Financial, legal and risk management services not covered within the meaning of FIS under the India-USA tax treaty

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In brief

In a recent decision,[1] the Kerala High Court (HC) has held that management services such as (i) management decision making, (ii) financial decision making, (iii) legal matters and public relation activities, (iv) treasury services and (v) risk management services provided by a non-resident would not be covered within the meaning of "fees for included services" (FIS), as defined under Article 12 of the Double Taxation Avoidance Agreement (tax treaty) entered into between India and USA.

The HC has held that the mere fact that the provision of a service may require technical input by the service provider does not *per se* mean that the technical knowledge, skills, etc., are made available to the person availing such services.

In detail

Facts

- The taxpayer made payment to a USA company (non-resident) for providing management, financial, legal, public relations, treasury and risk management services.
- The taxpayer claimed that the aforesaid services were not chargeable to tax, therefore no taxes were withheld on the payments under section 195(1) of the Income-tax Act, 1961 (Act).
- The tax officer (TO) considered the said payment as income deemed to accrue or arise in India under section 5(2) and 9(1)(vii) of the Act and disallowed the expenditure claimed by the taxpayer under section 40(a)(i) of the Act, relying on a ruling of the Authority for Advance Rulings (AAR).[2]
- The Commissioner of Income-tax (Appeals) upheld the TO's order.
- On further appeal, the Income-tax Appellate Tribunal (the Tribunal) relied on the Andhra Pradesh HC's decision[3] and held that the taxpayer was using the advice, input experience, experimentation and assistance rendered by the non-resident in its decision-making process of financial and risk management, etc. Thus, it held that the services so rendered being technical in nature would be covered within the ambit of clause 4(b) of Article 12 of the tax treaty.
- Aggrieved, the taxpayer appealed before the HC.

Issues before the High Court

Whether the management services "made available" any technical knowledge, experience or skill to the taxpayer, and therefore, are covered within the ambit of FIS under Article 12 of the tax treaty?

[1] I.T.A. No. 38 of 2014
[2] Wallace Pharmaceuticals Private Limited, *In re* [2005] 148 Taxman 347 (AAR-New Delhi)
[3] GVK Industries Limited *v.* ITO [1998] 96 Taxman 179 (Andhra Pradesh)

Taxpayer's contentions

- Although management and financial services are categorised as "technical" or "consultancy" services and are covered within the ambit of "fees for technical services" (FTS) under the provisions of the Act, but these services are excluded from the meaning of "FIS" under the tax treaty, as they do not make technology available to the person acquiring these services.
- The taxpayer relied on the explanation provided in the Memorandum of Understanding (MoU) of the tax treaty on FIS.

Revenue's contentions

- The tax treaty provisions specifically grants relief from taxation by both countries. However, the taxpayer in this case has not established that the non-resident had paid taxes in the USA. Hence, the benefit of availing the provisions of tax treaty did not arise.
- Further, sub-section (3) of section 90 makes it mandatory to follow the definition of "technical and consultancy services" as given in the Act, and hence, the analysis in the Tribunal ruling should sustain.

High Court's decision

- The HC, after referring to the terms of the agreement, confirmed that the impugned services were in the nature of FTS, as defined under the Act.
- The HC observed that the definition of FIS, as given in the tax treaty, is narrower than the definition of FTS given under the Act, as there is an additional condition of services being made available to the recipient in case of FIS.
- Referring to a few examples given in the MoU, the HC observed that a technology would be considered to be "made available" only when the person acquiring the service is enabled to apply the technology.
- The HC held that the mere fact that the provision of a service may require technical input by the service provider did not *per se* mean that the technical knowledge, skills, etc., were made available to the person availing such services.
- Based on the MoU and the narrow definition of FIS, the HC held that the services provided by the US Co. to the taxpayer were beyond the ambit of Article 12 of the tax treaty, and accordingly, these services would not be taxable in India.
- It was also observed that the Andhra Pradesh HC's decision[3] relied upon by the Tribunal (which was affirmed by the Supreme Court[4]), was not relevant in the present case, as the said decision was on the interpretation of a definition under the Act, and the present tax treaty in question was never a relevant factor in that decision.
- In the Karnataka HC's decision[5] facts were more similar to that of the present case. In the present case, the services provided by the non-resident was merely advisory in nature, which assist the taxpayer in making correct decisions related to management, financial and legal matters and no transfer of technology, plan or strategy would be made available to the taxpayer by the non-resident.
- The HC specifically disagreed with the Revenue's contention that the non-payment of taxes in the USA could not automatically enable taxation in India.

The takeaways

The decision reaffirms the position that the mere provision of general support and routine advisory services related to finance, management and legal matters by a non-resident will not be considered as "making available" technical knowledge or skill to the taxpayer. This decision also reaffirms that technology would be considered "made available" only when the person acquiring the service is enabled to apply the same to its business.

Let's talk

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

[4] GVK Industries Ltd. *v.* ITO [2015] 371 ITR 453 (SC)

[5] CIT *v.* De Beers India Minerals (P) Limited [2012] 208 Taxman 406 (Karnataka)

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