

India

Taxation of Fees for Technical Services: An Analysis of Indian Tax Treaties and Their Journey Through the Courts

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This article presents an analysis of the definitions of “fees for technical services” in India’s domestic tax law and double tax treaties. The author undertakes a comprehensive review of Indian case law interpreting the provisions of the Income Tax Act and tax treaties that deal with the taxation of income derived from the supply of technical services by non-residents. Using this analysis, the author proposes measures to fill the lacunae in the current OECD and UN model tax treaties, and thereby curb the tax leakage presently suffered by source states which import technical services.

1. Introduction

The term “service” is not defined in either the United Nations Model Tax Convention (“UN Model”) or the Organisation for Economic Cooperation and Development Model Tax Convention (“OECD Model”).^[1] However, an appropriate definition of the term “service” for tax treaty purposes may be borrowed from Black’s Law Dictionary: “the act of doing something useful for a person or a company for a fee”.^[2]

There are various types of services. Under the OECD and UN models, there are separate taxing rules for certain types of services, e.g. shipping and air transport, independent personal services (in the case of the UN Model), employment services, services of directors, services of artists and athletes and government services. All other types of services are treated in the same way as business activities. Thus, as far as such other types of services are concerned, by application of article 7 (read with article 5), or article 14 (in the case of the UN Model), income of service providers becomes taxable in a country other than their residence country only if the services are performed in such other country and the activities of the service providers create a permanent establishment (PE) or, if the UN Model is followed, a fixed base.

Due to development in technology, the manner of rendering cross-border services is changing, and actual presence of a service provider in a country to render services there is not necessarily a requirement. In view of such developments, under the current OECD and UN models, many service providers are able to avoid taxation in the countries where services are rendered. Not only does income from these services avoid taxation in those countries, but the tax bases of service recipients are also reduced, as payments for services are claimed as business expenses. This is a concern particularly for countries that import more services than they export.

With respect to technical services, India’s domestic law provides for taxation of income of non-resident service providers without requiring technical services to be performed in India.^[3]

India also deviates from the OECD and UN models to the extent that, in almost all of its tax treaties, India has included a specific provision allowing shared taxation of income from technical services, the only requirement being that the payment should be made by a resident or a PE of a non-resident.

India has extensive judge-made law with respect to domestic and treaty provisions dealing with technical services. This article seeks to analyse various cases decided by different Income Tax Appellate Tribunals (ITATs) dealing with this topic, and to advance possible solutions to fill the lacunae in the OECD and UN models.

2. Treatment of Technical Services under the OECD and UN Models

2.1. General remarks

Neither the OECD Model nor the UN Model has a separate provision for fees for technical services.

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1. Collectively referred to in this article as “the OECD and UN models”.

2. The United Nations Committee of Experts on International Cooperation in Tax Matters, *Note on the taxation of services under the United Nations Model tax convention*, UN, 2010, referred to *Black’s Law Dictionary* for the definition of the term “service”, at p. 2.

3. Section 9(1)(vii) of the Income Tax Act 1961 (the ITA).

Under the current OECD Model (2014), except for income from certain services, which are covered within the scope of specific provisions,^[4] income from all other kinds of services (including technical services) falls under either article 7 (Business profits) or article 21 (Other income).^[5]

Unlike the OECD Model, the current UN Model (2011) continues to have a separate provision for independent personal services (i.e. professional services or other activities of an independent character). Thus, under the UN Model, depending upon whether the services are independent personal services or otherwise,^[6] income from technical services may fall under article 7 (Business profits), article 14 (Independent personal services) or article 21 (Other income).^[7]

2.2. OECD Model

2.2.1. Business profits

Article 7(1) provides that “[p]rofits of an enterprise of a Contracting State shall be taxable only in that Contracting State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein”. Article 7 captures business income, including service income, of an enterprise, as well as individuals’ income from professional services and other activities of an independent character to the extent that such income is not subject to different rules under other articles.^[8] There are no separate rules for service and non-service income of an enterprise. Thus, under article 7, if a service provider of one contracting state provides its services in another contracting state, income earned from rendering such services may be taxed in the other state only if the service provider has a PE, as defined in article 5, in the other state.^[9]

2.2.2. Deemed service PE

In 2008, an alternative deemed service PE provision was added to the OECD Commentary on Article 5.^[10] This addition takes into consideration the concerns of various states which were reluctant to accept the position of exclusive residence taxation of income from services that are not attributable to a PE situated in their territory, but are nevertheless performed in their territory.^[11] Now, where an enterprise of a contracting state performs services in another contracting state, the activities carried on in the other state in performing the services are deemed to be carried on through a PE, if either of the following two conditions is satisfied:

- (1) where an enterprise is carried on by a single individual and services are performed by that individual, the individual is present in the other state for more than 183 days in any 12-month period and revenue derived from the services performed by the individual in the other state constitutes more than 50% of the gross revenue attributable to the active business activities of the enterprise during that period; or
- (2) in the case of other enterprises and services performed by one or more individuals, the services are performed in the other state for more than 183 days in any 12-month period for the same project or for connected projects.

This provision firstly requires physical presence and performance of services in the other state. Thus, it does not solve the problem of base erosion in cases where physical presence in a country is not necessary to provide services there.

