MAKE AVAILABLE CLAUSES IN RELATION TO FEES FOR TECHNICAL SERVICES

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Introduction

Section 9(1)(vii) of the Income Tax Act, 1961 defines fees for technical services as follows:

"Explanation 2.—For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head "Salaries"."

Through the years, there has been extensive litigation on what exactly would constitute "fees for technical services". This is because in many cases the Department tries to re-classify the payments made by Indian taxpayers to non-residents u/S 9(1)(vii) as FTS instead of as business profits u/S 9(1)(i) because there is no requirement for attribution to India PE for S.9(1)(vii) taxability in India. In other words, even though the payments are made to a foreign entity who renders their services in a foreign country S.9(1)(vii) posits a *deemed fiction* of accrual of that amount in India thus making it taxable in India.

Article 12 or 13, as the case may be, in most DTAA's have typically same definitions of FTS as in S.9(1)(vii) of the Income Tax Act BUT in many DTAA's there is a "make available" clause present in their FTS Article which restricts the scope of what can be called FTS thus leading to certain payments as not being FTS but business profits thereby benefiting taxpayers under the DTAA. S.90(2) of the Act along with well-settled jurisprudence allows assessee's to take the Act or the DTAA whichever is beneficial to them and in cases where there are make available clauses the assessee's tend to take shelter under the DTAA thereby avoiding payment of tax as FTS and assuming the foreign entity payee does not have PE in India it is taxed solely in that foreign country under Article 7 ie Business Profits and not Article 12/13 i.e FTS.

Given this background we now look at S.9(1)(vii) and then the DTAA's with the make available clause

Interpretation of Section 9(1)(vii) of the ITA

Section 9(1)(vii) has remained a grey area and specifically how to interpret the wide ranging definition of the phrase "technical services" has been subject matter of various decisions:

In the case of ***Skycell Communications Ltd. v. DCIT (2001 119 Taxman 496)***, the Madras High Court had to decide whether a company that provided cellular phone services would fall "fees for technical services" and as it was domestic payment whether Section 194-J would apply for deducting tax at source.

The Department of course treated the payments they received from their subscribers as "fees for technical services", and the matter reached the Madras High Court which observed that:

"17. At the time the Income-tax Act was enacted in the year 1961, as also at the time when Explanation 2 to Section 9(1)(vii) was introduced by the Finance (No. 2) Act, with effect from April 1, 1977, the products of technology had not been in such wide use as they are today. Any construction of the provisions of the Act must be in the background of the realities of day-to-day life in which the products of technology play an important role in making life smoother and more convenient. Section 194J, as also Explanation 2 in Section 9(1)(vii) of the Act were not intended to cover the charges paid by the average house-holder or consumer for utilising the products of modern technology, such as, use of the telephone fixed or mobile, the cable T. V., the internet, the automobile, the railway, the aeroplane, consumption of electrical energy, etc. Such facilities which when used by individuals are not capable of being regarded as technical service cannot become so when used by firms and companies. The facility remains the same whoever the subscriber may be-individual, firm or company.

18. "Technical service" referred in Section 9(1)(vii) contemplates rendering of a "service" to the payer of the fee. Mere collection of a "fee" for use of a standard facility provided to all those willing to pay for it does not amount to the fee having been received for technical services."

The term "technical services" therefore is construed in a manner where there must be expertise in technology or skill or know-how relating to a field of technology. The feature must set the provider apart and would not include when the service is available to all and is a necessity to all. Thus, *Skycell* introduces the concept of not being a standard service and requirement of human expertise for a service to be brought under FTS. This argument of human expertise or human intervention is required for it to be FTS has been a key factor and reiterated in a number

of judicial decisions such as *CIT vs. Bharti Cellular 330 ITR 239 SC* as well as cases such as *Reliance Communications Ltd. vs ACIT [2016] 69 taxmann.com 307 ITAT Mumbai, DDIT (International Taxation) vs Avavya Global Connect Ltd. [2011] 43 SOT 439.* But the bottom line is that the Act's definition of FTS as being any technical, managerial or consultancy service is of very wide ambit thus making it very easy for the Department to classify any and all services as FTS.

Make Available Clauses in various DTAA's

For avoidance of double taxation, India has signed tax treaties with a number of countries, and DTAA's with certain countries have the 'Make Available' clause that imposes a restrictive and narrow interpretation of what constitutes Fees for technical services. The definition of FTS in various DTAAs (Australia, Canada, Cyprus, Malta, Netherlands, Singapore, US and UK) which have this make available clause could create a situation favourable to the assessee. Some important DTAAs and judgements interpretating them are as follows:

India

1. India-UK DTAA:

Paragraph 4 of Article 13 in the India-UK DTAA states that *"the term "fees for technical services" means payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which:*

a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3(a) of this article is received or

b) are ancillary and subsidiary to the enjoyment of the property for which a payment described in paragraph 3(b) of this Article is received or

c) make available technical knowledge, experience, skill know-how or processes, or consist of the development and transfer of a technical plan or technical design."

