

Implementation/ maintenance services taxable as FIS, being ancillary and subsidiary to the licensed software

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In brief

In a recent ruling¹, the Bangalore Income-tax Appellate Tribunal (Tribunal) has held implementation/ consultancy/ maintenance services for effective use of the software was taxable as “Fee for included services” (FIS) under the India-USA Double Taxation Avoidance Agreement (tax treaty), being ancillary and subsidiary to the licensing of the software.

In detail

Facts

- The taxpayer, a non-resident foreign company, was incorporated in USA and was involved in the supply of software to Indian customers. Further, implementation, consulting, maintenance and other technical services in connection with software were also supplied. During the assessment year 2008-09, the company earned the following income from its customers in India:
 - Sale of software licenses
 - Implementation and consulting

- Annual maintenance fees
- Training fees
- Partnership Fees
- The taxpayer, filed the return of income offering only the training fees as taxable income in India.
- The subject matter of appeal was the taxability of sale of software licenses as royalty and revenue from implementation, consulting and annual maintenance of software as FIS.
- However, the matter relating to income from licensed software being considered as royalty has not been considered in this Alert as the Tribunal has followed the jurisdictional HC

pronouncement² in this regard.

Issue before the Tribunal

Whether the revenue from consultancy, implementation and maintenance of software would be taxable as technical services as per the provisions of the section 9(1)(vii) of the Act or Article 12(4) of the India-USA tax treaty considering that the income from licensed software was considered as royalty?

Implementation, consultancy charges and annual maintenance fee on “Packaged Software”

Taxpayer’s contentions

- As per the provisions of Article 12(5) of the

¹ TS-263-ITAT-2017 (Bangalore-Tribunal)

² [2011]203 Taxman 477 (Karnataka)

India-USA tax treaty, FIS do not include amounts paid for services that are ancillary and subsidiary to the sale of property. Since the implementation and consultancy charges was part of the sale of software, the same should fall outside the definition of FIS.

- Further, relying on the judicial precedents the taxpayer contended that the maintenance services did not make available any technical knowledge to the Indian customers. The services did not enable the Indian customers to perform the maintenance services on their own in the future.

Revenue's contentions

- As the software supplied by the taxpayer was taxable as royalty under Article 12(3) of the India-USA tax treaty, the implementation, consultancy and maintenance charges received by the taxpayer in connection with software should have been covered by the definition of 'FIS' under Article 12(4)(a) of the India-USA tax treaty.

- Implementation & Consultancy charges received by the taxpayer were in connection with the software supplied and therefore it was to be charged in India as per Article 12(4) of the India-USA tax treaty.

Tribunal's ruling

- The payment for licensed software qualifies as royalty as per the provisions of Article 12(3) of the India-US tax treaty. The implementation and consultancy services were provided for the effective use of licensed software.
- The terms of the agreement between the taxpayer and the customers stated that the taxpayer had no right to use any information wherein the customers had the right to intellectual property.
- The maintenance and consultancy services for the software were the customer's specific requirements rendered for the purposes of effective use of the existing software. These services were ancillary and subsidiary to the software supplied, as per Article 12(3) and without these

services, the software could not be used in an efficient way.

- Implementation, consulting and maintenance was incidental to the sale of software licenses and fall within the purview of Article 12(4)(a) of the tax treaty and hence, taxable in India.

The takeaway

- The Bangalore Tribunal has held that the implementation, consultation and maintenance services for the effective usage of software would be taxable as FIS under Article 12(4)(a) of India-USA tax treaty.
- If the sale of software is held to be taxable as Royalty, the services ancillary and subsidiary to the usage of software would constitute FIS under India-USA tax treaty.
- Please note that the facts of each case would have to be considered separately while relying on the above rulings.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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