Secondly, although this provision does not require service providers to have a fixed place of business in the source state, services must nonetheless be performed for a minimum period of 183 days. With the use of advanced technology to provide services over a short time span, 183 days seems too high a threshold, allowing relatively easy avoidance of source state taxation by service providers. Therefore, while many countries have kept this service PE provision in their tax treaties, they have reduced the time threshold.^[12]

2.2.3. Royalties

Article 12 provides for allocation of taxing rights to royalties. Services, as such, are not explicitly covered under this article. However, in the case of mixed contracts, which encompass both:

- the granting of the right to use intellectual property (IP)^[13] or transferring know-how; and
- the provision of technical assistance and other kinds of services,

4. For example, Shipping and air transport (article 8), Employment, i.e. dependent personal services (article 15), Director’s services (article 16), Artistes and athletes (article 17) and Government services (article 19).

5. OECD Model article number references in this section refer to the 2014 OECD Model.

6. Excluding dependent personal services dealt with under article 15.

7. UN Model article number references refer to the 2011 UN Model.

8. *OECD Model: Commentary on Article 7* (2014), para. 1, 1st sentence and para. 77, 5th sentence, Models IBFD.

9. Article 5(1) provides that “... the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on”.

10. *OECD Model: Commentary on Article 5* (2014), para. 42.23, Models IBFD.

11. See OECD, *Public Discussion Draft on the Tax Treaty Treatment of Services: Proposed Commentary Changes* (OECD 2006).

12. See W. Wijnen, J. de Goede & A. Alessi, *The Treatment of Services in Tax Treaties*, 66 Bull. Intl. Taxn. 1 (Jan. 2012), at pp. 29-30, Journals IBFD.

13. Mentioned in article 12(2).

where the service element is of an ancillary or largely unimportant character, the treatment applicable to the principal part of the contract (i.e. application of article 12) is also applied to the service portion.^[14]

2.2.4. Other income

Article 21, which addresses income not dealt with in any other article, provides for exclusive residence taxation, unless the recipient of such income carries on business in the other state through a PE, in which case article 7 applies. Application of article 21 to income from technical services is possible only if the country where services are performed refuses to consider service income as business profits under its domestic law, thus putting it out of the scope of article 7.^[15]

2.3. UN Model

2.3.1. Business profits and service PE

Under article 7(1) of the UN Model, if a service provider of one contracting state provides services in the other contracting state, the service provider may be taxed in the other contracting state only if the activities carried on to provide the services creates a PE, as defined in article 5, in the other contracting state.^[16]

Interestingly, article 5 of the UN Model has contained a service PE clause since the first UN Model (1980). Article 5(3)(b) provides that the furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose is considered to be a PE if the activities:

- continue within a contracting state;
- for a period or periods aggregating to more than 183 days in any 12-month period; and
- are for the same or a connected project.

In accordance with article 7(1)(c), which provides for limited force of attraction, the PE state may also be able to tax income from other services of the same or similar kind as those rendered by the service PE.

However, again the UN Model's service PE clause does not really solve the problem of base erosion in the service recipient's state, for the reasons given at [section 2.2.2](#).

2.3.2. Royalties

The analysis of article 12 of the UN Model is the same as that for services falling under article 12 of the OECD Model.^[17]

2.3.3. Independent personal services

Article 14(1) provides that income derived by a resident of a contracting state in respect of professional services or other activities of an independent character is taxable only in that state except in the following circumstances, in which case the income may also be taxed in the other contracting state:

- (1) the person has a fixed base in the other contracting state for the purpose of providing the services. In such case, only income attributable to the fixed base may be taxed in the source state; or
- (2) the person stays in the other contracting state for a period(s) aggregating to more than 183 days in any 12-month period, even if there is no fixed base. In such a case, only income derived from performance of services in the other contracting state may be taxed there.

In the UN Model (1980), an additional third condition was also present, which allowed the source state to tax service income if the income was borne by the resident of that state or by a PE or fixed base situated therein, and the amount exceeded a minimum sum, which was left open for the contracting states to decide in their treaties. However, this condition was omitted from the UN Model in 1999 on the ground that the exportation of skills, such as the exportation of goods, should not give rise to taxation in a country of destination unless the person concerned has a fixed base comparable to a PE in that country.^[18] In 1999, this reasoning may have been reasonable and acceptable; however, nowadays services, which earlier could have been rendered in another state only through a fixed base, or by the provider physically being in that state for a certain time, can now be rendered either without having any presence, or having only a minimal presence, in the country. As Arnold correctly states:

the fixed-place-of-business threshold (i.e., PE or fixed base) that applies to the source country taxation of business profits generally is clearly inappropriate for income from services. That threshold was adopted at a time when most cross-border business activity

14. [OECD Model: Commentary on Article 12](#) (2014), para. 11.6, Models IBFD.

15. See W. Wijnen, J. de Goede & A. Alessi, *supra* n. 12, at p. 36.

16. Article 5(1) of the UN Model is exactly the same as that in the OECD Model.

17. See [section 2.2.3](#).

18. [UN Model: Commentary on Article 14](#) (2001), para. 2, Models IBFD.

involved the manufacture or production and sale of goods. In the modern economy cross-border services are much more important. Such services can usually be performed without the need for any fixed place of business and certainly without the need for a permanent (more than 6 months) fixed place of business.^[19]

2.3.4. Other income

As noted under [section 2.2.4.](#), application of article 21 to income from technical services is possible only if the country where services are performed refuses to consider service income as business profits, professional service income or income from other services of an independent character under its domestic law, thus putting it out of the scope of articles 7 and 14. In that case, the source state may tax the income in accordance with article 21(3), which does not require any threshold to be met by service providers, the only requirement being that the source of income should be in the other state.