This make available condition in this treaty was recently interpreted by the Mumbai Bench of the Income Tax Appellate Tribunal in ***Buro Happold Ltd. v. DCIT (TA No. 1296/Mum./2017)*** where it was held that the second part of Article 13(4)(c), i.e., *"or consists of the development and transfer of a technical plan or technical design"* must be satisfied to consider the amount received as fees for technical services. In this matter, the assessee, a resident of UK engaged

primarily in the business of providing engineering design and consultancy services. He had earned an income from providing this service to its affiliated company in India.

This receipt was considered as FTS by the Assessing Officer and it was alleged that the term "make available" must be read in consonance with the words 'technical knowledge, experience, skill, know-how or processes' as in the Article and not with the words 'the development and transfer of a technical plan or a technical design' as in the second limb of Article 13(4)(c).

The assessee contended that, since there was no technical knowledge that was made available so that they could apply it independently, the amount cannot be classified as FTS and is only business income. However, since there was no PE in India for the taxpayer, the business income was not taxable in India. Moreover, supply of design and drawings to its affiliate was only incidental to the consultancy services provided by the assessee. The main contention was that the second limb of the Article cannot be read separately and must be read in consonance with the first limb of the Article.

The Tribunal places reliance on the principle of *ejusdem generis* and observes that the second limb of Article 13(4)(c) would exist complementary to the first limb of the provision. Therefore, the make available clause only applies when the recipient of the technology has been made competent and authorised to use the technology independently without any dependence on the provider of the service. In this case, the rule was not satisfied.

This interpretation could be adopted in various other DTAAs where the second limb is *pari materia* to the second limb of the India-UK DTAA.

In the case of ***Raymond Ltd. v. DCIT (86 ITD 791),*** the Tribunal held that the services that are rendered by a UK lead manager in the management of a GDR issue would not particularly make available any technical knowledge, know-how etc. as the recipients must be able to use the technical knowledge for his own benefit without assistance from the service provider. So the Article must be interpreted in such a manner as to take into consideration the facilitation of the recipient's benefit through enabling him to use the technical service without any help from the service provider.

2. India-US DTAA:

In Paragraph 4 of Article 12 of the India-US DTAA:

""fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services:

a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

b) Make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design."

As per this definition, services would fall within the scope of FTS only if they make available technical knowledge, experience, skill, know-how, or processes and a technology is made available when there is a person is acquiring services. A line of difference has been drawn between services that possess some technical aspects and technology that is made available. This line of difference has also been iterated in the MoU to the India-US DTAA wherein it is stated that a technology is made available when the recipient of the service has been enabled to apply the technology, and the MoU has been referred to by a multitude of judgements.

In the case of ***US Technology Resources Pvt. Ltd. v. CIT ((2018) 407 ITR 327)***, the Kerala High Court reaffirmed the meaning of the term 'make available' with reference to fees for included services. The High Court made a distinction between fees for included services as per the DTAA and 'technical and consultancy services' as under the Income Tax Act, and the judicial precedents cannot be interchangeably used. A reference was made to ***CIT v. De Beers India Minerals (P) Ltd. (TS-312-HC-2012 (Kar))*** where it was held that the services that were rendered by the Netherlands company to the assessee had not made available any technical service to the assessee. In light of the similarity in facts, the Kerala High Court held that the advice promised to the assessee by US Technology Resources LLC was not fall within 'included services' and FTS would not be taxable in India. In reaching this conclusion, the High Court relied on the MoU to state that there should be a transfer of technology with the recipient applying the service to his business.

To elaborate further, **<u>an example from the India-US DTAA MoU is considered:</u>**

"Example 8

Facts : An Indian company purchases a computer from a U.S. computer manufacturer. As part of the purchase agreement, the manufacturer agrees to assist the Indian company in setting up the computer and installing the operating system, and to ensure that the

staff of the Indian company is able to operate the computer. Also, as part of the purchase agreement, the seller agrees to provide, for a period of ten years, any updates to the operating system and any training necessary to apply the update. Both of these service elements to the contract would qualify under paragraph 4(b) as an included service. Would either or both be excluded from the category of included services, under paragraph 5(a), because they are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of the computer ?

Analysis: The installation assistance and initial training are ancillary and subsidiary to the sale of the computer, and they are also inextricably and essentially linked to the sale. The computer would be of little value to the Indian purchaser without these services, which are most readily and usefully provided by the seller. The fees for installation assistance and initial training, therefore/are not fees for included services, since these services are not the predominant purpose of the arrangement. The services of updating the operating system and providing associated necessary training may well be ancillary and subsidiary to the sale of the computer, but they are not inextricably and essentially linked to the sale. Without the upgrades, the computer will continue to operate as it did when purchased, and will continue to accomplish the same functions. Acquiring the updates cannot, therefore, be said to be inextricably and essentially linked to the sale of the computer."

