



Tax implications in
relation to remittance of
Fees for technical
services, royalties,
interest and business
profits

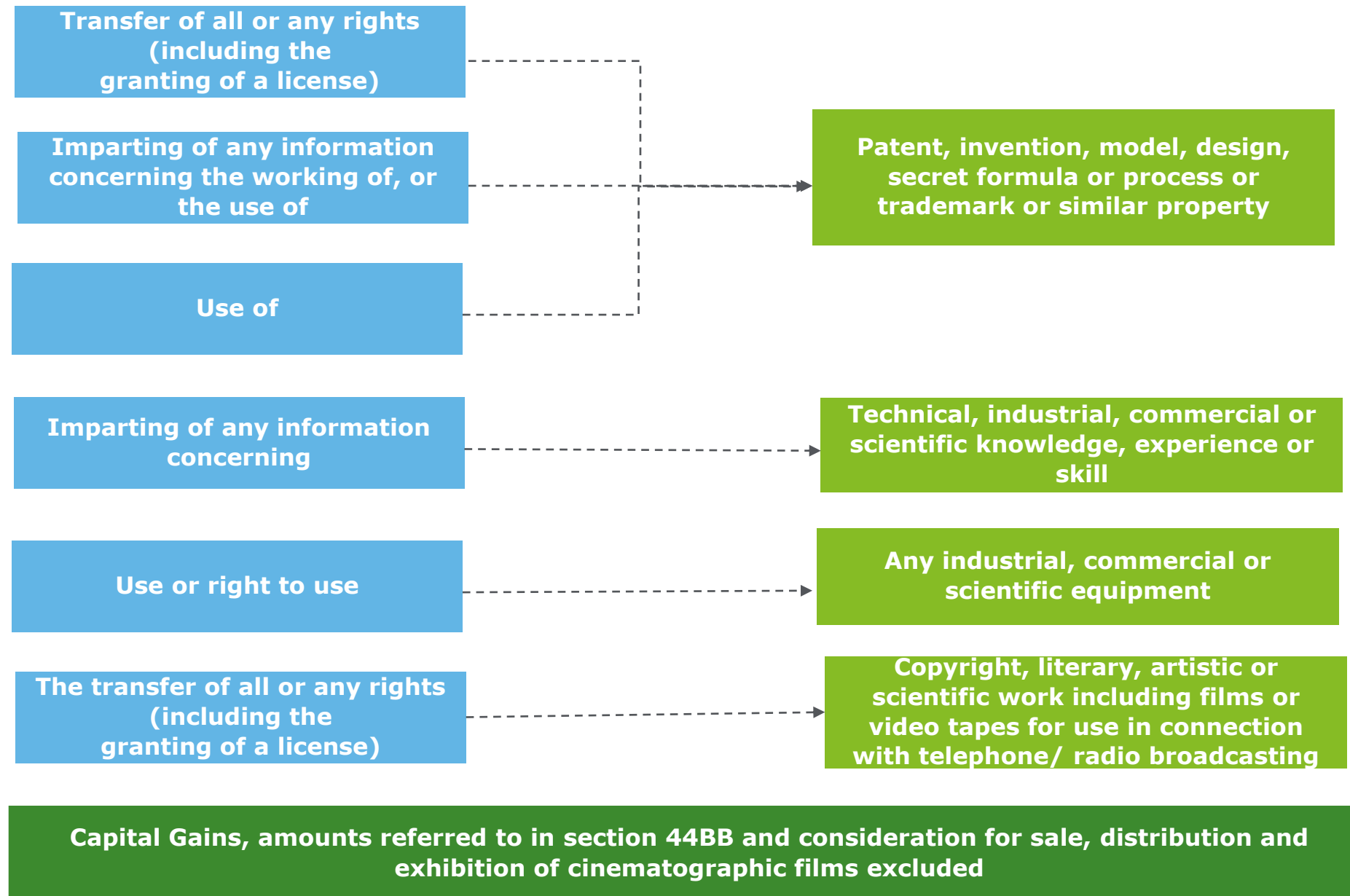
Contents



Royalty

Royalty – Definition under the ITA

Consideration (including lump sum consideration) for:



Royalty – Definition under the ITA ...(Cont'd)

Amendment in Finance Bill 2020:

Rationale

- Currently, the definition of "royalty" under section 9(1)(vi) excludes consideration for the sale, distribution or exhibition of cinematographic films.
- However, similar exclusion in the definition of royalty is absent in India's DTAA's

Proposed amendment

- It is proposed to remove the said exclusion (with regard to cinematographic films) from the definition of "royalty" under section 9(1)(vi)

The proposed amendment to be effective from assessment year 2021-22 onwards

Royalty – Definition under the ITA ...(Cont'd)

Finance Act 2012 inserted following explanations with retrospective from 1 April 1976:

Explanation 4

- The transfer of right, property or information includes transfer of all or any right for use or right to use computer software (including granting of a license) irrespective of the medium through which such right is transferred

Explanation 5

- Royalty shall include consideration in respect of any right, property or information whether or not such right, property or information (a) is under the control of the payer, (b) is used by the payer, (c) is located in India

Explanation 6

- The expression “process” includes transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret.

Exempted Royalty

- Royalty payable in respect of computer software exempted if-
 - Lump sum payment is made by a resident
 - For transfer of all or any rights relating to computer software supplied along with a computer or computer-based equipment
 - By a non-resident manufacturer
 - Under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India

“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

Royalty – Definition under the Model conventions

OECD Model – Article 12.2

- payments of any kind received
- as a consideration
- for the use of, or the right to use
 - any copyright of literary, artistic or scientific work
 - including cinematograph films
 - any patent, trademark, design or model, plan, secret formula or process
- for information concerning industrial, commercial or scientific experience

UN Model – Article 12.3

- payments of any kind received
- as a consideration
- for the use of, or the right to use
 - any copyright of literary, artistic or scientific work
 - including cinematograph films, **or films or tapes used for radio or television broadcasting**
 - any patent, trademark, design or model, plan, secret formula or process
- **for the use of, or the right to use, industrial, commercial or scientific equipment**
- for information concerning industrial, commercial or scientific experience

Royalty – Definition (certain notable variations under the Indian DTAAAs)

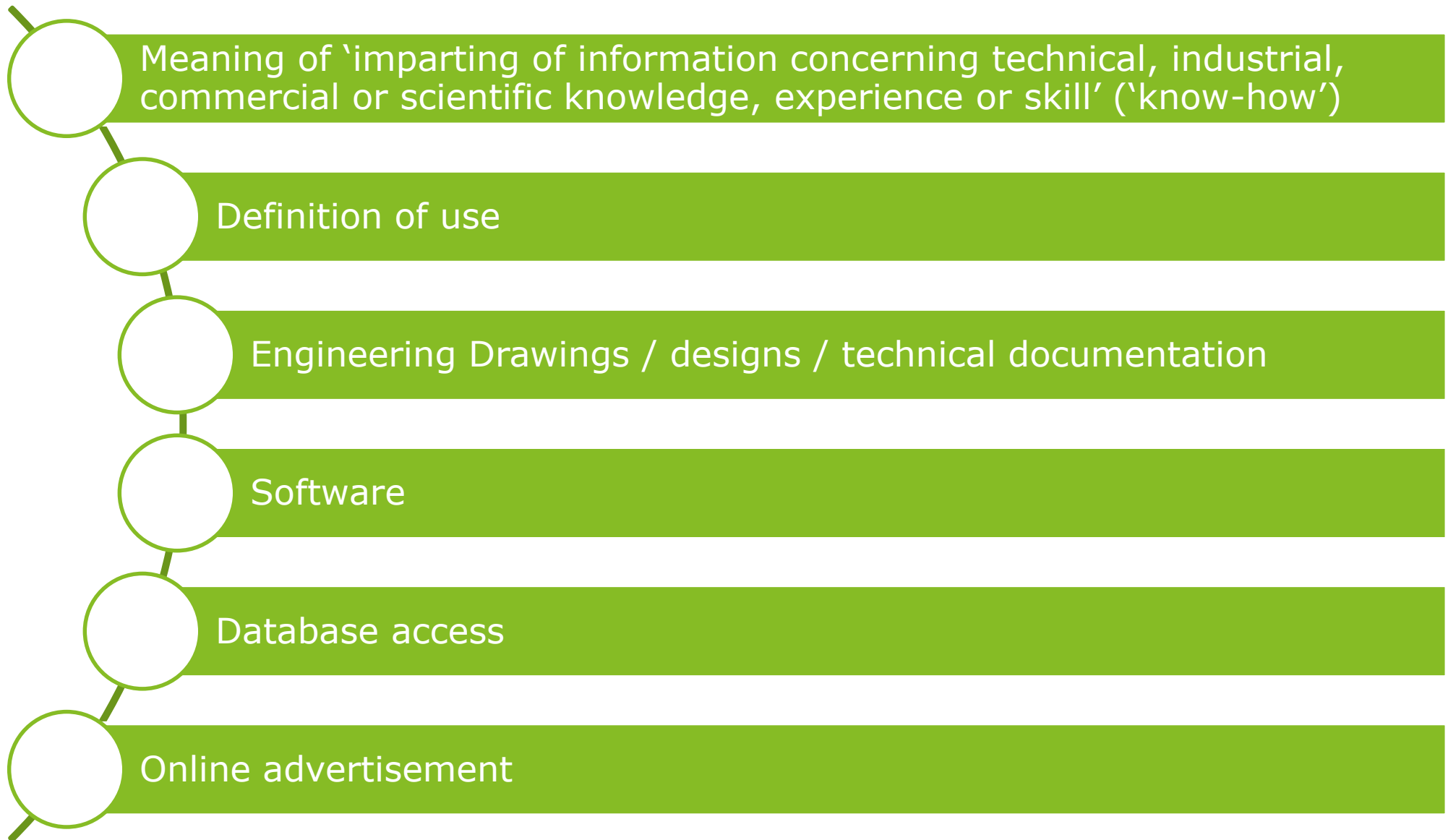
Country	Definition
Singapore	Includes gains from alienation of IPRs
US	Includes gains derived from the alienation of IPR which are contingent on the productivity, use, etc.
Morocco, Namibia, Russia, Trinidad & Tobago, Turkmenistan, Kazakhstan and Kyrgyz Republic	Specific inclusion of software
Libya	Rental 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

