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Inspection and boroscoping activity carried out in India not taxable

Turbine overhaul services taxable as it grants non-exclusive royalty free license

In brief

The Authority for Advance Ruling (AAR) in the case of Solar Turbines International Company¹ (the applicant or the company) held that:

- Consideration for inspection and boroscoping activity carried out in India not taxable as 'fees for technical services' (FTS) as no technical knowledge, skill are made available as per Article 12 of the India-US Double Taxation Avoidance Agreement (the tax treaty).
- Part consideration for turbine overhauling services that included grant of royalty free non exclusive right for use of technical information in respect of modification and upgradation of overhauled turbine is taxable in India as FTS under section 9(1)(vii) of the Income-tax Act, 1961 (the Act) and Article 12 of the tax treaty.

¹ Solar Turbines International Company, *In re* [TS-367-AAR-2012]

Facts

- The applicant, a company based in USA, is engaged in the business of manufacturing industrial gas turbines.
- The applicant had supplied gas turbines to Oil and Natural Gas Corporation (ONGC) in the past. Subsequently, the applicant entered into two contracts with ONGC as given below:
 - For carrying out trouble shooting repair and maintenance of turbines
 - For repair and overhaul services of turbines (including inspection and boroscoping periodically to ascertain the health of the installed parts)
- The issue raised before the AAR was with respect to the contract for overhauling services.
- The applicant secured the contract for overhauling services in 2009, pursuant to a tender floated by ONGC. As per this contract:
 - on notice of any defect, the particular turbine would be taken out for service and would be transported by ONGC for delivery at Dallas Air Port, USA, wherein the applicant would collect and transport the same to its work site at Desoto USA for rectifying the defect.
 - the dismantling, stripping and inspection of turbines was carried out by the applicant at its work site at Desoto, USA.
 - after completion of overhauling work, a report of result and details of modification was to be furnished to ONGC.
 - after completion of the overhauling work, the obligation to bring back the overhauled turbines from Desoto was on ONGC.

- an obligation was casted upon the applicant to provide detailed drawings and data to ONGC with respect to replaced parts or upgradation of machinery. This intellectual property right was licensed by applicant, in the form of a grant of right to use of technical information by way of royalty free non-exclusive license. ONGC could use such technical information for its turbines, but could not allow it to be used for the benefit of anyone else.
- the entire overhauling activity was carried out by the applicant at its work site at USA, except the activity of inspection and boroscoping of the equipments in India.

Issue

Based on these facts, whether the consideration received from ONGC under the contract for repair and overhaul was taxable as “FTS” having regard to the provisions of the tax treaty and the Act.

Revenue’s Contention

- The applicant has attempted to artificially split up the contract for supply, installation, commissioning, trouble shooting and maintenance of turbines, when all such activities are part of the integrated activity.
- While the income from installation and trouble shooting, repair and maintenance has been offered to tax under section 44BB and as FTS under the Act, the income from overhaul and repair has not been offered to tax, despite it also being part of the integrated activity.
- It cannot be said that there is no connection between the overhauling services to be carried out and the contract for the supply, installation and commissioning, as the applicant carries out periodic inspection as per the contract and remains in constant touch with the position of machines, their

technical capability etc. Accordingly, income from inspection and boroscoping activity carried out in India is subject to tax in India.

- Further, as per the terms of contract, the applicant is required to provide detailed drawings, data, technical specifications and engineering designed data to ONGC along with overhauled machinery. By doing so, the applicant makes available technical services to ONGC, thereby satisfies the criteria under paragraph 4 of Article 12 of the tax treaty

Applicant's Contention

- There is no permanent establishment (PE) of the applicant in India.
- The contracts of supply and subsequent services are independent transactions and had no direct connection as alleged by the Revenue.
- Entire overhauling work is done at its work place in USA and hence no part of overhauling work is carried out in India.
- Though the activity of overhauling would fall under the category of FTS as per section 9(1)(vii) of the Act, however, it is entitled to claim benefit under the tax treaty and thus payment received by it cannot be subjected to tax in India as the applicant is not "making available" any technical knowledge, experience, skill, know-how or processes to ONGC by rendering overhauling services.
- The transfer of right to use technical specification information in respect to overhauled machinery, apart from being royalty free, forms only a miniscule part of the transaction value and hence there is no occasion for going behind the assertion that it was royalty free non-exclusive license.

AAR's Ruling

- The AAR noted that all activities relating to overhauling services are carried out in USA, apart from, inspection and boroscoping activity and thus a major part of overhauling work is done in USA.
- Normally, in a contract for overhauling, when the machinery is overhauled and given back to the owner to resume its business, it cannot be said to involve making available any technical knowledge or information.
- Part consideration towards inspection and boroscoping activity carried out in India are not subject to tax in India, as these activities do not make available any technical knowledge, skill in terms of paragraph 4 of Article 12 of the tax treaty.
- The applicant had the intellectual property right over the data that was granted under a royalty free, non exclusive license. Hence by granting such royalty free license, the applicant does make available the technical knowledge or information to ONGC which it can use for its own benefit.
- Therefore, the AAR held that a part of the payments towards overhauling services must be assigned towards grant of non-exclusive license to ONGC (in relation to replaced parts or upgradation of machinery) for its own use and the same would constitute fee for technical services under the Article 12 (4)(a) of the tax treaty.

Conclusion

The ruling throws light on circumstances that would result in "make available" technical knowledge or experience for Article 12 of the tax treaty to trigger. The conclusion that a royalty free non-exclusive license to use data relating to the overhaul of turbines does indeed trigger the "make available" criteria is relevant.

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