2.3.5. Proposed article

There is a proposal to insert a separate article for fees for technical services (FTS) in the UN Model.^[20] For the purpose of that article, FTS are any payments made in consideration for any service of a managerial, technical or consultancy nature, with few exceptions. Its scope is very broad, and not limited to payments for the transfer of technology or technical know-how, as is the case, for example, in the [India-United States Income Tax Treaty \(1989\)](#).

As is the case for interest and royalties, the UN proposes that the new article allocates the taxing rights between the resident state and the source state.

The proposed article also provides for a source rule according to which a payment is deemed to arise in a contracting state if the payer is a resident of that state or if the person paying the fee (whether or not that person is a resident of a contracting state) has a PE or fixed base in the contracting state, and the payment is incurred and borne by the PE. It does not require physical presence in the source state at all and, thus, to a great extent, should solve the FTS type of base erosion in source states.

3. Treatment of Technical Services in India

To protect its tax base, in almost all its tax treaties India includes a specific provision dealing with FTS. The language of the provision in each treaty is not the same; hence, the scope of the provision varies widely.

Before discussing these provisions, it is important to understand the relevant provisions of Indian domestic law, which deal with the taxation of FTS.

3.1. Indian domestic law

FTS earned by non-residents and sourced in India are taxable in India under section 9(1)(vii) of the Income Tax Act 1961 (the Act) by way of withholding tax deducted at source at the rates mentioned in section 115A of the Act.^[21] Section 9(1)(vii) of the Act defines the term “fees for technical services” and also provides the rule to determine the source of such fees.

3.1.1. Meaning of “fees for technical services”

Explanation 2 to section 9(1)(vii) of the Act defines the term “fees for technical services” as:

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’.

This definition is made up of two parts: first, meaning and inclusions and, second, exclusions.^[22] The second part of the definition, which excludes certain income, is quite clear. However, there is much debate about the meaning of the first part. The Act does not define the term “managerial, technical or consultancy services”, leaving it to be interpreted by tax authorities, taxpayers and ultimately the courts.

In *Skycell Communications Ltd. v. DCIT*,^[23] the Madras High Court analysed the term “technical service” and noted that the word “technical” may have more than one meaning, viz. (i) relating to a particular subject, art or craft or its techniques, or (ii) involving, or concerned with,

19. United Nations Committee of Experts on Cooperation in International Tax Matters, *Note on the taxation of services under the United Nations model tax convention*, *supra* n. 2, at p. 18.

20. United Nations Committee of Experts on Cooperation in International Taxation Matters, *Revised Draft Article XX and Commentary United Nations Model Tax Convention* (UN 2015).

21. See sections 4, 5(2)(b), 9(1)(vii), 28, 115A and 195 of the Act.

22. See *CIT v. Bharti Cellular Ltd* [2008] 175 Taxman 573 (High Court of Delhi), 31 Oct. 2008, at para. 11.

23. [2001] 119 Taxman 496 (High Court of Madras), 23 Feb. 2001, at paras. 9-11, 14 and 17-18.

applied and industrial sciences. The High Court remarked that the popular meaning associated with “technical” is “involving or concerning applied and industrial science”. However, the court stated that the term must be understood in the context in which it is used. Accordingly, FTS could only be meant to cover such technical things that are capable of being provided by way of service for a fee.

In *In re. Intertek Testing Services India (P.) Ltd.*,^[24] the Authority for Advance Rulings (AAR) in New Delhi held that the scope of technical services should not be confined to only technology relating to engineering, manufacturing or other applied sciences; rather, a wide interpretation should be given to technical services, keeping in mind its dictionary meaning.

The scope of the term “technical services” includes the rendering of managerial, technical and consultancy services. The problem is that the definition is in the form of A = B + A + C, i.e. use of the word “technical” twice makes the definition of FTS circular and, therefore, uncertain.

A reasonable interpretation of the definition should require that all three categories of services, viz. managerial, technical and consultancy, be technical in the sense that only such technical or managerial or consultancy services that require expertise in a particular subject, art, craft or technique should be brought within the scope of FTS. The word “technical”, used inside the definition, probably refers to technical services in the narrow sense, which requires expertise in applied or industrial science.

It is thus important that all three terms be read together to understand the correct meaning and scope of the term “fees for technical services”. In *Bharti Cellular*, the High Court did exactly that by applying the rule of *noscitur a sociis*.^[25] The Court thus analysed the meaning of the terms “managerial” and “consultancy” to understand the term “technical”, noting that a managerial service and a consulting service will always have a human element attached to them. On the basis of its analysis, the Court held that, in Explanation 2 to section 9(1)(vii), the expression “technical service” would have reference to only such technical services as are rendered by humans and would not include any service provided by machines or robots.

It may therefore be said that a service is a technical service if:

- (1) there is a service element (not merely being the provision of technical goods or facilities) given to a person who is ready to pay for it;
- (2) the service is in the nature of a managerial, technical or consultancy service;
- (3) the service is provided by humans and not by machines or robots;
- (4) the service is not in the nature of construction, assembly, mining or like projects; and
- (5) the service is not provided in the course of employment by an employee to his or her employer.