Impact of the change in definition on DTAA

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

CIT v. Siemens Aktiengesellschaft (310 ITR 320) Bom HC and DIT v. Nokia Networks OY (212 Taxman 68) Delhi HC]

Royalty – Interpretation issues



Fees for Technical Service (FTS)

FTS – Definition under the ITA

FTS - Explanation 2 to Section 9(1)(vii) of the ITA

“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)”

Exclusion

- consideration for any construction, assembly, mining or like project undertaken by recipient; or
- consideration which would be income chargeable under the head "Salaries"

Exhaustive Definition under the Act

FTS – Definition under the ITA

Key Components of FTS

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

Provision of services of technical or other personnel

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

FTS – Definition

- No FTS clause under OECD or UN Model (Article on FTS at draft stage in UN Model)
- FTS as defined under most Indian DTAAAs

FTS clause

- FTS means
 - payments of any amount in consideration
 - for the rendering of managerial, technical or consultancy services
 - including the provision of services of technical or other personnel
 - does not include payments for services mentioned in Independent/ Dependent Personal Services

FTS clause + Make available

- FTS means
 - payments of any amount in consideration
 - for the rendering of managerial, technical or consultancy services
 - including the provision of services of technical or other personnel
 - does not include payments for services mentioned in Independent / Dependent Personal Services
 - which make available technical knowledge, experience, skill know-how or processes
 - Consist of the development and transfer of a technical plan or technical design
 - Excluding services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment

Fees for Included Services ('FIS')

- Deals with Technical Services - but, coverage is of FIS.
- Definition of FIS (Refer for example Indo - US DTAA, India-Canada DTAA)
- "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

Concept of 'Make Available'

- Person acquiring the service is enabled to apply the technology
- Mere requirement of technical input by a person providing services does not necessarily mean that technical knowledge is "made available"
- Use of a product which embodies technology cannot be considered to make technology available
- Cases of development and transfer of technical plans or designs / making technology available may include engineering services, architectural services, computer software development, technical training, etc.

**"Make available" significantly narrows
down the scope of FTS**

Services that could make available technology

- Categories of technical and consultancy services that could make available technology are as under:
 - Bio-technical services
 - Food processing
 - Environmental and ecological services
 - Communication through satellite or otherwise
 - Energy conservation
 - Exploration or exploitation of mineral oil or natural gas
 - Geological surveys
 - Scientific services
 - Technical training
- Services that generally involve either the development and transfer of technical plans or technical designs, or making technology available:
 - Engineering services including the sub-categories of bio-engineering and aeronautical, agricultural, ceramics, chemical, civil, electrical, mechanical, metallurgical, and industrial engineering
 - Architectural services
 - Computer software development

An overview of selected India's DTAA (FTS/ FIS)

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 (independent personal services) and 15 (dependent personal services)</p> <p>...</p>

An overview of selected India's DTAA (FTS/ FIS)

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 • Services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic 	<p>Similar exclusions as in India and US DTAA with further 2 exclusions:</p> <ul style="list-style-type: none"> • for services rendered in connection with an installation or structure used for the exploration or exploitation of natural resources referred to in paragraph 2(j) of Article 5 • services referred to in paragraphs 4 and 5 of Article 5 		

Absence of FTS

- Conveys no special treatment envisaged for FTS
 - Eg. Philippines, Thailand, UAE, Bangladesh, Greece, Indonesia, Libya, Mozambique, Myanmar, Nepal
 - Article 7 of DTAA may apply
 - If PE in India, then taxable in India
 - If no PE in India, then not taxable in India
- OR
- Other income Article required to be examined
- OR
- Governed by the provisions of the domestic tax law

