clause, “computer software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

Explanation 4.—For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred.

Explanation 5.—For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not— (a) the possession or control of such right, property or information is with the payer; (b) such right, property or information is used directly by the payer; (c) the location of such right, property or information is in India.

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression “process” includes and shall be deemed to have always included transmission by satellite (including uplinking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret” Consequent to the above insertion the following transactions shall now be deemed to be royalty.

Royalty – Definition under the Act

- Consideration (incl. lumpsum consideration) for:

Use of or right to use

- Patent, invention, model, design, secret formula or process or trademark, etc. (IP)
- copyright, literary, artistic or scientific work

Imparting of any information concerning

- the working of or use of IP
- technical, industrial, commercial or scientific knowledge, experience or skill

Use of

- any IP
- or right to use any industrial, commercial or scientific equipment

- Rendering of any services in connection with above

Capital Gains and consideration for sale, distribution and exhibition of cinematographic films excluded

Definition of Royalty as per India-US DTAA

Article 12(3) of the India-US DTAA defines Royalty as under:

- a) payments of any kind received as a consideration for the use of, or the right to use, any copyright of a literary, artistic, or scientific work, including cinematograph films or work on film, tape or other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; and
- b) payments of any kind received as consideration for the use of, or the right to use, any industrial, commercial, or scientific equipment, other than payments derived by an enterprise described in paragraph 1 of Article 8 (Shipping and Air Transport) from activities described in paragraph 2(c) or 3 of Article 8.

Royalty – Definition under the Treaties

- OECD Model – Payments of any kind received as a consideration for:

Use of or right to use

- Copyright of literary, artistic or scientific work **including cinematograph films**
- Patent, trademark design or model, plan, secret formula or process,

Information concerning

- industrial, commercial or scientific experience

- UN Model – Payments of any kind received as a consideration for:

Use of or right to use

- Copyright of literary, artistic or scientific work **including cinematograph films** or films or tapes used for radio or television broadcasting
- Patent, trademark design or model, plan, secret formula or process
- industrial, commercial or scientific equipment

Information concerning

- industrial, commercial or scientific experience

Royalty – Definition under certain Indian Treaties

Country	Definition
Singapore	Includes gains from alienation of IPRs
US	Includes gains derived from the alienation of IPR which are contingent on the productivity, use, etc.
Morocco, Namibia, Russia, Trinidad & Tobago, Turkmenistan, Kazakstan and Kyrgyz Republic	Specific inclusion of software
Libya	Rental and other income from cinematograph films considered as business profits and not Royalties
Greece, Israel, Sweden, Netherlands	Does not include 'Equipment Royalty'
Belgium, France, Kazakhstan, Netherlands and Spain	Does not include 'Equipment Royalty' – MFN clause
Australia	Includes FIS

Royalty – Interpretation issues

Meaning of ‘imparting of information concerning technical, industrial, commercial or scientific knowledge, experience or skill’ (‘know-how’):

OECD Commentary

- Refers to the concept of know-how
- Corresponds to undivulged information arising from previous experience
- Payments for new information obtained as result of performing services for payer – not royalty

Some judicial precedents

- Every information concerning the industries or commercial ventures does not qualify as royalty. Some sort of expertise or skill is required. Some sort of confidentiality/secretcy & exclusivity is required. It should not be something readily available in the market.
(CIT vs. HEG Ltd. (263 ITR 230) (MP))
- Allowing access and downloading business information reports, which is a compilation of publicly available commercial information is not royalty.
Dun & Bradstreet Espana SA (272 ITR 99) (AAR)
- Royalty signifies an extended or perpetual use for the payee, where as FTS are relevant for one time job and useful for which they are rendered. Similar interpretation should also apply to information concerning ‘industrial experience’.
(Kirloskar Oil Ltd. (83 ITD 436) (Pune))

Royalty – Interpretation issues

Engineering Drawings / designs / technical documentation

OECD Commentary

- Development of design, etc that does not already exist – not Royalty
- Right to use / modify / reproduce previously developed plan – Royalty

Some judicial precedents

Acquisition of designs or drawings in the course of acquiring Plant & Machinery

- Supply of machine design to enable buyer to operate it without transfer of license of patent/copyright, thereby not allowing buyer to manufacture machine itself, cannot be regarded as Royalty. [*Neyveli Lignite Corporation Ltd. (243 ITR 459) (Mad)* & *Mitsui Engg. & ship Bldg. Co. Ltd (259 ITR 248 (Del))*]
- Supply of technical documentations like designs, process, specification etc. before commencement of production is not royalty [*Nisshinbo Ind. Inc. vs. ACIT (83 ITD 748)(Chennai)*]

Royalty – Interpretation issues

Engineering Drawings / designs / technical documentation

Some judicial precedents

Outright sale of designs / drawings

- Consideration for outright purchase of drawings and designs (i.e. transfer of ownership per se) is not royalty [*CIT v Davy Ashmore India Ltd.* 190 ITR 626 (Cal), *Leonhardt Andra Und Partner, GmbH v. CIT* (2001) 249 ITR 418 (Cal), *Swadesh Polytex* (38 ITD 326)]
- Engineering drawings & designs supplied to an Indian Co. for lump sum consideration for setting up plant for its own client with the right to use, sell or transfer it is not alienation of right/property contingent upon productivity/use or disposition but an 'out and out' sale of property. [*Pro-quip Corporation (AAR)* (255 ITR 354)]

Royalty – Interpretation issues

Use or right to use any industrial, commercial or scientific equipment

Some judicial precedents

Decisions	Ratio
Cargo Community Network Pte. Ltd. - 289 ITR 355 (AAR)	- Whether payments made by Indian agent/subscriber to applicant for providing a password to access and use portal hosted from Singapore are in nature of royalties and fees for technical services and taxable under article 12 of DTAA as also under section 9 and subject to deduction of tax at source - Held, yes

Royalty – Interpretation issues

Use or right to use any industrial, commercial or scientific equipment

Some judicial precedents

Decisions	Ratio
IMT Labs (India) Pvt Ltd, In re (2006) 287 ITR 450 (AAR)	Whether periodical payments made by a resident to a non-resident in America, having no office/establishment in India, in connection with use of software developed by him on internet, being 'royalties and fees for included services' as per Explanation to section 9(1)(vi) and 9(1)(vii), are chargeable to tax in India under article 12 of DTAA with USA as also under section 9 and, therefore, are subject to tax deduction at source - Held, yes