3.1.2. Source rule

The source rule for FTS is provided under section 9(1)(vii) of the Act, which states that the fees are deemed to accrue or arise in India (so that they are taxable in India by way of inclusion in the total income of the service provider) where they are payable by:

- (1) the government – there are no conditions or exceptions; or
- (2) a resident – there are no conditions, but two exceptions, viz. where the fees are payable in respect of services utilized:
 - in a business or profession carried on by the resident outside India; or
 - for the purposes of making or earning any income from any source outside India; or
- (3) a non-resident – there are no exceptions, but two conditions: the fees must be payable in respect of services utilized:
 - in a business or profession carried on in India by the non-resident; or
 - for the purposes of making or earning any income from any source in India.

When a resident is the payer, it seems from the plain reading of the section that, if the services are utilized outside India for any purpose other than a business or profession carried on outside India by that resident or to earn income from a source outside India, the fees would still be taxable in India. This result is strange because, if an Indian resident utilizes a technical service outside India for personal purposes, a tax liability in India would arise; but if the same service is utilized by the same Indian resident in a business or profession carried on outside India by that resident, a tax liability in India would not be attracted. Such an incongruous result may be avoided by excluding services provided for the personal use of individuals from the scope of FTS in tax treaties, e.g. under the India-United States Income Tax Treaty.

24. [2008] 175 Taxman 375 (AAR New Delhi), 7 Nov. 2008.

25. *Supra* n. 22, at paras 13-15 and 20. Maxwell explains that “where two or more words which are susceptible of analogous meanings are coupled together, they are understood to be used in their cognate sense. They take, as it were, their colour from each other, the meaning of the more general being restricted to a sense analogous to that of the less general.”: P. St. J. Langan, *Maxwell on the Interpretation of Statutes*, 12th ed. (2008), at p. 321.

Where the fee is paid by a non-resident, the services must be utilized in India before the income derived therefrom becomes taxable in India. Thus, taxability of FTS under this rule is dependent only upon who the payer is and where the service is utilized. The place where the services are performed is not a condition here.

3.2. Indian tax treaties

Indian tax treaties vary as far as the meaning and scope of FTS is concerned. One can find an FTS clause with an extremely narrow scope in one treaty and, at the same time, in another treaty, an FTS clause with a broad and vague scope can be found.

3.2.1. “Plain vanilla” example

The [India-Germany Income and Capital Tax Treaty \(1995\)](#) offers an example of the simplest FTS article, which is found in most of India’s tax treaties. Here FTS are dealt with under article 12 (Royalties) of the India-Germany treaty. “Fees for technical services” are defined as:

... payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel, but does not include payments for services mentioned in Article 15 of this Agreement.

This definition is very wide. All services of a managerial, technical or consultancy nature are covered, except if they are provided by employees to their employers.

3.2.2. Exclusion for independent personal services

There might be some overlap between the scope of provisions dealing with FTS and independent personal services. It is an internationally accepted legal doctrine that a specific rule prevails over a general one,^[26] but the debatable question is which provision (independent personal services or FTS) is the more specific. To avoid such debate, many tax treaties set the rule of precedence in the definition of FTS itself. For example, article 13(3) of the [India-Malaysia Income Tax Treaty \(2012\)](#) provides that:

[t]he term “fees for technical services” means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel *but does not include payments for services mentioned in Article 15 and Article 16 of this Agreement.*

(Emphasis added.)

The effect of such an exclusion in the definition provides clarity and certainty to taxpayers and service providers.

3.2.3. “Make available” clause

3.2.3.1. India-United States Income Tax Treaty

The scope of the definition of FTS in certain treaties entered into by India is restricted by a “make available” clause. Among such treaties, the India-United States treaty is the most important and the most elaborate. This treaty addresses the term “fees for included services” (rather than “fees for technical services”) in article 12(4), as follows:

For purposes of this Article, “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;^[27] 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.

In short, “included services” in the India-United States treaty fall into three categories:

- (1) services ancillary and subsidiary to the application or enjoyment of a right, property or information;
- (2) the making available of technical knowledge, experience, skill, know-how or processes; and

^{26.} Known as the maxim of *generalia specialibus non derogant*.

^{27.} That is, payments for the use of, or the right to use, a copyright of a literary, artistic, or scientific work, a patent, trademark, design or model, plan, secret formula or process, or information concerning industrial, commercial or scientific experience, and payments received as consideration for the use of, or the right to use, industrial, commercial, or scientific equipment.

(3) the development and transfer of a technical plan or technical design.

According to the OECD Commentary, the first category of services has always been a part of article 12, even if it is not expressly included in the article.^[28] The second and third categories constitute a more restricted version of services.

The scope of this provision is explained in detail in the *Memorandum of Understanding Concerning Fees for Included Services in Article 12* (MoU), annexed to the Protocol signed by India and the United States along with the treaty. There, article 12 is said to include only certain technical and consultancy services. “Technical services” means services requiring expertise in a technology. “Technology” means the application of scientific knowledge to the practical aims of human life.^[29] Thus, the scope of “technical services” in the India-United States treaty is a narrow one and is confined to services where a service provider is required to utilize its scientific knowledge.

The MoU goes on to explain that consultancy services means advisory services. It provides that, as far as clause (a) of article 12(4) is concerned, consultancy services may include advisory services, whether or not expertise in a technology is required to perform them. But, in the case of clause (b), only such consultancy services that are of a technical nature can be included services.