FTS – Interpretation issues

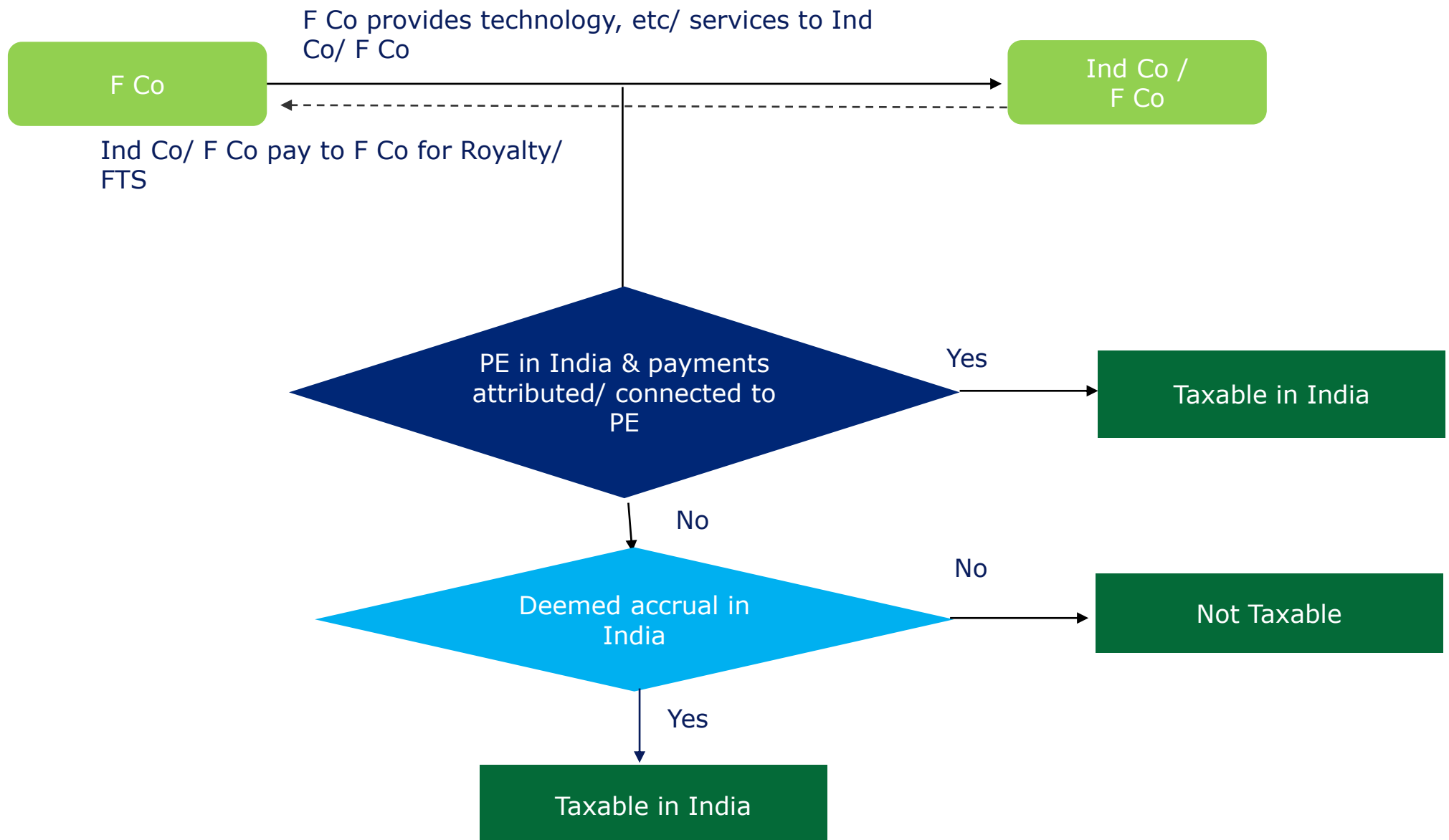


Taxation of Royalty/FTS

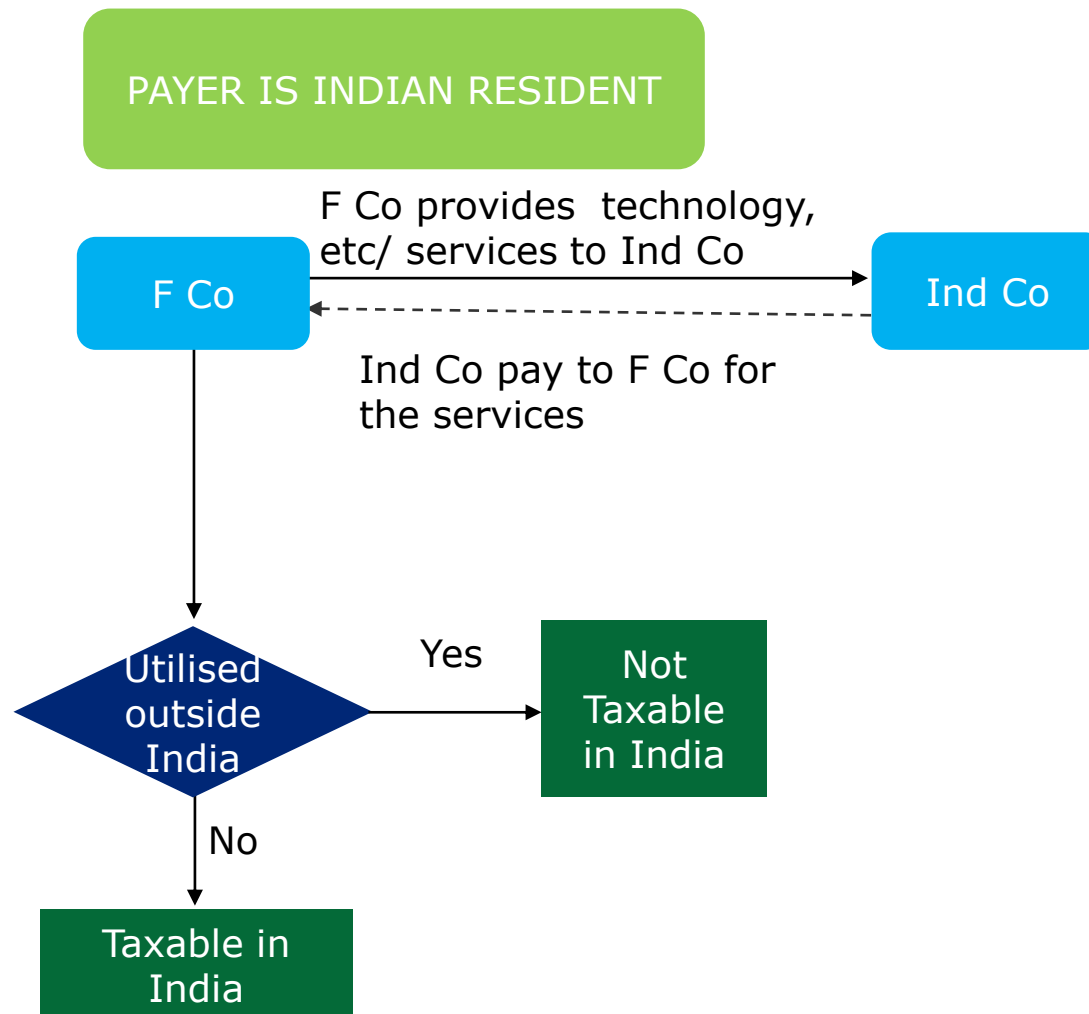
Taxability under the ITA

- Scope of taxable income of a foreign company
 - Income accrues or arises in India
 - Income is deemed to accrue or arise in India
 - Income received in India

Taxability of a foreign company in India under the ITA

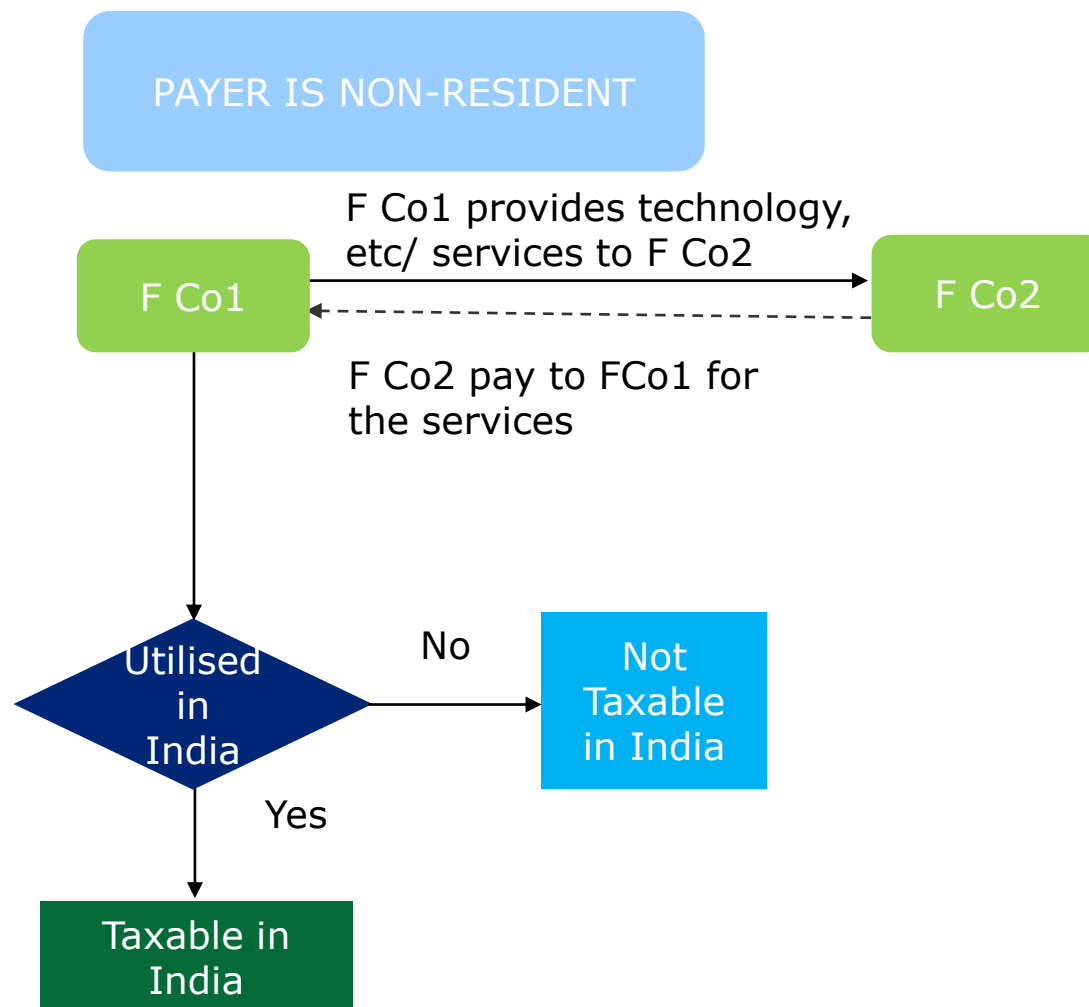


Deeming rules under the ITA



Utilised in a business or profession carried on in India or for the purpose of earning income from any source in India

Deeming rules under the ITA



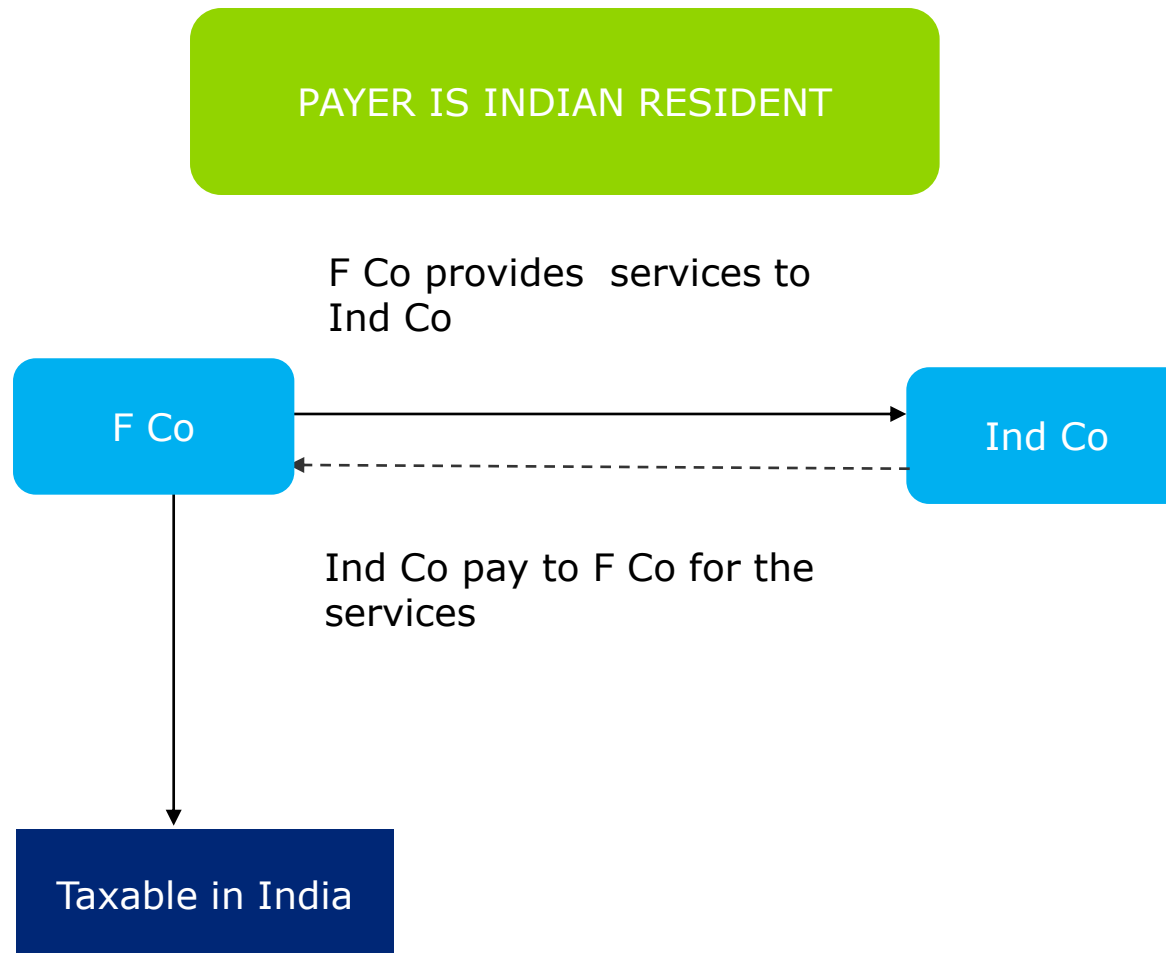
Utilised in a business or profession carried on in India or for the purpose of earning income from any source in India