Royalty – Interpretation issues

Use or right to use any industrial, commercial or scientific equipment

Decisions	Ratio
Bharati Axa General Insurance Corporation Ltd (326 ITR 477) (AAR)	<p>Applicant is an Indian company engaged in business of general insurance - It entered into a service agreement with AXA ARC, a Singaporean company, which acts as a central service organisation and caters to requirements of AXA group of companies in region for receiving assistance such as business support, marketing, information technology support services and strategy support services, etc., so that it can carry on business in line with best practices followed by other AXA group entities globally - Services are advisory in nature and by receiving such services applicant is not enabled to apply technology contained therein, i.e., technology, knowledge, skills, etc., possessed by service provider or technical plan developed by service provider - Under said agreement, AXA ARC will receive fee based on actual cost incurred plus a mark up of 5 per cent - Whether, on facts, payment made by applicant to AXA ARC amounts to 'fee for technical services' and 'royalty' within meaning of article 12 of DTAA with Singapore - Held, no - Whether further, since AXA ARC does not have a permanent establishment in India, payments received by it cannot be taxed as business profits under Treaty - Held, yes</p>

Software

Software may be covered under the following clauses of Explanation 2 to Section 9(1)(vi)

Clause (v):

- Transfer of all or any rights (including granting of a license) in respect of copyright, literary, artistic or scientific work, including films, video tapes for use in connection with radio broadcasting, but not including consideration for sale, distribution or exhibition of cinematographic films

Clause (i):

- Transfer of all or any rights (including granting of a license) in respect of patent, invention, model, design, secret formula or process or trade mark or similar property

Clause (iii):

- Use of patent, invention, model, design, secret formula or process or trade mark or similar property

Software

Meaning of 'Copyright'

- Section 14 of the Copyright Act - 'Copyright' means the exclusive right to do or authorize the doing of any of the following acts in respect of a work or any substantial part thereof, namely :
 - To reproduce the work;
 - To issue copies of the work;
 - To perform the work in public, or communicate it to the public;
 - To make any cinematographic film/ sound recording in respect of the work;
 - To make any translation of the work;
 - To make any adaptation of the work;
 - To do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in the above sub-clauses;
- In case of computer programme
 - To do all acts as specified above
 - To sell or give on commercial rental or offer for sale or for commercial rental any copy of the computer programme

Royalty – Interpretation issues

Software

- Distinction between 'copyrighted articles' and 'copyright' is relevant. Payment for 'copyrighted article' is not in the nature of royalty.
[DIT v. Ericsson A.B. [2012] 204 Taxman 192 (Del HC)].
- Software copyright supplied along with hardware as its integrated part is not Royalty.
[Lucent Technologies Hindustan Ltd (92 ITD 366)(Bang) & Motorola Inc. etc. 95 ITD 269 (Del.) (SB)]
- Following the decision of Tribunal in the case of *Motorola Inc. (supra)* it was held that the amount received by the assessee under the license agreement for allowing use of the software was not 'royalty' either under the ITA or under DTAA but was in the nature of business profits, chargeable to tax in its hands under article 7 of the DTAA. It was also held that the other receipts on account of maintenance charges and training fees being incidental to the software receipts assume the same character as that of software receipts and the same are liable to be taxed accordingly.
[Infrasoft Ltd v. ADIT 125 TTJ 53 (Del)].

Royalty – Interpretation issues

Software

- Sale of a standardized but special purpose software and not customized software is not Royalty under Art12 of India-Japan DTAA.
[Dassault Systems K.K. (322 ITR 125)(AAR)]
- Ready made off the shelf computer programme acquired for business is not Royalty
[Samsung Electronics Ltd. (93 TTJ 658)] overruled by Karnataka High Court in the case of CIT v. Samsung Electronics Co. Ltd. [2012] 345 ITR 494]
- Sale of canned software would tantamount to sale of goods and not royalty
[TCS vs. State of Andhra Pradesh (271 ITR 401) (SC)]

Software

Copyright vs. Copyrighted Article

As per OECD Commentary

What constitutes Royalty ?

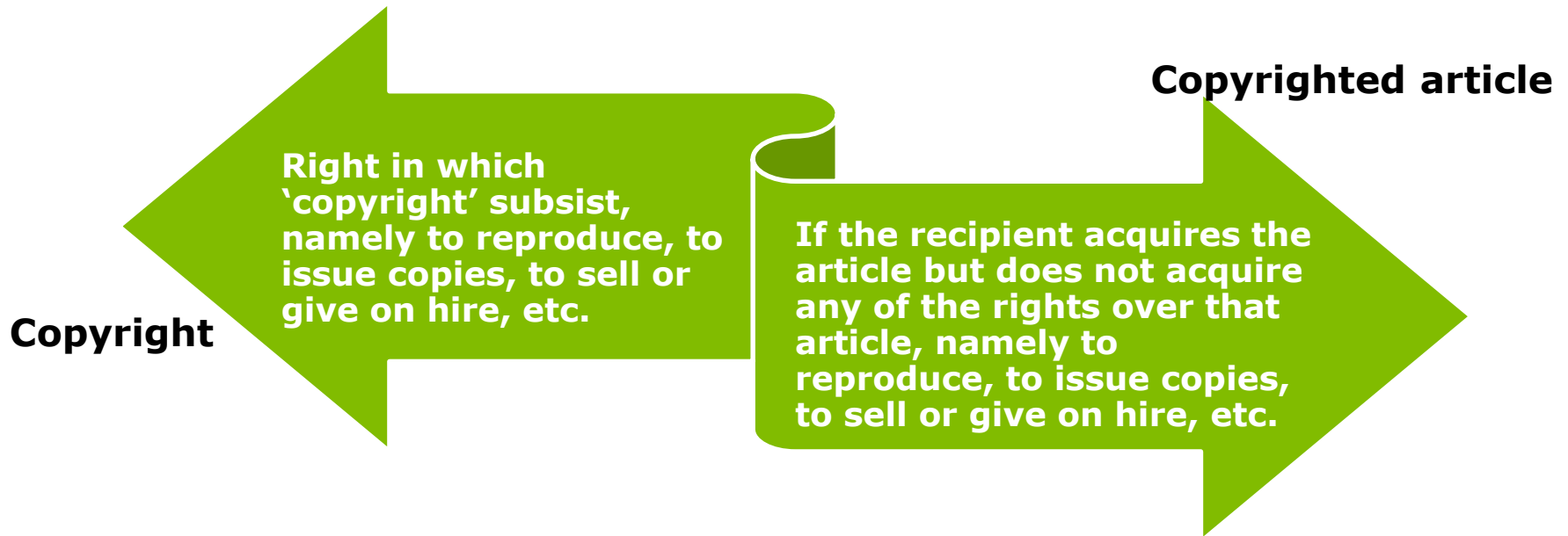
- Payment for exploitation of rights that would otherwise be the sole prerogative of the copyright holder
- Transfer of partial rights in the copyright (E.g. License to reproduce & distribute the software to public)
- Transfer of Know-how (secret code, etc.) underlying the program (E.g. Transfer of access code, algorithms, etc. to commercially exploit)

What does not constitute Royalty?

