Marketing and other support services not taxable as FIS where the 'make available' test is not satisfied; where dependent agent PE is remunerated at arm's length, no further amount is taxable

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In brief

Recently, the Bangalore bench of the Income-tax Appellate Tribunal (Tribunal), upheld the following two principles in the case of the United States of America (USA) based taxpayer -

- The 'make available' test for taxability of fees for included services (FIS) was not satisfied unless there was a transfer of technology involved in rendering of technical services by the service provider to the service recipient.
- Where a permanent establishment (PE) had been remunerated on arms' length basis, no further income could be attributed to it and brought to tax in India.

In detail

Facts

- The taxpayer[1] was a company incorporated, and fiscally domiciled, in the USA.
- The taxpayer was engaged, *inter alia*, in providing business development, market services and other support services to its two associated enterprises (AEs) in India.
- The taxpayer earned fees aggregating to INR 110,411,826 for providing these services in the financial year under consideration.
- The taxpayer, in its return of income, claimed that the sum was not liable to tax in India under Article 12(4)(b) of the India-USA Double Taxation Avoidance Agreement (tax treaty), since the said services did not make available any technical knowledge, experience, skill, etc. to the AEs.
- During the course of assessment proceedings, the Tax Officer (TO) held that a person without the technical knowledge could not provide such services. Having held so, the TO concluded that the taxpayer was providing technical services to its AEs and it was also making available technical knowledge to its AEs, i.e., the service recipients. Accordingly, the TO held that the fees earned pursuant to rendering of services by the taxpayer were taxable as FIS under the India-USA tax treaty.
- The taxpayer filed objections with the Dispute Resolution Panel (DRP).
- The DRP confirmed the TO's stand. Further, the DRP also alleged that one of the AEs of the taxpayer was acting as its agent for the purchase and sale of the products of the taxpayer. Accordingly, it was alleged that the taxpayer had a dependent agent PE in

[1] [TS-386-ITAT-2015 (Bangalore)]

India through the presence of the Indian AE, and the profits attributable to the operations in India were to be brought to tax in India.

- In this backdrop, the TO proceeded to tax the sum in the taxpayer's hands as FIS. Further, an additional sum of INR 437,161 was brought to tax as business profits on account of the dependent agent PE's estimated profits, in accordance with the DRP's directions.

Issues before the Tribunal

- Were the payments received by the taxpayer from its AEs in India taxable as FIS under Article 12(4)(b) of the India-USA tax treaty?

- Did the AE in India constitute the taxpayer's dependent agent PE?

Tribunal's ruling

Taxability of fees as FIS

- A condition precedent for invoking the 'make available' test in Article 12(4)(b) of the India-USA tax treaty was that the services should have enabled the person acquiring the services to apply the technology contained therein. The Karnataka High Court's decision in De Beers India Private Limited,[2] approving this school of thought, was relied upon.

- Unless there was a transfer of technology involved in the technical services extended by the taxpayer, the 'make available' test was not satisfied.

- With respect to taxability of a consideration under the India-USA tax treaty, the decisive factor was not the rendering of training services *per se*, but the fact that the training services were of such a nature that it resulted in a transfer of technology. The consideration could not be brought to tax under Article 12(4)(b) of the India-USA tax treaty as the services did not enable the recipient to utilise the knowledge or know-how on his own in future without the aid of the service provider.

Constitution of dependent agent PE

- Even if a PE existed, and the taxpayer carried on business through it, under Article 7(1) of the India-USA tax treaty, the taxpayer's profits could be taxed in the source jurisdiction – but only so much as attributable to that PE. This also included attribution of profit to sales of goods or business activities carried on in the other state which was of the same or similar kind as those effected through the PE. On facts, even if the PE existed, it was constituted on account of the trading transactions only. Therefore, no part of the earnings from the rendering of services to the AE could be related to the nature of the PE's activities and thus be brought to tax in India.

- Since the Indian AE, which was treated as the taxpayer's dependent agent PE, had been paid an arm's length remuneration, nothing further could be brought to tax, in view of the settled legal position as per the case of SET Satellite (Singapore) Pte Limited[3].

- Even if there was a dependent agent PE based on facts, it would have no taxable profits in the hands of the taxpayer in absence of a finding that the PE had been paid less than arm's length remuneration. Accordingly, existence of the PE, being academic, need not be examined.

The takeaways

It is a welcome ruling wherein the aspect of 'make available' in connection to the marketing services has been analysed. The Tribunal has endorsed the well-settled principle of the 'make available' condition.

Furthermore, the ruling has reiterated that in cases where the impugned PE is being remunerated at arms' length, the issue of constitution of PE is academic, as nothing additional can be brought to tax in India.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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[2] CIT *v.* De Beers India Minerals Private Limited [2012] 346 ITR 467 (Karnataka)

[3] SET Satellite (Singapore) Pte Limited *v.* DDIT [2008] 307 ITR 205 (Bombay). The said judgment had relied on the principle laid down by the Supreme Court in the DIT *v.* Morgan Stanley & Co. Inc. [2007] 292 ITR 416 (SC)

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