Considering the aforementioned analysis, the fees for installation assistance and initial training were never a crucial part and purpose of the arrangement between the service provider and the recipient, and the purpose was entirely different. This service is only ancillary in nature and therefore, this cannot fall within FTS as it is not essential in nature.

3. <u>India-Singapore DTAA:</u>

In Article 12(4) of the India-Singapore DTAA, the term "fees for technical services" means *"payments of any kind to any person in consideration for services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel) if such services:*

(a) …

(b) make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein ; or

(c) consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein."

In the case of ***Filtrex Technologies Pvt. Ltd. v. ACIT (2018] 93 taxmann.com 301)***, ITAT Bangalore held that the payments made under a Technology Transfer Agreement make available technical knowledge and would fall within the scope of fees for technical services under Article 12 of the India-Singapore DTAA. This case further observes that a confidentiality clause has been inserted in the TTA and this shows that the service provider did not want the technology to go beyond the recipient, i.e. the assessee or its employees. It was also observed that when the services for which payment was made was in the nature of marketing support and other administrative services, no technical knowledge has been made available and Article 12 will not apply in that case.

4. <u>India-Netherlands DTAA:</u>

Under Article 12(5) of the India-Netherlands DTAA,

""fees for technical services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services:

(a).....

(b) make available technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design."

In the landmark judgement ***CIT v. De Beers India Minerals (P) Ltd. (TS-312-HC-2012 (Kar))***, the Karnataka High Court made crucial observations regarding the scope of fees for technical services. It was held that the payment for conducting airborne geophysical survey services made by service provider would not constitute FTS under the India-Netherlands DTAA. In this matter, it was not a matter of dispute that the services rendered by the assessee were technical in nature, and that it is liable to tax under the Income Tax Act, 1961. However, the make available clause in Article 12(5)(b) of the India-Netherlands DTAA and whether the service rendered came within the purview of this provision was the question involved.

The Karnataka High Court concluded that this would not fall within the meaning of fees for technical services that observed that the **MoU between India and USA** would apply to Article 12 of the India-Netherlands DTAA.

"22…Example 7 given in the Memorandum of Understanding between India and USA is relevant and is extracted below for ready reference:

Example 7 Facts:

The Indian vegetable oil manufacturing firm has mastered the science of producing cholesterol-free oil and wishes to market the product world-wide. It hires an American Marketing consulting firm to do a computer stimulation of the world market for such oil and to advice it on marketing strategies. Are the fees paid to the US company for included services?

Analysis:

The fees would not be for included services. The American company is providing a consultancy service which involves the use of substantial technical skill and expertise. It is not, however, making available to the Indian Company any technical experience, knowledge or skill etc. Nor is it transferring a technical plan or design. What is transferred to the Indian company through the service contract is commercial information. The fact that technical skills were required by the performer of the service in order to perform the commercial information service does not make the service a technical service within the meaning of paragraph 4(b)."

The Court also considers an example given by the arguing counsel that when a patient undergoes various tests as advised by the doctor, the patient is only interested in the end result and not the technical know-how that is required. So, the specialized equipment used by the scan center or the specialised service provided alone would not make it fees for technical services.

The Court also considers the second limb of Article 12(5)(b) which is on "development or transfer of technical plans or designs". It was observed that the assesse that contract in the matter was only for provision of services and not for supply of technical designs or plans. The provider had compiled the data and processed them for correction of errors, later delivering them to the assessee in an accessible manner. Further processing was done by the assessee that was not owned by the provider and later generated a report to determine the targets required. No technical plan or design was made by the provider and the reports and maps were only an

additional means of representation of data that was in question. It was thus observed that this would not constitute transfer of technical plan or design.

The need for making available technical knowledge, experience etc. to the assessee in question and the need for it to consist of the development and transfer of any technical plan or technical design was also reiterated ***DIT v. Guy Carpenter & Co. Ltd. ((2012) 346 ITR 504)*** by the Delhi High Court, with respect to the Make Available Clause in the India-UK DTAA.

Conclusion:

The services rendered and their interpretation are to be decided on the basis of the facts of each case. However, there is no dispute that the definition of "fees for technical services" is of very wide ambit under S.9(1)(vii) of the Act albeit for a few exceptions laid out in landmark judicial decisions of the requirement of having human expertise and not being a standard service. Further, while most DTAA's have similar definition as found in the Act for FTS, many of them do have a "make available" clause in their FTS Article (Article 12/13) which provides for a narrow interpretation of what would fall within the meaning of FTS, since it is not just technical knowledge being transferred but also the recipient being able to utilise the same without any assistance from the provider. Provided that such condition is satisfied, the receipt of income by the non-resident for these services would not fall within the meaning of fees for technical services, and thus the income of the non-resident would not be exigible to tax in India under the DTAA. Several judicial decisions have clearly outlined the ambit of the "make available" clause and this has become a very useful shelter for non-taxability of fts payments to foreign entities by Indian assessee's.