- Payment for transfer of full ownership of the rights in the copyright
- Granting of rights for a limited period or for limited geographical area
- Acquisition of a program copy (eg. Microsoft Windows Package)
- Right to make multiple copies of program for operation within own business
- Payment by distributors to acquire and distribute software copies (without reproducing)

Software

Copyright vs. Copyrighted Article



OECD recognises a distinction between the copyright in the program and software which incorporates a copy of the copyrighted program

Software

Illustrative types of Software payments

- Bundled/ Embedded software ~ Software is loaded on the hardware and does not have any independent existence
- Shrink - wrapped software
 - ✓ Software is provided in a packed form to the customers along with end user license agreement
 - ✓ The end user is not permitted to make any modification or make, works derivative of the software and user is not entitle to reverse engineer, decompile, disassemble or otherwise discover the source code of the software
- Customized off-the-shelf software
- Software development

Software

Judicial Rulings

- Ericsson Radio System A.B. [2011] (343 ITR 470) (Del.)

Distinction between 'copyright' and 'copyrighted article' - payment was towards title of GSM system and not towards software and hence not in nature of royalty under ITA and under DTAA

- Synopsis International Old Limited [2012] (212 Taxman 454) (Kar.)

Consideration paid is for rights in respect of copyright and for use of information embedded in software – falls within mischief of definition of 'royalty' under the ITA and under the DTAA

- Samsung Electronics Co Ltd (345 ITR 494) (Kar.)

Transfer of copyright including right to make copy of software for internal business and payment made in that regard would constitute 'royalty', both under ITA and respective DTAA's

- Lucent Technologies Hindustan Ltd (92 ITD 366)(Bang) & Motorola Inc. etc. 95 ITD 269 (Del.) (SB)

Software copyright supplied along with hardware as its integrated part is not Royalty

Software ~ Distribution

Dassault Systems KK (322 ITR 125) (AAR)

- Payments made by Value Added Reseller (VAR) to non-resident supplier for computer software
- Rights, enumerated in copyright law directed towards commercial exploitation
- Where such rights conferred to enable enjoyment as an owner, implies use of copyright
- End user/ VAR not given such 'copyright'
- Enabling end user to have benefit of software with no right to deal with them independently, no right in relation to copyright and therefore not 'royalty'

Software ~ Distribution

CBDT Notification

- No withholding under Section 194J on transfer of software to a resident where:
 - Software acquired on subsequent transfer without any modification;
 - Tax has been deducted on payment on any previous transfer;
 - Transferee obtains a declaration that the tax has been deducted and PAN of the transferor is quoted
 - Effective from 1 July 2012

(Notification No. 21/2012 dated 13 June 2012)

Software ~ Relevant Judicial Decisions – Post amendment

Particulars	Forum	Decision
CIT, International Taxation v. P.S.I Data System Ltd. [2012] (208 Taxman 452)	Karnataka High Court	<ul style="list-style-type: none"> • Payment to non-resident for purchase of software held as royalty • Reliance placed on CIT v. Samsung Electronics Co. Ltd.
DIT v. Nokia Networks OY [2012] (253 CTR 417)	Delhi High Court	<ul style="list-style-type: none"> • Distinction has to be made between a 'copyright' and a 'copyrighted article' • The definition in Article 13(3) of the DTAA is narrower than the ITA and refers to payments for use / right to use a copyright of a literary work • The amendment to the definition of 'royalty' under Section 9(1)(vi) by the Finance Act, 2012 cannot be read into the DTAA • The payments are for supply of goods and are not 'royalty'
Novel Inc. v. DDIT(Intl. Tax) [2014] (49 SOT 45)	Mumbai Tribunal	<ul style="list-style-type: none"> • Payment received by non-resident from sale of software to the Indian distributors for onward sale to its end customers held not taxable as royalty
CIT, International Taxation v. Customer Asset India (P.) Ltd. (42 taxmann.com338)	Karnataka High Court	<ul style="list-style-type: none"> • Consideration paid by Indian end users to foreign supplier, for transfer of the right to use the software falls within the mischief of 'royalty' defined under the ITA • Reliance placed on CIT v. Synopsis International Old Ltd. and CIT v. Samsung Electronics Co. Ltd.

Royalty – Interpretation issues

Digital Economy transactions

- Banner advertisement and hosting services not taxable – Yahoo India P. Ltd. (45 SOT 105) (ITAT – Mumbai)
- Search engine advertisement payments not in the nature of royalty – Pinstorm Technologies Pvt. Ltd. (45 SOT 278) (ITAT – Mumbai)
- Subscription of online database is royalty income – Gartner Ireland Ltd. (60 SOT 43) (ITAT – Mumbai)
- Online subscription fee is royalty income – ONGC Videsh Ltd. (141 ITD 556) (ITAT – Mumbai)
- Payment for website hosting not royalty – People Interactive India Pvt. Ltd. (TS-129-ITAT-2012(mum))
- Payment for International private lease circuit(IPLC) taxable as royalty – (361 ITR 575) (Madras – HC)

Online Advertisement

Nature of transaction

- A person is an owner of a web portal
- Customer approaches to the owner of web portal to advertise its products online on the web
- Web portal provides web search engine. A web search engine is basically a software code designed to search for information on the world wide web
- When an internet user visits web portal, it keys in the search words
- The results produced by search engine are sponsored search results which is de-facto advertisement
- Sponsored search results help advertisers visibility of their respective websites

Taxability

- Whether the payment is for use of an 'equipment'

Relevant Judicial Rulings

- Right Florists (P.) Ltd. (2013) (154 TTJ 142) (Kol.)
- Pinstorm Technologies (P.) Ltd. (2012) (154 TTJ 173) (Mum.)
- Yahoo India (P.) Ltd. (2011) (140 TTJ 195) (Mum.)
 - Payment for advertising does not involve use or right to use by the client any industrial, commercial or scientific equipment;
 - Uploading the advertisement was entirely the responsibility of the advertiser and client had no right to access the portal of the advertiser.

Database Access Fee

Taxability

- Whether payment for the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill

Relevant judicial rulings:

- P. T. McKinsey Indonesia (2013) (141 ITD 357) (Mum.)
 - Information supplied was in the nature of data it did not arise due to exploitation of the know-how generated by the skills or innovation. Hence, the payment for the same does not amount to royalty
- Dun & Bradstreet Information Services India (P.) Ltd. (2011) (338 ITR 95) (Bom.)
 - Payment for purchases of Business Information Reports which is a compilation of data in user friendly manner cannot be termed as ‘royalties’ under India-Spain Tax Treaty.
- Wipro Ltd. (2011) (203 Taxman 621) (Kar.)
- Thoughtbuzz (P) Ltd. (346 ITR 345) (AAR)
 - Payment to obtain license to use database maintained by a non-resident is in the nature of royalty.
 - Use or right to use the process or information concerning industrial, commercial or scientific experience
- Gartner Ireland Ltd. (60 SOT 43) (ITAT – Mumbai)
 - Subscription of online database is royalty income

Database Access Fee

ONGC Videsh Ltd. (2013) (155 TTJ 114) (Del.)