With regard to clause (b), the MoU provides that:

technology will be considered “made available” when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service may require technical input by the person providing the service does not per se mean that technical knowledge, skills, etc., are made available to the person purchasing the service, within the meaning of paragraph 4(b). Similarly, the use of a product which embodies technology shall not per se be considered to make the technology available.^[30]

With respect to the requirement that technical or consultancy services must make available technical knowledge, experience, skills, etc., does the technology that is transferred to the service recipient and the technology that is used to render the service have to be the same, or can they be different? In many cases, it is possible that the service provider does not transfer exactly the same technology or technical knowledge that was used in rendering the services, but the output of the service which is provided to the service recipient has some form of technical knowledge.

The text of article 12(4) of the India-United States treaty is not explicit in this regard. However, the MoU provides that technical services means “services requiring expertise in a *technology*”^[31] (emphasis added) and that “technology will be considered “made available” when the person acquiring the service is enabled to apply *the* technology”.^[32] Use of the definite article “the” before “technology” in the second sentence implies that this technology is the same as the technology referred to in the first sentence. In other words, it requires the technology in both the cases to be the same.

The make available clause has been interpreted by the courts in various cases in India. While analysing the meaning of the clause under the [India-United Kingdom Income Tax Treaty \(1993\)](#) in *Raymond Ltd. v. DCIT*,^[33] the ITAT Mumbai held that:

a mere rendering of services is not roped in unless the person utilising the services is able to make use of the technical knowledge etc. by himself in his business or for his own benefit and without recourse to the performer of the services in future. The technical knowledge, experience, skill etc. must remain with the person utilising the services even after the rendering of the services has come to an end.

This rule was explained in more detail by Karnataka High Court in *CIT v. De Beers India Minerals (P.) Ltd.* ^[34] Here, the court confirmed the position that, for a service to fall within the scope of FTS, the service recipient should be enabled to render the same service in the future without the help of the service provider. The court further noted that the service should be aimed at, and result in, transmitting technical knowledge or know-how, so that the service recipient could derive an enduring benefit from utilizing the knowledge or know-how on his own in future without the aid of the service provider.

The rule was also explained by ITAT Hyderabad^[35] by way of a very simple example: when a doctor provides a prescription or medical advice to a patient, the doctor is not making available his medical knowledge to the patient. Whereas, if the same doctor teaches or trains students on the aspects of diagnosis or techniques of surgery, the doctor is making available his medical knowledge to the students.

It is also possible that, in certain situations, technical skills and knowledge is acquired by service recipients by observation, their own efforts, inquisitiveness or continuous use of the service without there being a formal agreement between the service providers and service

28. [OECD Model: Commentary on Article 12](#) (2014), para. 11.6, Models IBFD.

29. Encyclopedia Britannica, *Britannica Academic*, “Technology”, Encyclopedia Britannica Inc., 2015, available at <http://academic.eb.com/EBchecked/topic/585418/technology>.

30. First paragraph under *Paragraph 4(b)*.

31. Second paragraph under *Paragraph 4 (in general)*.

32. *Supra* n. 30.

33. [2003] 86 ITD 791 (ITAT Mumbai), 24 Apr. 2002, at para. 92.

34. [2012] 21 taxmann.com 214 (High Court of Karnataka), 15 Mar. 2012.

35. See *ACIT v. Viceroy Hotels Ltd.*, [2011] 11 taxmann.com 216 (ITAT Hyderabad), 27 May 2011, at para. 32.

recipients for any transfer of technical knowledge.^[36] In such cases, the ITAT Delhi, has stated, in the context of article 12(4)(b) of the India-United States treaty, that technical knowledge and skills cannot be said to have been made available from a service provider to a service recipient.^[37]

The second limb of article 12(4)(b) of the India-United States treaty covers services that involve development of technical plans or designs and transfers of the developed designs plans or designs. To fall in this category, it is necessary for a service to have both the elements of development of the technical plan or design and then its transfer. Mere transfer of technical plans or designs, which already existed with the transferor would not come within the scope of this category, as it does not have any service element in it. That a technical plan or design has to be developed first and then transferred implies that this category of services involves only customized or tailor-made technical plans or designs.

The definition of “fees for included services” in article 12(4) of the India-United States treaty is very narrow in scope as it is restricted to only services that are ancillary to the transfer of IP rights (clause (a)), are merely media for the transfer of technology (clause (b)) or are performed with the intention of transferring technical plans or designs (clause (b)).

3.2.3.2. The India-Singapore Income Tax Treaty (1994)

Article 12(4)(b) of the India-US treaty can be divided into two parts, viz. services that:

...

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

(Emphasis added.)

The purpose of dividing article 12(4)(b) in this way is to point out that the make available clause is not expressly applicable in cases where services consist of the development and transfer of a technical plan or design.

By contrast, the [India-Singapore Income Tax Treaty \(1994\)](#) uses different wording in its corresponding clause. “Fees for technical services” is defined under article 12(4) of that treaty in the following manner:

The term “fees for technical services” as used in this Article 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:

...

- (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.*

(Emphasis added.)

According to this definition, the make available rule is expressly applicable to services consisting of the development and transfer of technical plans or designs. The fact that the rule is expressly stated in the India-Singapore treaty, and not in the India-United States treaty, may imply two things – either that:

- its absence from the India-United States treaty means that the rule is not applicable; or
- it is an implied rule which is applicable even without express inclusion.