Deeming rules under the ITA

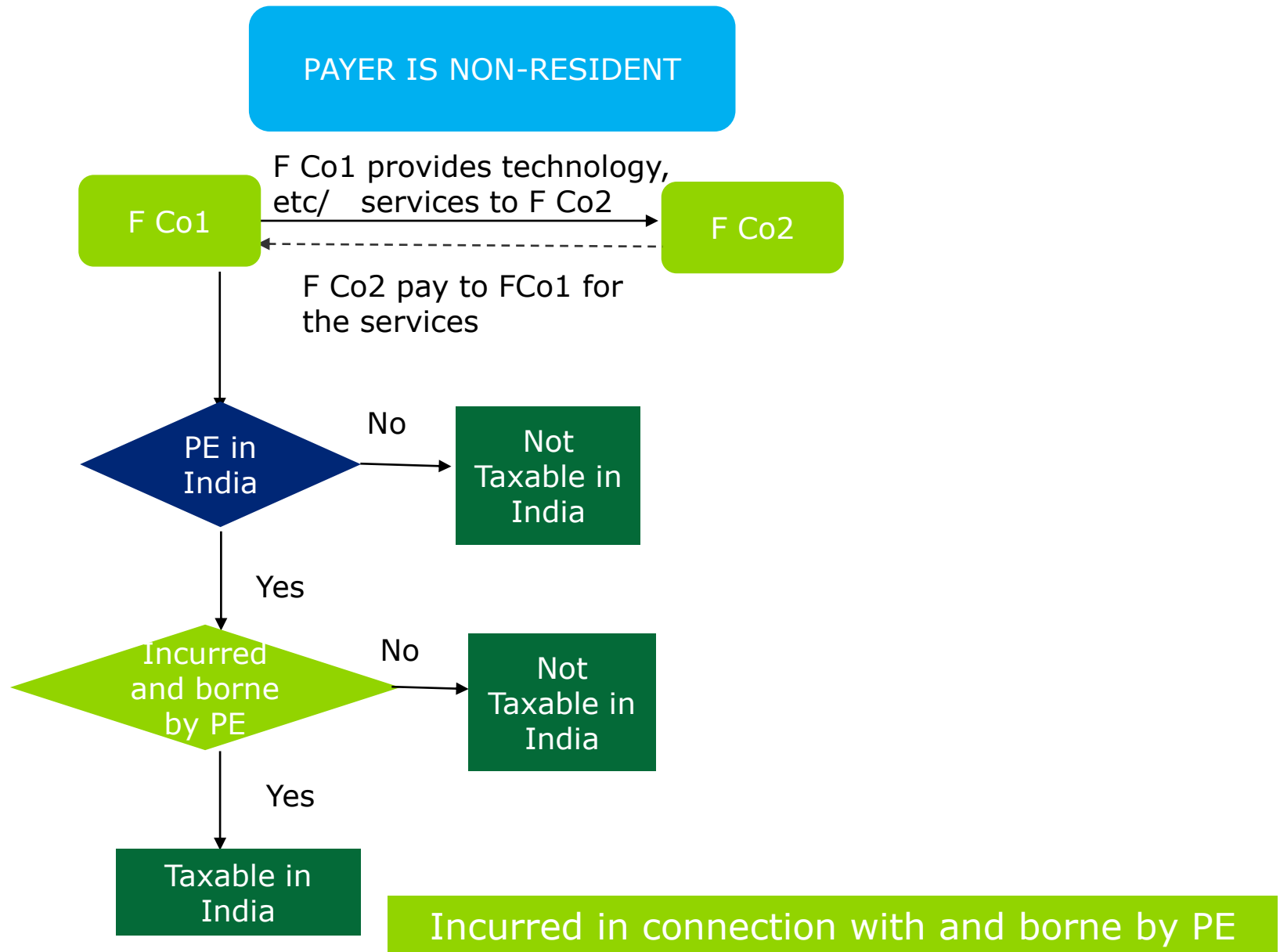
Payer of royalty/ FTS	Utilization*	Taxable in India
Indian resident	In India	Yes
	Outside India	No
Non-resident	In India	Yes
	Outside India	No

*Utilised in a business or profession carried on in India or for the purpose of earning income from any source in India