- Information contained was not for the public at large.
- Certainly the payment is in the nature of technical consultancy. Oil and natural gas and its exploration are a field of specialized technical knowledge and not for the use of public at large.
- The information obtained by the assessee are also of technical nature.
- The information /knowledge available was made through a license, consequently it is covered under the definition of royalty under the domestic law and as per the DTAA with UK.

Court rulings on retrospective amendments

- Any amendment in the provision of the Act does not have the effect of automatically altering the analogous provisions of the Double Taxation Avoidance Agreements.

[WNS North America Inc. vs. ADIT (152 TTJ 145) Mumbai Trib

and DIT v. Nokia Networks OY (212 Taxman 68) Delhi HC]

Similarly, many other judgements such as B4U International Holdings Limited [18 ITR(Trib.) 62] (Mum.), have upheld applicability of definition under the tax treaty

- Contra: in Verizon Communications Singapore

The Madras High Court relied on the amended definition of royalty under domestic law and ruled that the definition of royalty in the India-Singapore tax treaty is the same as the definition of royalty under domestic law, and therefore denied treaty benefits

Similar judgement against the matter has been pronounced in the case of Viacom 18 (44 taxmann.com 1) (Mum.)



FTS



What do you mean by FTS?

Thrust is on 'Services'

- Distinguish between: Product v. services
 - Created Vs. person agrees to create, develop
 - Anticipated Demand Vs. Work begins after setting specifications
 - Equipment Hire Vs. Service
- Managerial, technical or consultancy services not defined
 - Dictionary meaning
 - Meaning as understood in common parlance
- Supply of technical or other personnel

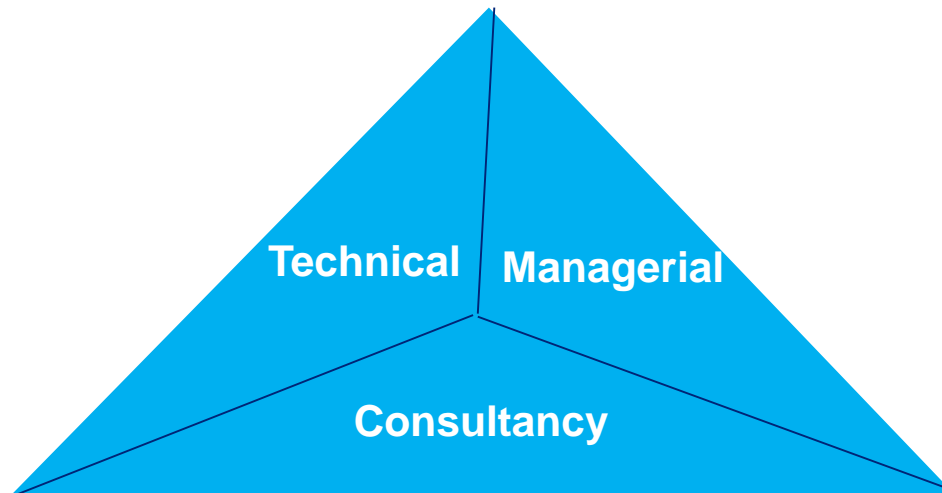
What do you mean by FTS?

Explanation 2 to section 9(1)(vii) of the Income-tax Act, 1961 defines FTS as under:

FTS means 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) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries".]

Definition under the ITA

- FTS income is taxed as per the source rule
- Explanation 2 to section 9(1)(vii) defines FTS to mean any consideration for:



- Includes: lump sum consideration and provision of services of technical or other personnel
- Excludes: consideration for any construction, assembly, mining or like project undertaken by the recipient of income or income chargeable as salary

Interpretation ~ Key components of FTS

Managerial	Technical	Consultancy
<ul style="list-style-type: none">• Management functions	<ul style="list-style-type: none">• Expertise in technology	<ul style="list-style-type: none">• Advisory services
<ul style="list-style-type: none">• Management of affairs/people	<ul style="list-style-type: none">• Knowledge/skill related to technical people	<ul style="list-style-type: none">• Overlaps with technical services

Provision of services of technical or other personnel

- Providing personnel to render technical services
 - For instance, engineers, technicians, consultants, etc. to furnish services for a fee
- Deputation arrangement?

Provision for professional services

- Whether covered?
- Distinction made between FTS and fees for professional services under section 194J

What do you mean by Managerial Services?

Dictionary definition

Black's Law dictionary defines 'manager' as:

“A person who administers or supervises the affairs of a business, office, or other organization”

OECD TAG Report

43. The Group considers that services of a managerial nature are services rendered in performing management functions. The Group did not attempt to give a definition of management for that purpose but noted that this term should receive its normal business meaning. Thus, it would involve functions related to how a business is run as opposed to functions involved in carrying on that business.

As an illustration, whilst the functions of hiring and training commercial agents would relate to management, the functions performed by these agents (i.e. selling) would not.

What do you mean by Technical Services?

Dictionary definition

Oxford's dictionary defines 'technical' as:

“Involving or concerned with the mechanical arts and applied sciences”

OECD TAG Report

39. For the Group, services are of technical nature when special skills or knowledge related to a technical field are required for the provision of such services. Whilst techniques related to applied science or craftsmanship would generally correspond to such special skills or knowledge, the provision of knowledge acquired in fields such as arts or human sciences would not.

As an illustration, whilst the provisions of engineering services would be of a technical nature, the services of a psychologist would not.

What do you mean by Consultancy Services?

Dictionary definition

Black's Law dictionary defines 'consultation' as:

“ The act of asking the advice or opinion of someone (such as lawyer)

Webster's Encyclopedia states that to 'consult' is to:

“...to consult is to seek from a presumably qualified personal or an impersonal source advice, opinion, etc”

OECD TAG Report

45. For the Group, “consultancy services” refer to services constituting in the provision of advice by someone, such as a professional, who has special qualifications allowing him to do so. It was recognised that this type of services overlapped the categories of technical and managerial services to the extent that the latter types of services could well be provided by a consultant.

Judicial Ruling

- Recently, the Mumbai Bench of Income-tax Appellate Tribunal in the case of **TUV Bayren (India) Ltd. v/s. DCIT**^[1] has while inter-alia analyzing the provisions of section 9 (1) (vii) of the ITA explained in brief the meaning of the said terms. The relevant portion of the Order is extracted hereunder:

Technical services require expertise in technology and providing the client such technical expertise Managerial services is used in the context of running and management of the business of the client, Consultancy is to be understood as advisory services wherein necessary advice and consultation is given to its clients for the purpose of client's business.