In cases of services falling under clause (b) of the India-United States treaty, it is possible to provide technical services without actually making available technical knowledge or skills to the service recipient. However, if the service recipient receives technical plans or technical designs, which he can keep and use for his own business or any other purpose, it is difficult to say that technical plans or designs are provided without providing technical knowledge to the service recipient. Knowledge in such a case is in fact provided in the form of a plan or design, which is left at the disposal of the service recipient to be used in future, even without assistance of the service provider. This view, albeit not in very clear words, was taken by the ITAT Mumbai in *Sargent & Lundy, LLC, USA v. ACIT*.^[38] However, in *DIT v.*

36. C.A. Anil, D. Doshi, C.A. Tarunkumar & G. Singhal, *Taxation of Fees for Technical Services – A Referencer*, Bombay Chartered Accountants' Society (2014), at pp. 56-60.

37. See *DCIT v. PanAmSat International Systems Inc.* [2006] 9 SOT 100 (ITAT Delhi), 11 Aug. 2006, at para. 26.

38. [2013] 37 taxmann.com 134 (ITAT Mumbai), 24 July 2013, at para. 14.

SNC Lavalin International Inc., the High Court of Delhi took the view that the condition of “make available” does not apply to services that consist of the development and transfer of a technical plan or design.^[39]

These cases were decided in relation to the India-United States Income Tax Treaty (1989) and the India-Canada Income and Capital Tax Treaty (1996), respectively. Unlike the India-Singapore Income Tax Treaty (1994), neither treaty contains a make available clause for services consisting of the development and transfer of technical plans or designs.

3.2.4. Specific exclusions

Article 12(5) of the India-United States treaty provides for certain services to be excluded from the scope of the definition of FTS. The following services are excluded:

- (1) services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than a sale described in paragraph 3(a);^[40]
- (2) services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic;
- (3) teaching in or by educational institutions;
- (4) services for the personal use of the individual or individuals making the payments; or
- (5) professional services defined in article 15 (Independent personal services).

These exclusions are also found in India’s treaties with the Netherlands, Canada, Portugal, Switzerland, Singapore and the United Kingdom.

3.2.5. Treaties not having a make available clause but importing the rule through a most-favoured nation (MFN) clause

There are treaties, like the [India-Spain Income and Capital Tax Treaty \(1993\)](#), which include an MFN clause in their protocols, restricting the otherwise wide scope of the provisions dealing with FTS. In such cases, provisions dealing with FTS having a narrow scope are read into a treaty with an MFN clause.

3.3. Concluding remarks

The definitions of the term “fees for technical service” in India’s tax treaties can be divided into two categories:

- those without a make available clause, which are similar to the domestic law definition; and
- those having a make available clause, which are based on the definition in the India-United States treaty.

The definitions falling in the first category are very wide in scope, covering all services that are technical in nature. The definitions falling in the second category are very narrow in scope, covering technology services alone. These are usually included as an extension in the article that deals with royalties.

4. Indian Court Decisions Concerning FTS

4.1. General remarks

FTS in section 9(1)(vii) of the Act and various tax treaties have been interpreted by Indian courts in a plethora of cases. The purpose of this part of the article is to analyse the way in which the courts have defined the scope of technical services – and their interpretations of the make available clause – and highlighting the extent of consistency or inconsistency in the decisions in terms of specific types of technical services.

4.2. Testing, analysis and grading services

4.2.1. Bio-analytical and testing services

The common questions posed in the bio-analytical and testing services cases heard between 2007 and 2014^[41] were whether:

^{39.} [2011] 11taxmann.com 23 (High Court of Delhi), 22 Sept. 2010, at paras. 8-11.

^{40.} I.e. sales of copyrights of a literary, artistic, or scientific works, patents, trademarks, designs or models, plans, secret formulae or processes, or information concerning industrial, commercial or scientific experience.

^{41.} See *Diamond Services International (P.) Ltd. v. Union of India* [2008] 169 Taxman 201 (High Court of Bombay), 12 Dec. 2007; *In re. Anapharm Inc.* [2008] 174 Taxman 124 (AAR New Delhi), 11 Sept. 2008; *M/s Orchid Chemicals & Pharmaceuticals Ltd. v. ITO*, ITA No 780, 781, 1786/Mds/07, (ITAT Chennai), 28 Mar. 2008, Tax Treaty Case Law IBFD; *Wockhardt Ltd. v. ACIT* [2011] 10 taxmann.com 208 (ITAT Mumbai), 30 July 2010; *DCIT v. Dr. Reddy's Laboratories Ltd.* [2013] 35 taxmann.com 339 (ITAT Hyderabad), 24 May 2013; *Denial Measurements Solutions (P.) Ltd.* [2014] 52 taxmann.com 443 (ITAT Ahmedabad), 14 Nov. 2014; and *Romer Labs Singapore Pte. Ltd. v. ADIT* [2013] 30 taxmann.com 362 (ITAT Delhi), 24 Jan. 2013.

- the income from bio-analytical and bio-equivalence^[42] services, testing services or diamond grading services fell within the scope of FTS; and
- the service providers were making available their technical knowledge or experience to the service recipients.

The decisions in those cases consistently held that, by issuing test reports, service providers do not make available their technical knowledge to the service recipients, and that the technology or knowledge or skill to conduct those tests is never made available to service recipients. In other words, service recipients are not able to conduct those tests on their own after receiving such services. Therefore, such services were held to be out of the scope of the treaty provisions dealing with FTS.