Deeming rules under the DTAA's



Deeming rules under the DTAAAs

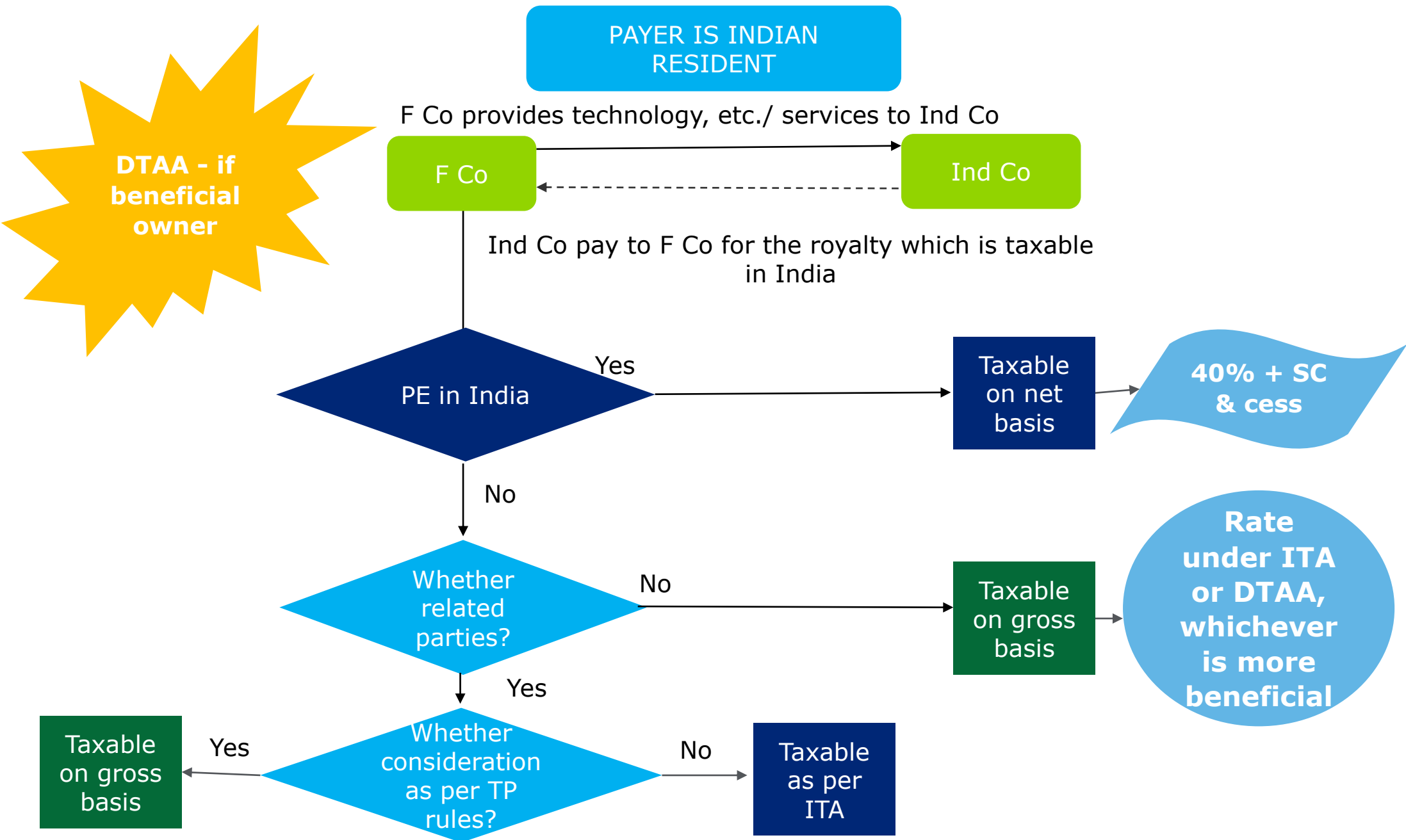


Deeming rules under the DTAA's

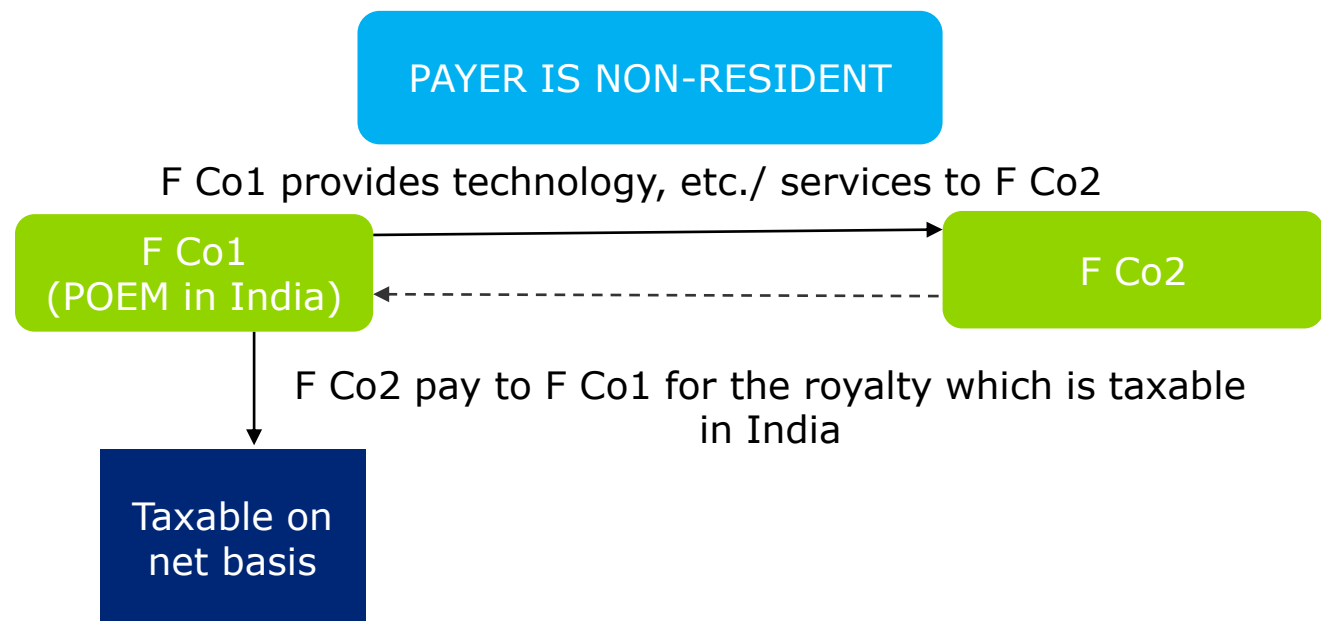
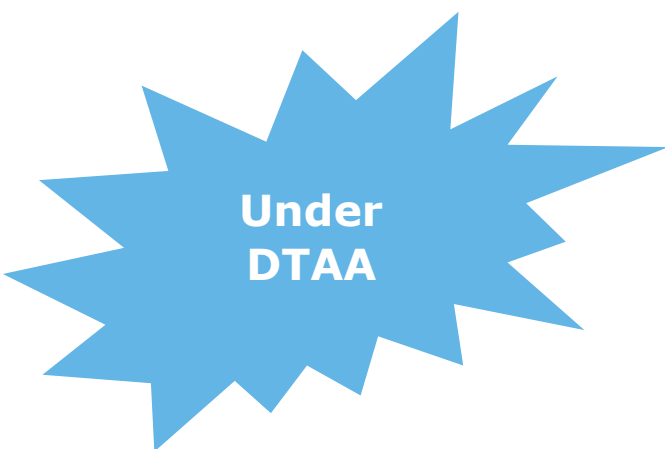
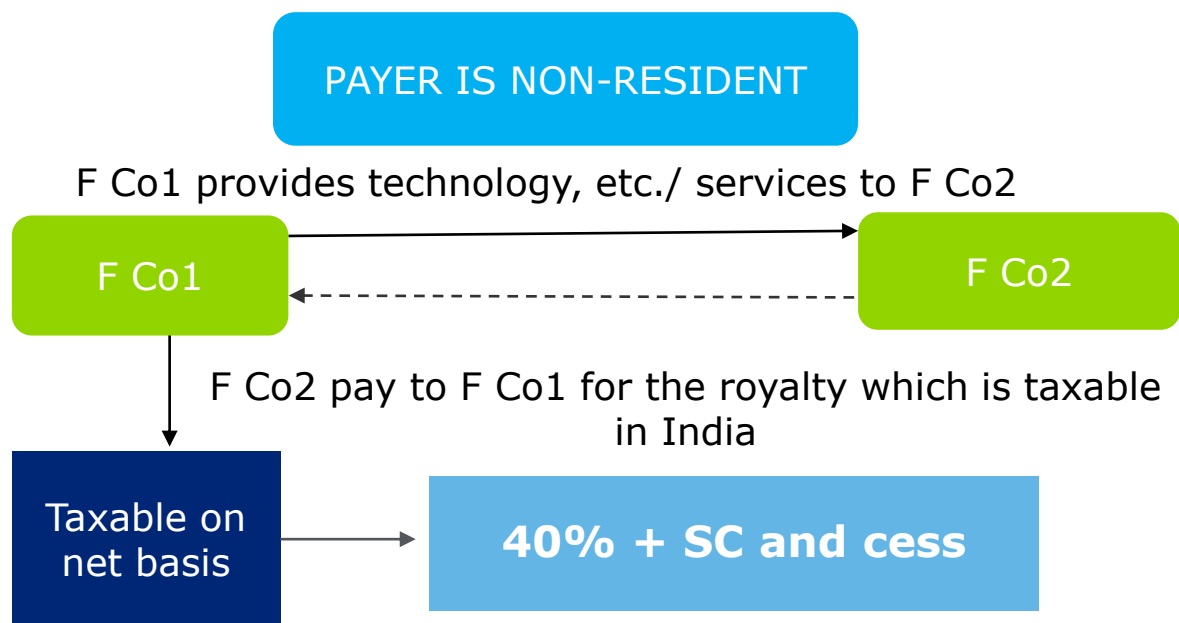
Payer of royalty/ FTS	Utilization*	Taxable in India
Indian resident	Anywhere	Yes
Non-resident	India	Yes
	Outside India	No