^[1] Reported in (2012) 23 taxmann.com 127 (Mum – ITAT)

Fees for Included Services (FIS)

- Deals with Technical Services - but, coverage is of FIS.
- Definition of FIS (Refer for example Indo - US Treaty)
- “For purposes of this article, “fees for included services” means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) 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, or consist of the development and transfer of a technical plan or technical design.”

Managerial services excluded under the FIS definition

Fees for Included Services

Extract from Memorandum of Understanding on India-USA treaty.

- “This FIS category is narrower because it excludes any service that does not make technology available to the person acquiring the service. Generally speaking, technology will be considered “made available” when the person acquiring the services is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not per se mean that technical knowledge, skills, etc. are made available to the person purchasing the service, within the meaning of 4(b). Similarly, the use of a product which embodies technology shall not per se be considered to make technology available.”

Make available clause

- Relevant tests:
 - Make use without recourse to the performer of the services in future
 - Should remain with the person even after the services comes to an end
 - There should be transmission from the person rendering the services to the person utilizing the same
 - Durability
 - Available in some concrete shape
- Irrelevant tests:
 - Provision of services may require technical inputs by service provider
 - The service recipient gets a product and not the technology itself
 - Merely allowing somebody to make use of services
 - Service recipient acquires some familiarity or insights into the manner of provision of services

'Make available significantly narrows down the scope of FTS

An overview of selected India's DTAA (FTS)

US	Singapore	China	Russia
<p>rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services are:</p> <p>(i) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment ; or</p> <p>(ii) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design</p> <p>Exclusions:</p>	<p>services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel) if such services :</p> <p>(i) are ancillary and subsidiary.....; or</p> <p>(ii) make available technical knowledge, experience, skill, know-how or processes,; or</p> <p>(iii) 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</p>	<p>The term “fees for technical services” as used in this Article means any payment for the provision of services of managerial, technical or consultancy nature by a resident of a Contracting State in the other Contracting State, but does not include payment for activities mentioned in paragraph 2(k) of Article 5 and Article 15 of the Agreement</p>	<p>payments ...in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Articles 14 and 15 ...</p>

An overview of selected India's DTAA (FTS)

US	Singapore	China	Russia
<ul style="list-style-type: none">• Services that are ancillary and subsidiary as well as inextricably and essentially linked, to the sale of property ...• For teaching in or by educational institution• for services for the personal use of the individual or individuals making the payments• Covered by Article relating to professional services	Similar exclusions as in India and US tax treaty		

Important points

- What happens when there is no FTS Article in tax treaty? Eg: Treaties signed by India with **Mauritius**, Thailand, Brazil, etc.
 - Conveys that there is no special treatment envisaged for Technical Fees
 - Treated at par with business income - Tekniskil (Sendirian) (222 ITR 551) (AAR)
 - Taxable as business profit only if PE
 - IPS needs to be checked in case of no FTS Article
 - FTS taxable in country of residence if no PE in source country
- What happens when reimbursements are made alongwith FTS?
- Concurrent Coverage under Independent Personal Services

Impact of Most Favoured Nation clause

- Most favoured nation clause - an indirect amendment
 - Reduced rate of tax charged in a subsequent tax treaty; and/or
 - Narrower scope of the applicability of an Article of a subsequent DTAA
 - For eg. India-France treaty
- Generally stated in protocol
- FTS / Royalty Article has to be read with the MFN clause
 - MFN may restrict FTS to FIS
- MFN trigger may be subject to subsequent notification
- Examples of Indian tax treaties with MFN status
 - India -Netherlands tax treaty
 - India -Belgium tax treaty
 - India -France tax treaty
 - India -Sweden tax treaty
 - India -Switzerland tax treaty
 - India -Spain tax treaty

Sales Report



Products



Statement of Cash Flows for the Group

	2011	2010
Operating activities		
Income before taxes	19,257	8,835
Depreciation & impairment	17,469	70,220
Losses from disposal of fixed assets	378	432
Gain on associated companies	-130	-71
Net income	36,982	28,570
Changes in inventories and short-term accounts	2,092	4,544
Changes in trade accounts payable and other	9,765	5,644
Changes in prepaids	2,804	-11,843
Changes in other fixed assets	-1,383	-427
Changes in trade receivables	242	-2,991
Changes in debt consolidation	-4,662	24,662
Changes in deferred taxes	45,854	211
Operating activities	164	-38,234
Investing activities	-13,544	112
Acquisition of tangible and intangible fixed assets	944	-23,912
Disposal of intangible fixed assets	-1,169	-1,168
Disposal of tangible fixed assets	-232	0
Long-term receivables	-1,259	-162
Financing activities	-15,202	-10,522
Dividends	-17,859	-13,853
Share repurchases	13,811	-11,103
Change in financial liabilities	15,132	26,069
Change in cash and cash equivalents	278	-166
Change in cash and cash equivalents at the beginning of the year	29,171	15,132
Change in cash and cash equivalents at the end of the year	13,811	14,966

