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Payment made under a management service agreement is covered within the expression 'fees for included services' – hence taxable and subject to withholding tax under section 195

In brief

In a recent decision in case of a software development service provider[1] (the taxpayer), the Cochin Bench of the Income-tax Appellate Tribunal (the Tribunal) held that payment made under a management service agreement to a non-resident company towards management services rendered by it for the purpose of decision-making, treasury, legal matters, etc., would be covered within the expression, 'fees for included services' (FIS). The taxpayer was therefore held liable to withhold tax under section 195 of the Income-tax Act, 1961 (the Act) on such payment, and suffer disallowance under section 40(a)(ia) of the Act for not withholding the tax.

Facts

- The taxpayer was engaged in providing software development services to its customers based in India. It claimed deduction of payment made to US Technologies LLC (US T), a non-resident company and tax resident of the United States, towards management services rendered by it. According to the management services agreement between the taxpayer and US T, it would provide assistance, advice and support to the taxpayer in management, decision-making, sales and business development, financial decision-making, legal matters and public relations activities, treasury service, risk management service and any other management support as may be mutually agreed between the taxpayer and US T.

[1] US Technology Resources Pvt. Ltd. *v.* ACIT [ITA No.222/Coch/2013, AY 2007-08, ITAT-Cochin]

- The Tax Officer disallowed the payments made by the taxpayer on the presumption that it was covered within the ambit of consultancy fees and hence tax was liable to be withheld under section 195 of the Act. The same was also confirmed by the Commissioner of Income-tax (Appeals) [CIT (A)].

Taxpayer's contentions

- Article 12(4) of the India-USA Double Taxation Avoidance Agreement (tax treaty) provides that FIS meant payments of any kind to any person as consideration for rendering, any technical or consultancy services, if such services, *make available* technical knowledge, experience, skill, know-how or process. The term 'managerial service' was specifically excluded from the definition of FIS as provided in Article 12(4) of the tax treaty.

- The taxpayer relying on various decisions[2] contended that US T did not *make available* any technical knowledge, expertise, etc. Technology could be considered as *made available* only when the person acquiring such service was itself able to apply the technology without depending on the provider. A mere provision of service may require the service provider to have or apply technical knowledge, but would not *per se* mean that such technical knowledge had been *made available* to the taxpayer at any point of time.

- At best, the payment made would be business profits under Article 7 of the tax treaty, which would be taxable in India if it could be attributable to a permanent establishment (PE) of US T in India. In absence of a PE, the management fee is not taxable in India, and hence not subject to withholding tax under section 195 of the Act. Also, the reference to the word 'training' used in the management service agreement by the CIT (A) is not justified.

Revenue's contentions

- The Revenue contended that as soon as the advice or support was received, the same was available to the taxpayer for making use in the decision-making process of the management and financial decisions, etc. and that the knowledge and expertise of US T would be used to support the taxpayer in managing its business and in training its employees. Therefore, the training provided by US T to the employees of the taxpayer in technical matters would fall within the expression 'fees for included services'.

Tribunal's ruling

- As per the Memorandum of Understanding to the tax treaty, consultancy services which are technical in nature alone are to be included as FIS.

- Based on the extract of the management services agreement as available from the CIT(A)'s order, the Tribunal held that US T provided highly technical services that were used by the taxpayer for taking managerial decisions, financial decisions, risk management decisions, etc.

- The Tribunal observed that the body of knowledge which was accumulated through study, experience and experimentation with regard to management, finance, risk etc. of a particular business is nothing but technical knowledge. In the era of technology transformation, the information /experience gathered by US T relating to financial risk management of business is also technical knowledge.

- The Tribunal noted that in the context of professional management and decision-making process, the advice and service rendered by US T which was made use of by the taxpayer in managerial decision-making process is in the nature of technical services which facilitated the taxpayer to take correct and suitable decision towards achievement of the desired objects and business goal. Similarly, the technical knowledge, experience, skill possessed by US T with regard to financial and risk management was made available in the form of advice or service which was made use of by the taxpayer in the decision-making process in financial matters and risk management matters also.

- Thus, in the present case, the information, expertise and training provided by US T had been absorbed by the taxpayer in its decision-making process and utilised for the purpose of business. Therefore, the expertise and technology which was *made available* by US T was a 'technical service' within the meaning of Article 12(4)(b) of the tax treaty.

[2] CIT *v.* De Beers India Minerals Ltd [2012] 346 ITR 467 (Karnataka), Raymond Ltd *v.* DCIT [2003] 86 ITD 791 (Mumbai), Sandvik Australia Pty Ltd *v.* DDIT [2013] 141 ITD 598 (Pune-Trib) and Workhardt Ltd. *v.* ACIT [2011] 10 Taxmann.com 208 (Mum-Trib) and Intertek Testing Services India Pvt. Ltd., In re [2008] 175 Taxman 375 (AAR)

Conclusion

- The Tribunal, relying on the tax officer's order and the CIT(A)'s order concluded that the payments made to a non-resident company under a management services agreement was for providing technical training to the taxpayer's employees and thus was covered within the expression, 'FIS' as per Article 12(4)(b) of the tax treaty by making available technical knowledge, skill, experience etc. Therefore, the sum was taxable in India and the taxpayer had defaulted by not withholding tax under section 195 of the Act, thereby rightly suffering disallowance of the same under section 40(a)(ia) of the Act.

- It is worthwhile to note that in the light of this ruling, the services of managerial nature need to pass the acid test/ touchstone of whether these are consultancy/technical in nature and whether the services really make available any technical knowledge, skills or experience, etc..

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