*Incurred in connection with and borne by PE

Computation and rates under the ITA and DTAA



Computation and rates under the ITA and DTAA




Summary



Characterization of income



Application of deeming provision



Effectively connected to PE



Rate of tax



Timing of withholding

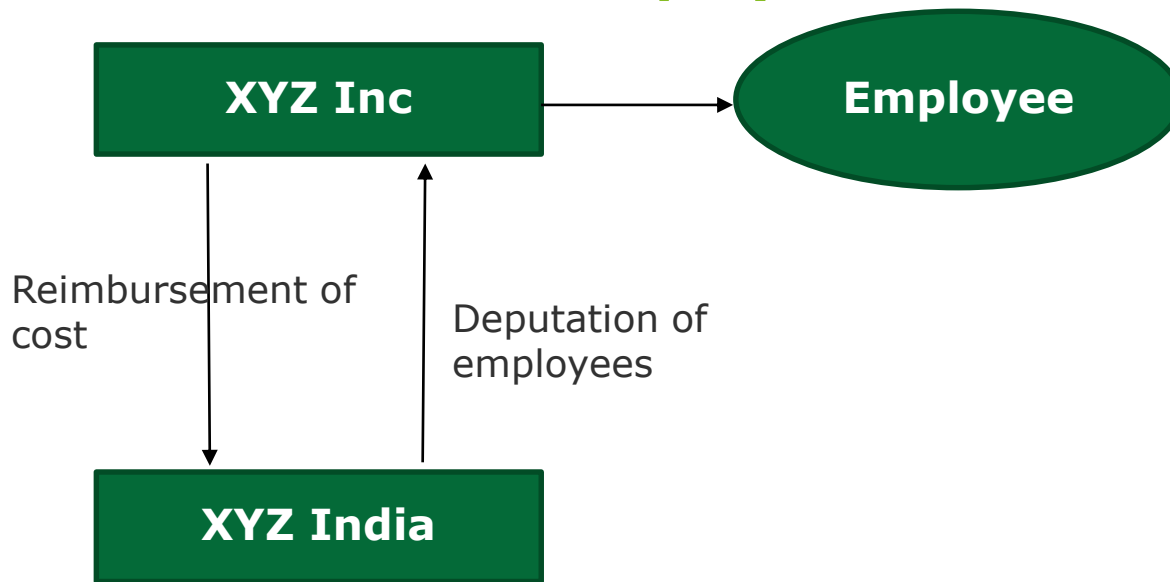


Documentation

Case Studies

Case Study 1

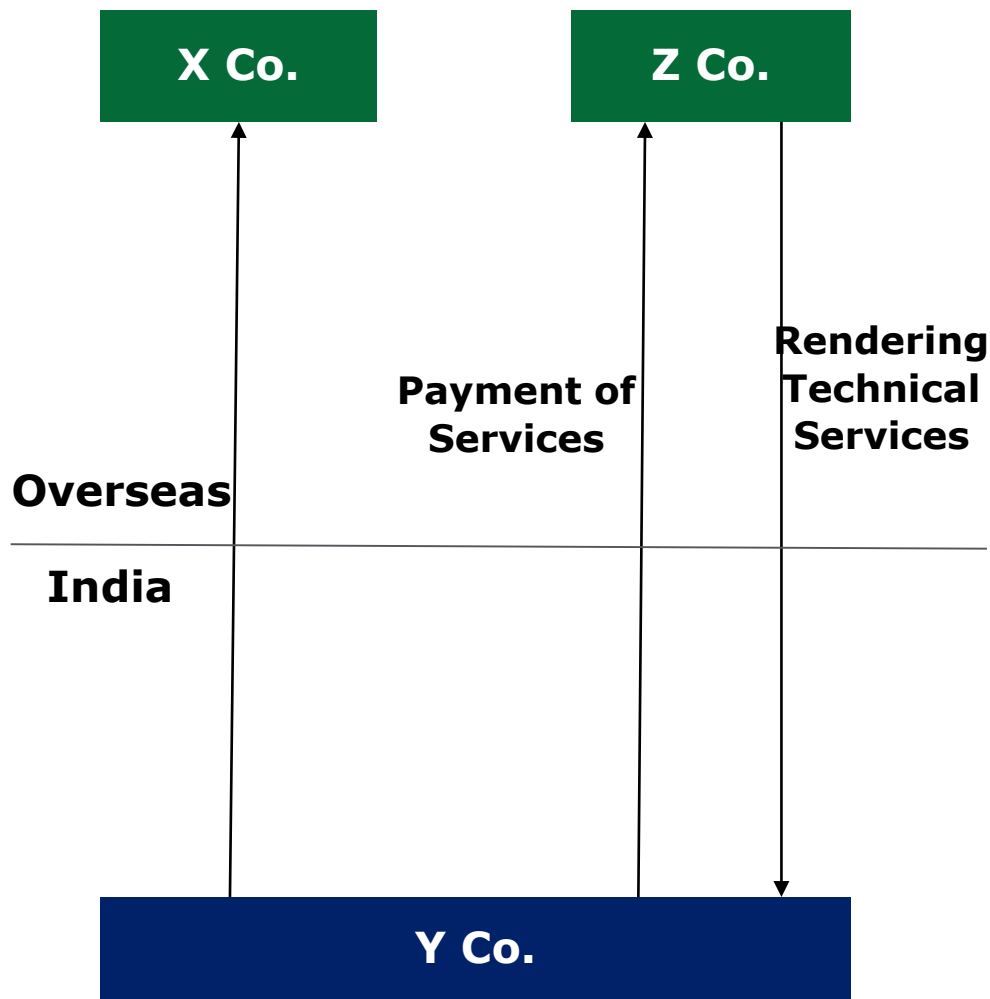
Secondment of employees



- Tax implication dependent upon the terms of deputation agreement

	FTS
XYZ India to qualify as an economic employer of employee. Salary cost re-charged at actuals by XYZ Inc. to XYZ India	✗
XYZ India to qualify as an economic employer of employee. Salary cost re-charged at mark up by XYZ Inc. to XYZ India	✓
XYZ Inc. deputed employee for providing services to XYZ India. Cost at actuals re-charged by XYZ Inc.	✓

Case Study 2



Facts

- X Co. enters into a contract 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

Issue

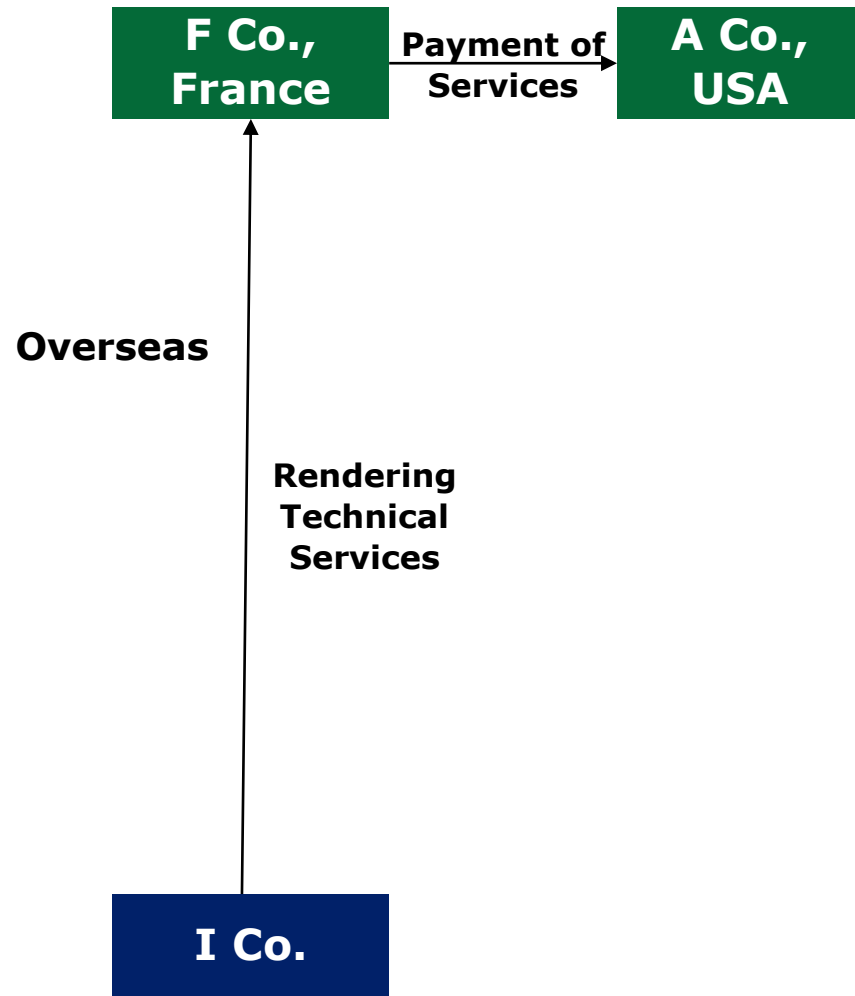
- Taxability of payment by Y Co. to Z Co. under the ITA?

Case Study 2

- **Section 9(1)(vii) of the ITA**

- 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 ITA
- 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 ITA (exclusion)

Case Study 3



Facts

- F Co. France engaged in the business of providing engineering & construction services, which has created PE for F Co. in India
- F Co. entered into an agreement with I Co. to provide technical/engineering services for a project 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

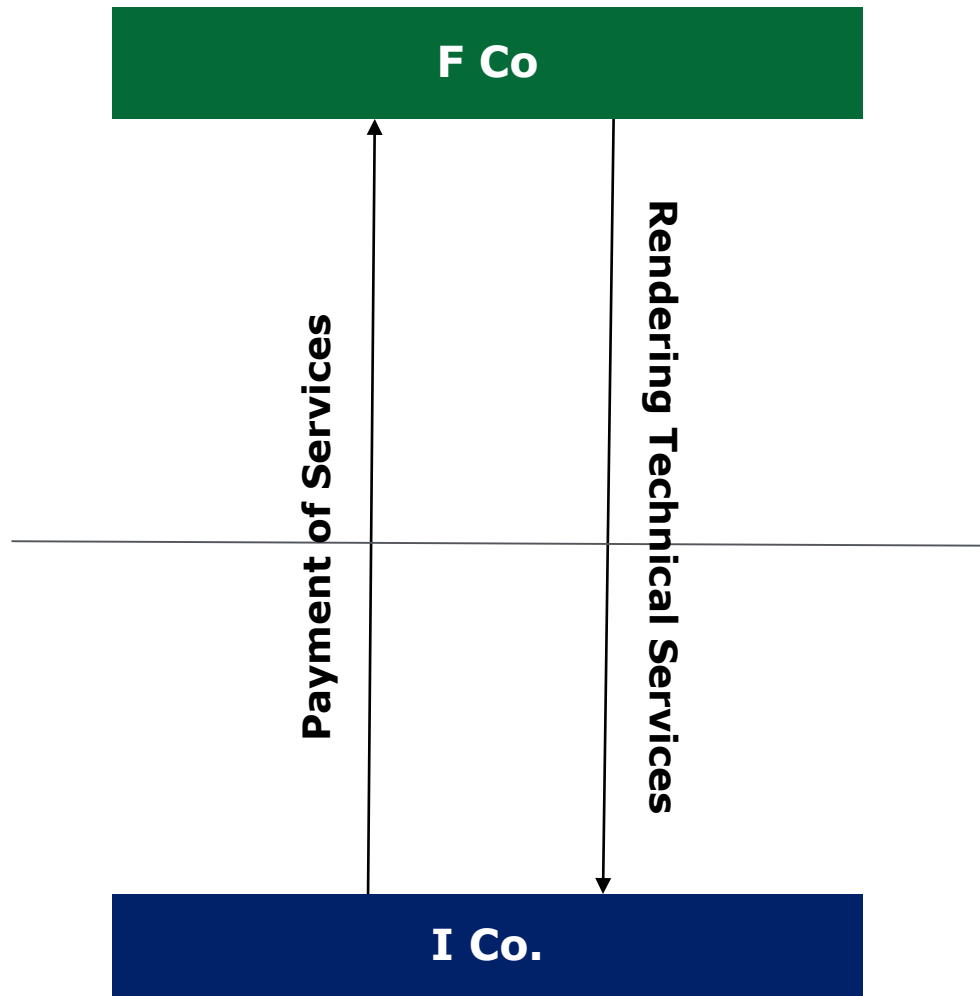
Case Study 3

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 ITA 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 4



Facts:

F Co., was engaged by I Co. to undertake technical services including technical drawings, detailed designs and reports