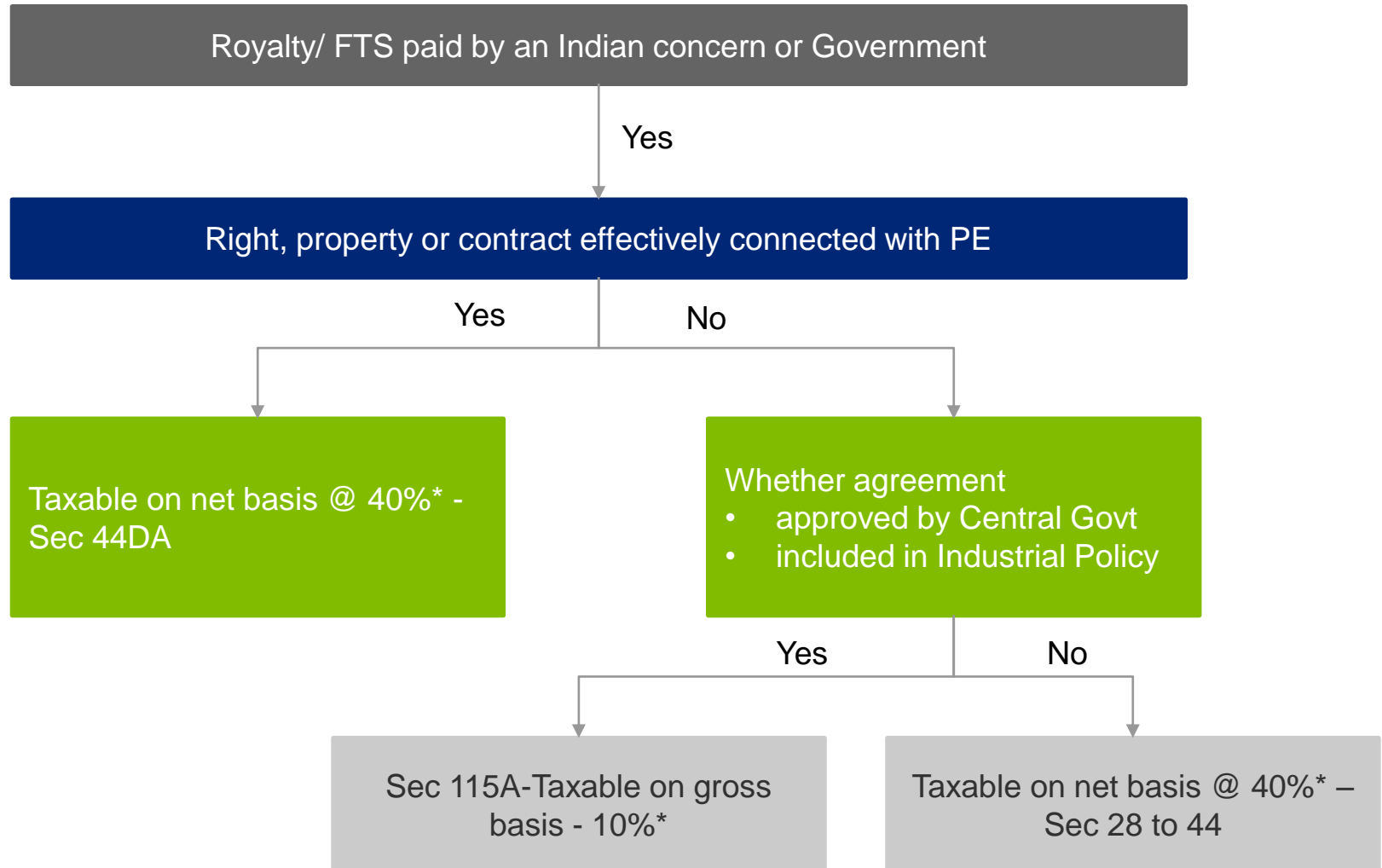
Taxability of Royalty and FTS



Royalty/ FTS under the Treaty

- Article 12(1) –Distribution of rights of the Contracting States
- Article 12(2) –Ceiling of Gross taxation by the State of Source
- Article 12(3) –Meaning of the term “Royalty” / “FTS”
- Article 12(4) –Taxation of Royalty / FTS if effectively connected with PE / Fixed Base of Non-Residents in the State of Source
- Article 12(5) –Where does Royalty / FTS arise?
- Article 12(6) –Adjustments for related party transactions

Taxation of Royalty/ FTS under the ITA



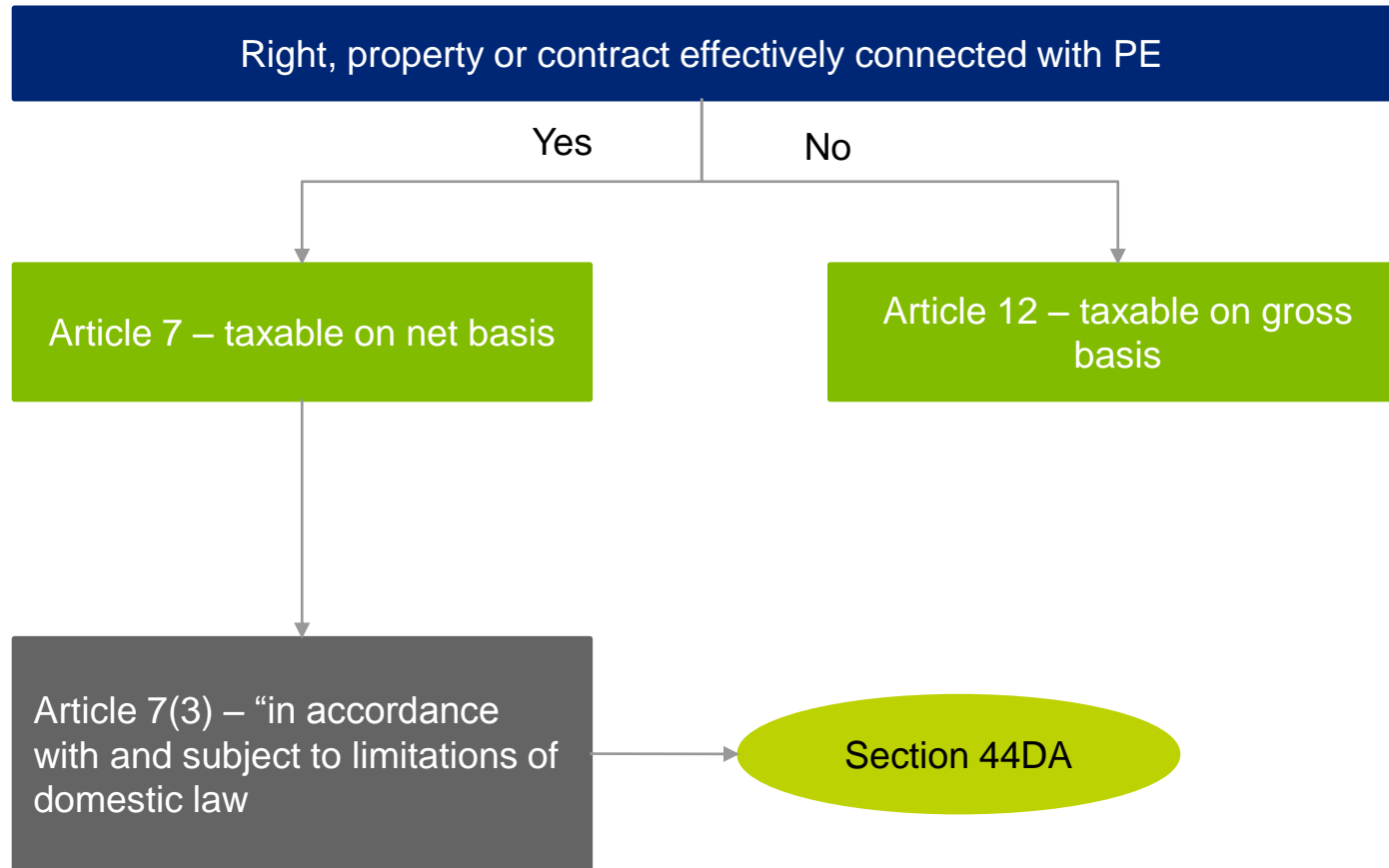
*Surcharge and cess as applicable

Taxation of Royalty/ FTS under the ITA

Taxation on net basis under Section 44DA

- No deduction shall be allowed in respect of:
 - Expenditure or allowance which is not wholly and exclusively incurred for the business of such PE or Fixed Base
 - Any payment made by PE to its head office or any of its other offices (except reimbursement of actual expenses)
- Books of Accounts and Audit:
 - Liable to maintain books of accounts under Section 44AA
 - Audit Report in Form No. 3CE

Taxation of Royalty/ FTS under the Treaty



When is Royalty Taxable ?