In addition to finding that the service does not make available any technical knowledge, the ITAT Mumbai also held that the service is a commercial service and not a technical one.^[43] Furthermore, the Bombay High Court noted particularly that professionals who were grading diamonds were in fact applying their technical experience in grading particular diamonds and not making available their technical expertise.^[44]

In all of the cases, the courts clearly confirmed that, for a service to be considered as making available the technology embodied in it, the service recipient must be enabled to perform such services on its own, without the help of the service provider. This view conforms with the interpretation of the make available clause by Karnataka High Court in the *De Beers* case.^[45]

In all cases, except *Wockhardt Ltd. v. ACIT*,^[46] the courts accepted that the services performed were technical services per se, because technical expertise was required to perform them. However, they were held to be outside the scope of FTS because the make available requirement was not satisfied. Thus, if a treaty does not contain a make available clause, the services would fall within the scope of FTS.

4.2.2. Project feasibility studies

In *ITO v. Adani Port-Infrastructure Pvt Ltd*,^[47] services in the nature of sedimentation, navigation and mooring assessment studies were provided to check the feasibility of a port development project. Preliminary assessment reports were given in graphic and tabular form. The reports were confidential and non-transferable.

The ITAT Ahmedabad held that the service provider had not made available its technical knowledge, experience, skills, etc. to its client and, therefore, the services were held to be outside the scope of the definition of FTS. The ITAT referred to cases involving income from diamond grading services, where reports are provided after testing, without making available any technical knowledge.

4.2.3. Testing of automobiles

Maruti Udyog Ltd. v. ADIT ^[48] and *TVS Motor Co. Ltd. v. ITO* ^[49] dealt with evaluation and appraisal of automobiles. In both the cases, the test reports provided to the service recipients were detailed and used by the recipients for further product development. Also, it was clear from the agreements that there was a clear intention to transfer the technical knowledge involved in such testing, in one case by allowing the client's presence at testing site and in the other by way of training.

In *Maruti*, a French company evaluated Maruti's cars by way of conducting impact tests on a sample of the cars' instrument panels. Detailed technical reports were provided, which highlighted deficiencies in the design of the cars. The reports were used by Maruti for removing the defects and modifying its cars. One person from Maruti was present at the testing site during the testing.

The ITAT Delhi held that the impact tests performed on the cars were purely technical and, therefore, the service was a technical service.

Regarding, satisfaction of the make available clause, the ITAT took into consideration two important facts:

- (1) the test reports were detailed and were being used for modification of the cars; and
- (2) one of Maruti's employees, who was involved in design development and testing, was present at the testing site.

According to the ITAT, such presence was with the intention of gaining technical knowledge and experience regarding the testing activity and its procedure. In view of these facts, the ITAT held that technical information was made available to Maruti.

In *TVS Motor Co*, two agreements were signed between TVS Motor Co. and a testing company from the United Kingdom. The first agreement was:

42. "Bio-equivalence tests" or "comparative bio-availability tests" are tests that analyse new generic drugs, vis-à-vis a particular reference drug, to check if the new drug is as efficacious as the reference drug.

43. See *Wockhardt Ltd. v. ACIT*, supra n. 41.

44. See *Diamond Services International (P.) Ltd. v. Union of India*, supra n. 41.

45. Supra n. 34.

46. Supra n. 41.

47. ITA Nos. 1405 & 1407/Ahd/2009 (ITAT Ahmedabad), 30 May 2014, Tax Treaty Case Law IBFD.

48. [2009] 34 SOT 480 (ITAT Delhi), 31 Aug. 2009.

49. [2010] 35 SOT 230 (ITAT Chennai), 18 Sept. 2009.

- for appraisal of motorcycles manufactured by TVS Motor Co., by reviewing certain aspects of ride, handling, vibration, etc. The objective was to create a two-dimensional “ADAMS” model of a prototype machine and a “competitor” identified by TVS Motor Co., to be used to identify and predict the dynamic ride behaviour; and
- to provide training to TVS Motor Co. engineering staff in the test techniques and procedures used to create and validate the ADAMS model.

It was decided that the ADAMS model would be fully documented and made available to TVS Motor Co. to enable future design solutions to be investigated.

The second agreement was for independent evaluation of motorcycles prior to their launch.

The ITAT Chennai held that the services performed under the first agreement were technical services, which made technical knowledge available to TVS Motor Co. The requirement of the make available clause was held to be satisfied because:

- the model created during the analysis and testing was to be fully documented and provided to TVS Motor Co. for further use in designing solutions; and
- it was agreed that the testing company would provide training to the employees of TVS Motor Co. concerning the test techniques and procedures used.

With respect to the second agreement, it was held (without much discussion) that the service did not make available any technical knowledge, experience or skill and, therefore, was out of the scope of the definition of FTS.

4.3. Training services

4.3.1. In-house training of employees

In *Steel Authority of India v. ITO* [50] and *ITO v. Veeda Clinical Research (P.) Ltd.* [51] the services provided were in the nature of training given to employees of Indian companies by United Kingdom companies. In *Steel Authority of India*, training services were provided to the company’s employees by imparting knowledge and skill to enable trainee engineers to improve their operational efficiency and to train managers to determine the improvement and changes required to enhance the Authority’s operational efficiency. The training was to make the Authority’s employees familiar with the technical development and techniques employed by the United Kingdom company to improve the operational performance of the Authority’s plant. Technical expertise, knowledge, experience and services of highly technical personnel were required on the part of the United Kingdom company to perform such training. The service was held to fall within the scope of the definition of FTS.