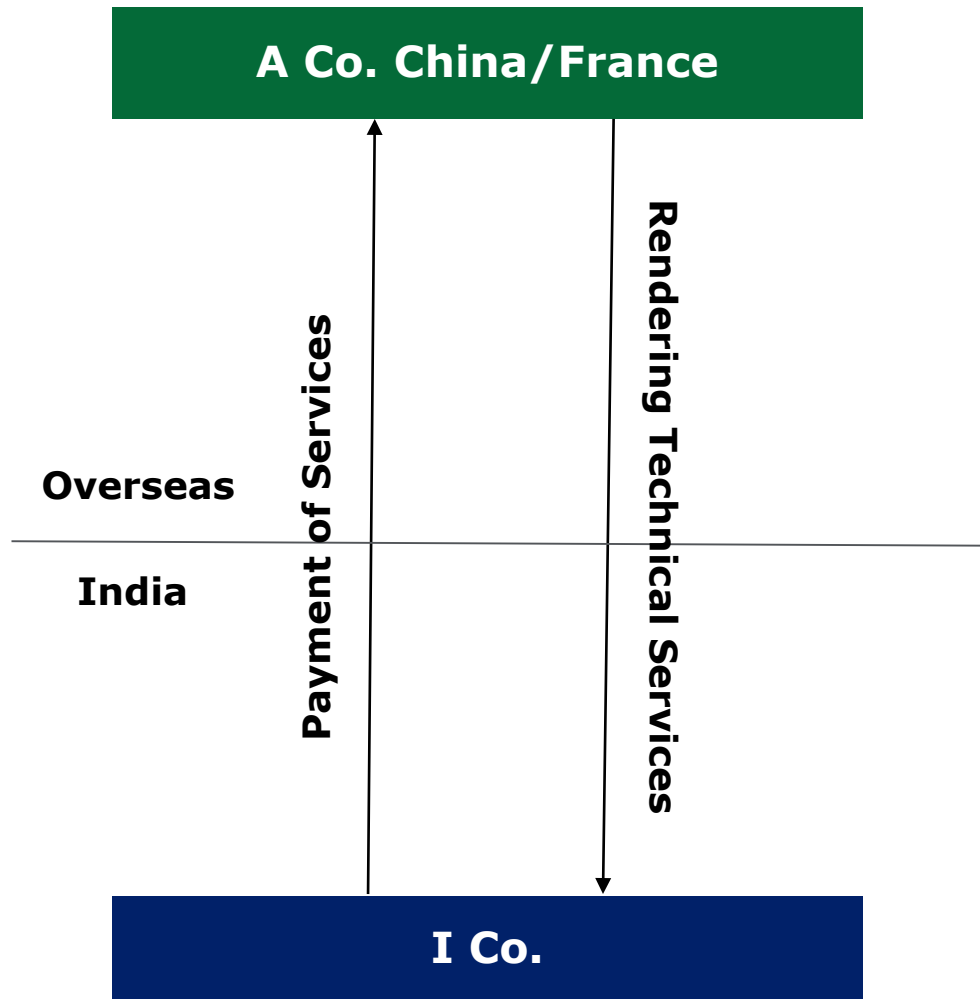
Issue:

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

Case Study 4

- **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 only where the technical or consultancy services consists of development and transfer of a technical plan or technical design only
 - 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 in India-US DTAA and India-Portugal DTAA

Case Study 5



Facts

- I Co. enters into a contact with ACo. for inspection of material/equipment overseas
- Services are rendered outside India

Issues

- Taxability of payment by I Co. to A Co. under India-China DTAA and India-France DTAA

Case Study 5

Under India-China DTAA

- Taxable in India only if underlying services are provided in India
- Payments to A Co. may not be taxable as FTS under India-China DTAA as the services are rendered outside India
- The Mumbai Tribunal in case of Ashapura MinichemLtd. held that even services performed outside India will be taxable in India

Under India-France DTAA

- Payment to A Co. may not be taxable as FTS under Article 13 read with clause 7 of Protocol of India-France DTAA in view of MFN clause
- Narrower definition of FTS under the India-Portugal DTAA can be applied
- Performance rule under India-Finland DTAA can be applied

Interest

Interest – under ITA

As per section 2(28A) of the ITA, the definition of interest is as under:

'Interest' means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilized.

As per section 9(1)(v) of the ITA, the following shall be deemed to accrue or arise in India:

Income by way of interest payable by—

(a) the Government ; or

(b) a person who is a resident, except where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the interest is payable in respect of any debt incurred, or moneys borrowed and used, for the purposes of a business or profession carried on by such person in India.

Explanation.—For the purposes of this clause,—

(a) it is hereby declared that in the case of a non-resident, being a person engaged in the business of banking, any interest payable by the permanent establishment in India of such non-resident to the head office or any permanent establishment or any other part of such non-resident outside India shall be deemed to accrue or arise in India and shall be chargeable to tax in addition to any income attributable to the permanent establishment in India and the permanent establishment in India shall be deemed to be a person separate and independent of the non-resident person of which it is a permanent establishment and the provisions of the Act relating to computation of total income, determination of tax and collection and recovery shall apply accordingly;

(b) "permanent establishment" shall have the meaning assigned to it in clause (iia) of section 92F;

Interest Article under the DTAA

Article 11(1) – Taxability of interest in Residence State

Article 11(2) – Taxability of interest in Source State

Article 11(3) – Meaning of the term 'Interest'

Article 11(4) – PE situation

Article 11(5) – Source of interest

Article 11(6) – Related party transactions – arm's length principle

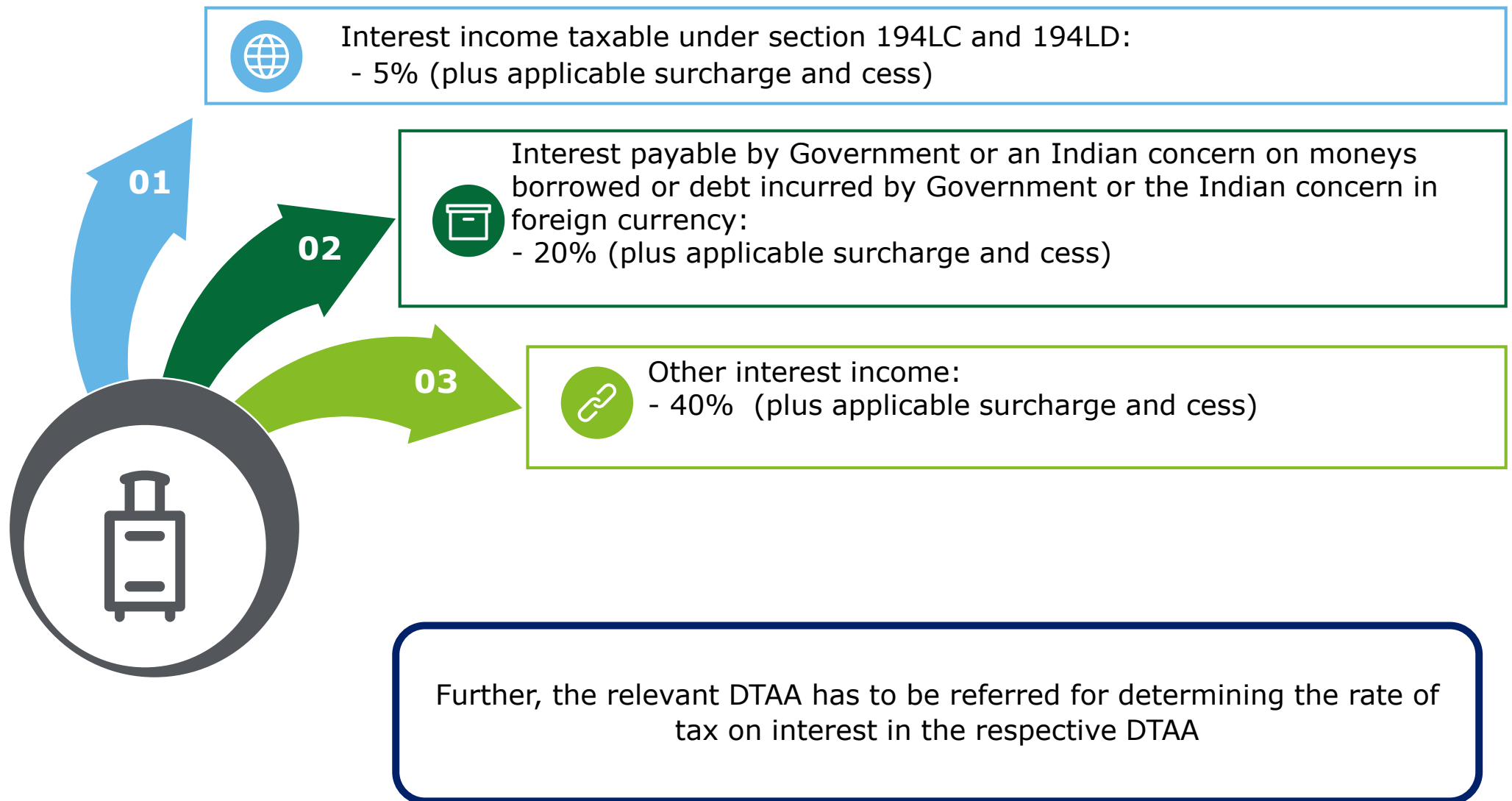
Taxation of interest in case of a PE

Interest is taxable under Article 7 (i.e. Business Profits) and not Article 11 if:

- Resident of State R carries on business in State S through a PE in State S; and
- Debt claim in respect of which interest is paid is effectively connected with such PE i.e. interest paid in respect of debt claims forming part of the assets of PE