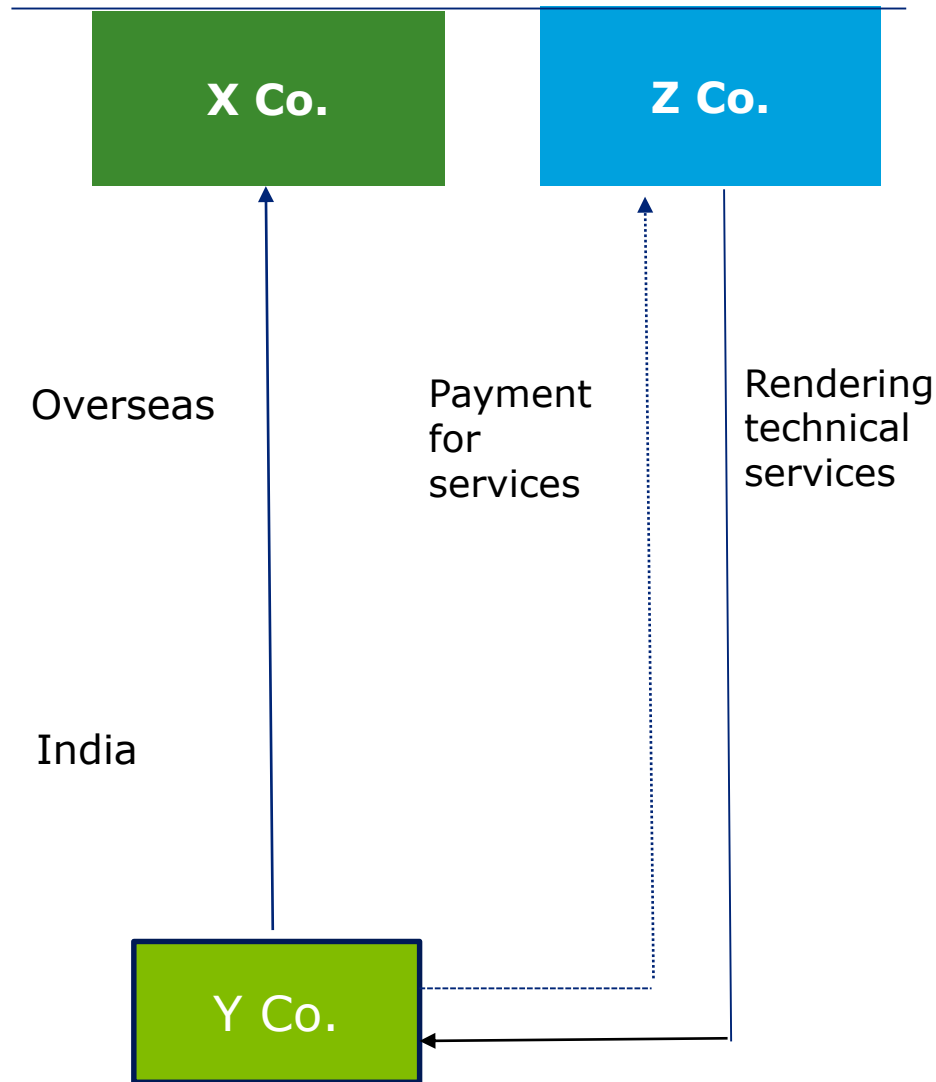
Whether Royalty is chargeable in the year of 'accrual' or 'payment' :

Article 12(1): Royalties arising in a CS and 'paid' to a resident of the other CS may be taxed in the other CS:

- Credit entry in the books of accounts of the payer to the account of the payee amounts to its receipts by the payee. [*CIT v. Standard Triumph Motor Co. Ltd (201 ITR 391) (1993)(SC)*].
- For taxability U/A 12 twin conditions of 'accrual' and 'payment' is required to be satisfied [*National Organic Chemicals Ltd. (96 TTJ 765) (2004)(Mum)*]
- Sec 43(2): 'Paid'- actually paid/incurred as per the method of accounting
- Flakt (India) Limited (AAR): For the purpose of taxing such royalties/fees in India , Para (1) is wholly irrelevant. It is also pointed out above that Para (2) thereof clearly lays down that the amount of such royalties/fees may also be taxed in India, in which they arise, and according to the laws of India. It is thus clear that the provisions of Article 12 of the treaty, discussed above, do not provide that taxability of such royalties/fees in India shall be on cash or receipt basis.

Case studies

Case Study 1



Facts

- X Co. enters into a contact with Y Co. for preparation of technical report
- Y Co. outsourced the contract to Z Co. a group Co. of Y Co.
- Z Co. perform the study and prepares the report overseas
- The report is then forwarded by Z Co. to Y Co. who in turns forwards the report to X Co.
- Z Co. does not have a PE in India

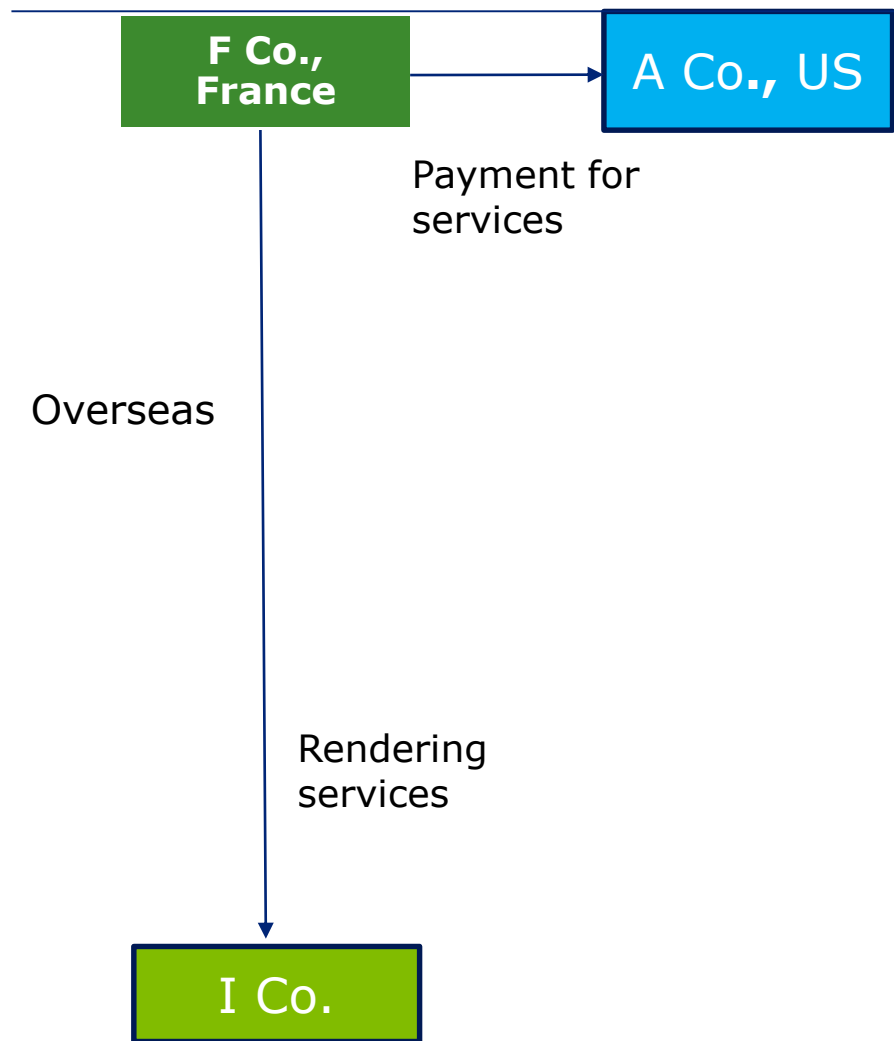
Issues

- Taxability of payment by Y Co. to Z Co. under the ITA?

Case Study 1

- Section 9(1)(vii) of the Act
 - Services provided by Z Co. in the nature of FTS and would get covered under the definition of 'FTS' under Explanation 2 to section 9(1)(vii) of the Act
 - Z Co. have performed the services outside India and the services are rendered pursuant to contract with X Co. which is located overseas
 - Payments to Z Co. is for earning income from a source outside India ~ not taxable in India under section 9(1)(vii)(b) of the Act (exclusion)

Case Study 2



Facts

- F Co. France and engaged in the business of providing engineering & construction services
- F Co. entered into an agreement with I Co. to provide technical/engineering services for a project in India which has created PE for F Co. in India
- In order to review and monitor the work done by the employees of F Co. in India, F Co. entered into another agreement with A Co. US
- The work done by A Co. included provision of execution plans, review of working in respect of plans and execution, provision of time schedules with emphasis on key milestones, etc.

Issues

- Payment by F Co. to A Co.
- Taxability under the ITA and Article 12 of the DTAA



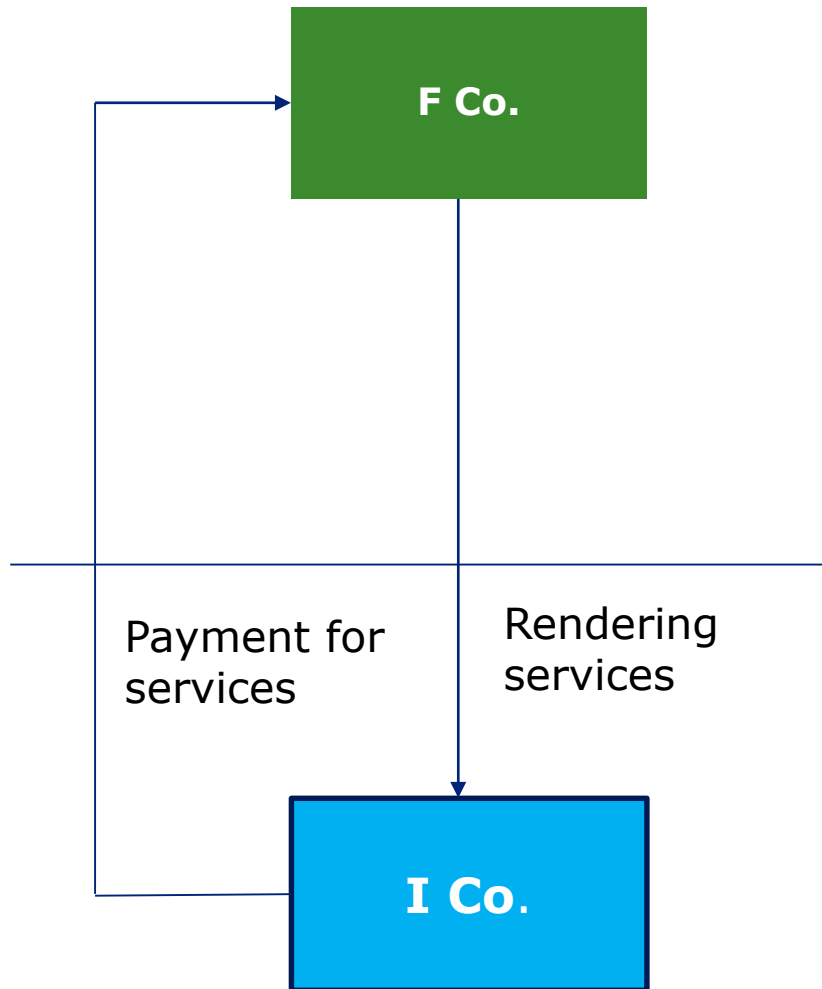
Case Study 2

Decision of Chennai Tribunal

- Payment to A Co. liable to tax in India in terms of Explanation 2 to section 9(1)(vii) and 9(1) of the Act since services were utilized for earning source of income in India
- Services provided by A Co. were made available to F Co. and is taxable as FTS in India under India-US DTAA
 - F Co. was not a layman and was an expert in providing technical and engineering services
 - F Co. was capable of observing the opinion/advice given by A Co. and implementing the same in their future projects
 - Technical knowledge, expertise and know-how provided by A Co. was made available to the F Co.

Foster Wheeler France SA. (157 ITD 793) – Chennai Tribunal

Case Study 3



Facts

- F Co., was engaged by I Co. to undertake technical services for development of technical drawings, detailed designs and reports

Issues

- Whether the payments to F Co. by I Co. constitute FTS under India-Canada DTAA and India-Singapore DTAA?



Case Study 3

- **India-Canada DTAA (Snc-lavalin International Inc.–Delhi High Court)**
 - Condition of making available technical knowledge is not an essential condition for considering the question as to whether the amount is FTS or not particularly when the payment is for development and transfer of a technical plan or technical design
 - The term 'transfer' as used in article 12(4) does not refer to absolute transfer of right of ownership; it refers to transfer of technical drawings or designs by the resident of one State to the resident of the other State, which is to be used by or for the benefit of the resident of the other State.
 - Even where the technical design or plan is transferred for the purpose of mere use of such design or plan by the person of the other Contracting State and for which the payment is to be made, article 12(4)(b) would be attracted
 - Accordingly, payment to F Co. was held to be in the nature of FTS
- **India-Singapore DTAA**
 - Services rendered by F Co. consist of development and transfer of a technical plan or design but it doesn't to enable I Co. to apply the technology contained therein
 - Payment to F Co. may not be taxable as FTS in India
 - Similar exclusion India-Portugal DTAA

Questions



Thank You