**Interest will be taxable on net basis in
Country S**

Rate of tax – under ITA

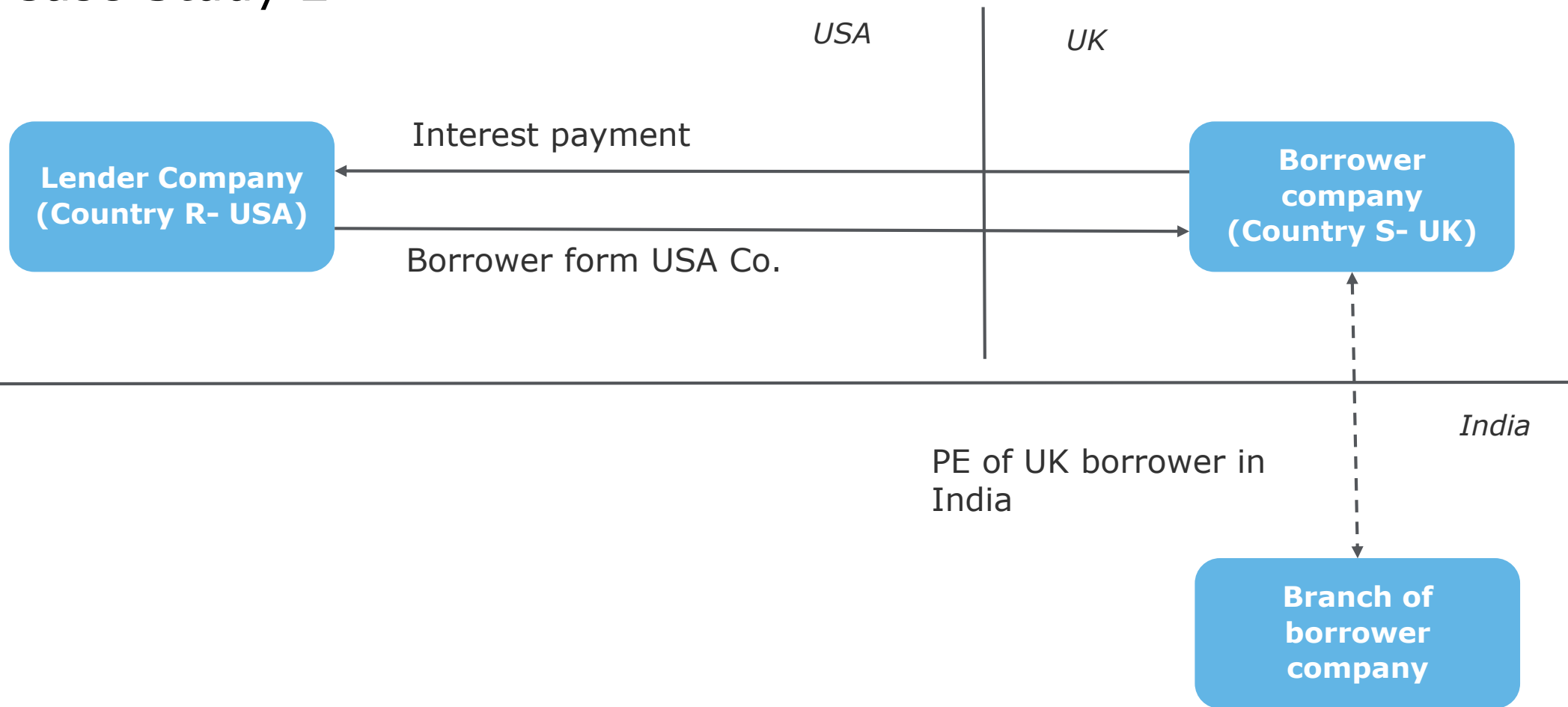


Case Study 1

Whether the following can be said to be interest under the DTAA?

Particulars	Answer
Interest rate swap	
Interest on Convertible bond / Debenture	
Interest on delayed income tax refund	
Premium received on Redemption of Debenture	
Guarantee Fee	
Commitment charges	

Case Study 2



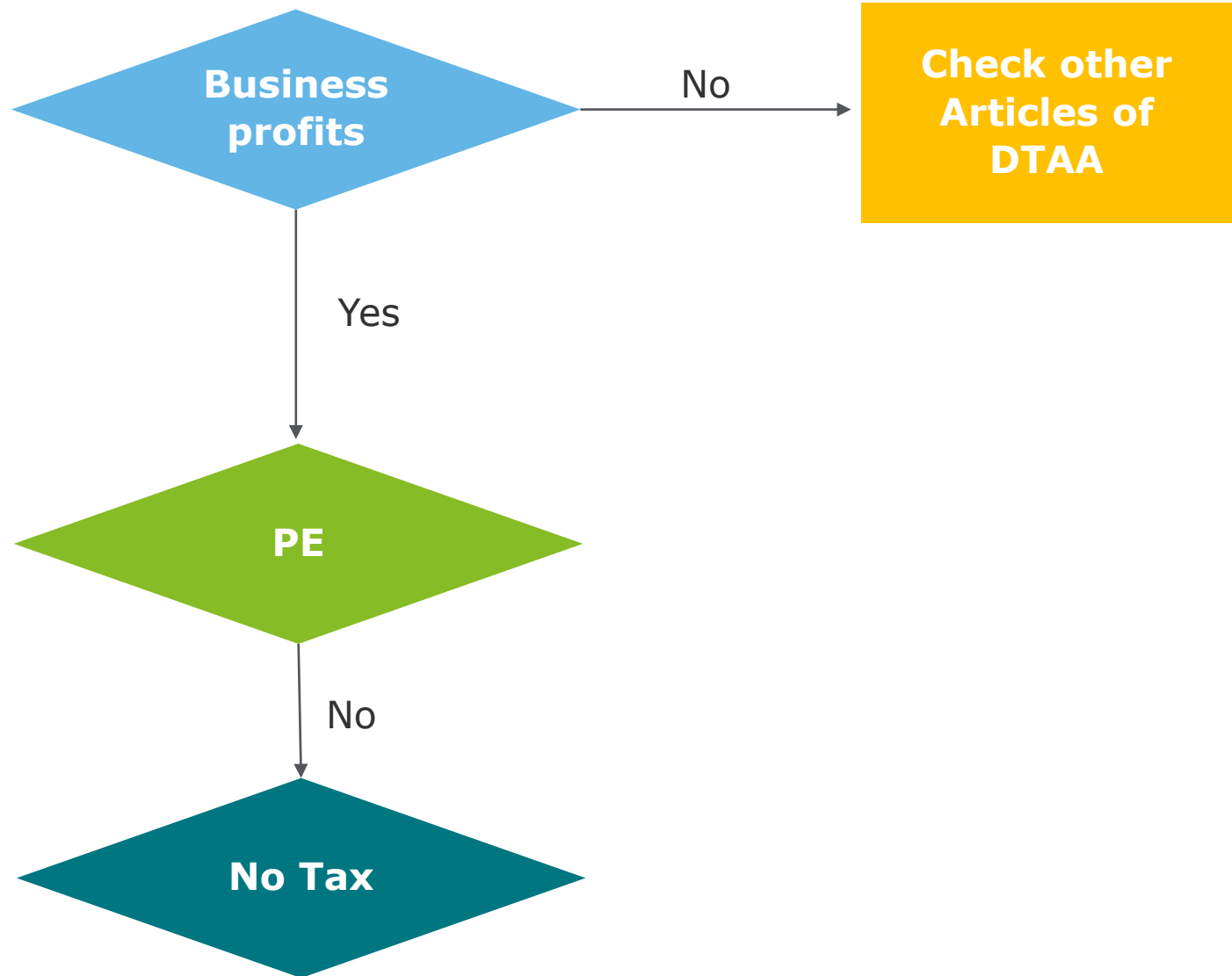
Issue for consideration

- Considering the fact that the indebtedness and interest incurred is borne by PE, would the interest received by the lender company be taxable in India?

Business Profits

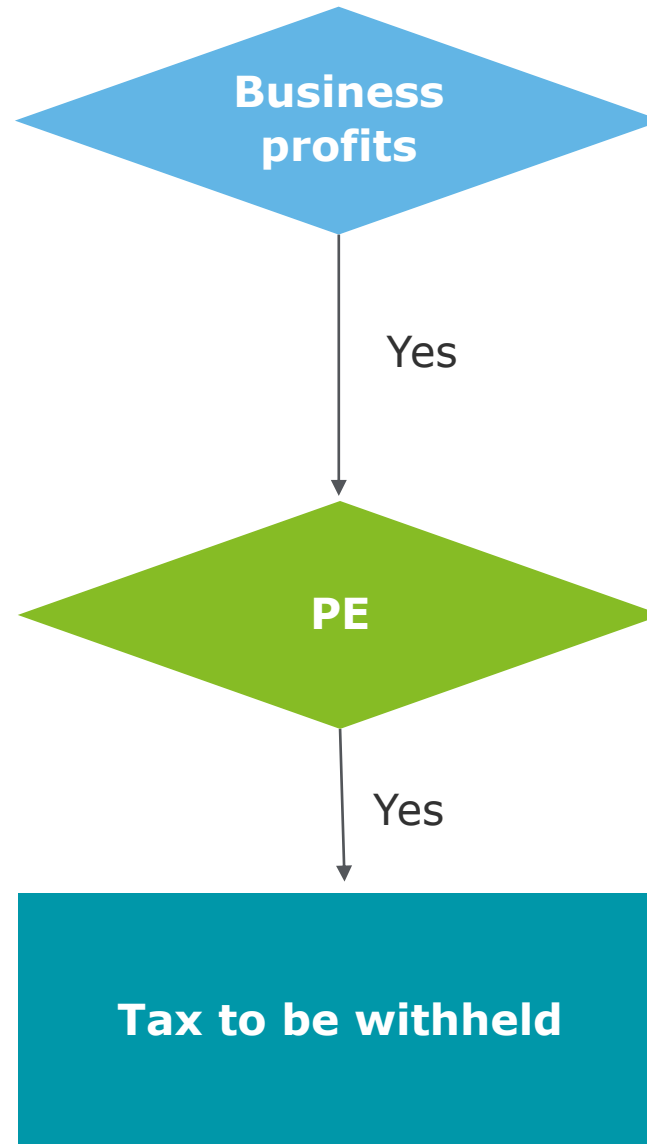
Business Profits

Scenario 1 – When there is no PE



Business Profits

Scenario 1 – When there is PE



Thank
you