In *Veeda Clinical Research*, training in the nature of “in-house training of IT staff and medical staff” and “market awareness and development training” was given to Veeda’s employees. Here, the service was held to be outside the scope of the definition of FTS: the training services were general in nature and did not involve any transfer of technology.

The reason for the conflicting decisions in these two cases was the nature of the training and the knowledge that was being imparted by the training. As rightly held by the ITAT Ahmedabad in the *Veeda* case, “what is really the decisive factor is not the fact of training services per se but the training services being of such a nature that it results in transfer of technology”. [52]

4.3.2. Training on the use of equipment

In *Sahara Airlines Ltd. v. DCIT*, [53] *ACIT v. PCI Ltd* [54] and *ITO v. Bennet Coleman & Co.*, [55] the objective of the training was to enable the trainees to know how to use a particular machine. In this category of services, the views of ITAT Delhi and Mumbai seem inconsistent and unclear.

In the *Sahara Airlines* case, Sahara Airlines entered into agreements with various United Kingdom companies to train its personnel in the use of flight simulators. Pursuant to one of the various agreements, the United Kingdom company provided free of charge four hours of simulator time with company instructors on the safe and efficient operation of the machine.

The ITAT Delhi held that the agreement entered into was to train Sahara Airline’s personnel and not merely for the use of the simulator. It noted that flight simulators are complex machines, which cannot be operated unless requisite knowledge is given to the user of the machine. The ITAT held that the trainers in this case were experts and experienced, who shared their experience with the trainees and, therefore, made available not only technical knowledge about the simulators but also their technical experience regarding the use of simulators. Thus, the training was held to be within the scope of the definition of FTS.

50. [2009] 120 TTJ 297 (ITAT Delhi), 31 Oct. 2008.
 51. [2013] 35 taxmann.com 577 (ITAT Ahmedabad), 28 June 2013.
 52. *Supra* n. 51, at para. 5.
 53. [2002] 83 ITD 11 (ITAT Delhi), 12 Feb. 2002.
 54. [2011] 12 taxmann.com 59 (ITAT Delhi), 5 May 2011.
 55. [2014] 52 taxmann.com 446 (ITAT Mumbai), 12 Nov. 2014.

In the *PCI* case, PCI Ltd was engaged in the business of importing and selling testing and measuring instruments, primarily in the power sector. It obtained training services from a German company, whereby PCI's employees were trained and educated about the salient features of the machines for the purpose of enabling them to further explain those features to their customers and, if required, to explain to customers how to use the machines.

The ITAT Delhi held that the training services were not covered by the definition of FTS because the German company did not make available any technical knowledge to the trainees.

In *Bennet Coleman*, a contract between Bennet Coleman & Co and a Swiss Company comprised of three parts: (i) the supply of a mail room printing machine; (ii) its installation and commissioning; and (iii) training of employees on the operation of the machine (this being the relevant component in the present discussion).

The ITAT Mumbai held that the training services fell within the scope of definition of FTS, but there was no discussion as to why, and, in particular, whether any technical knowledge was made available.

4.3.3. Teaching services

In *In re. Eruditus Education (P.) Ltd.*^[56] there was a collaboration between Eruditus Education (P.) Ltd. and a Singaporean company, both companies being involved in the business of providing education. The Singaporean company was to provide teaching services in the form of training, in-class teaching and online teaching at different global locations. Eruditus Education was responsible for marketing, organizing, managing and facilitating the teaching programme.

An advance ruling was sought by Eruditus Education on multiple questions regarding taxability in India. One of the questions was whether the payments to the Singaporean company would constitute FTS under article 12 of India-Singapore treaty and section 9 of the ITA. The AAR New Delhi held that this case was excluded by article 12(5)(c) of the India-Singapore treaty, which provides for exclusion of payments for teaching in or by educational institutions.

4.4. IT services

4.4.1. Software development and customization

In *re. Airports Authority of India* ^[57] and *Organisation Development Pte Limited v. DDIT* ^[58] dealt with service providers developing or customizing software according to the specific needs of the service recipients. In both the cases, a complete packaged service included the cost of standard software and the cost of a service element. It was proposed in both cases that if the two elements were to be separated, the cost attributable to the software component should not be considered as FTS.

In *Airports Authority of India*, a United States company performed the service of automation upgrades of the runway at Delhi Airport. The scope of the services covered (i) the supply of hardware; (ii) the supply of customer off-the-shelf software; (iii) the supply of standardized software, which had been customized to suit the operational requirements of Delhi Airport, along with associated documentation; (iv) installation of an automation system; and (v) other services, which encompassed integration of the new system with the existing system, remote technical system transition support and providing information necessary to operate, maintain and repair the delivered system.

The AAR New Delhi held that income attributable to services related to software and installation, and other services were FTS. As to separation of the software element from the service element, the AAR held that the software was a part of the package of setting up the upgraded automation system, and that it had no value unless the service provider made the system functional at all times without the presence of the service provider's technicians.

Regarding the make available clause, it was held that the automation system software (which was customized for the Delhi Airport, and was the mechanism through which the information and inputs concerning various technical aspects based on the expertise and experience of the service provider was garnered) was made available to the service recipient, and in turn equipped it with the necessary technical skills to operate the upgraded automated runway system efficiently.

The AAR also noted that the service provider was to provide necessary information to operate, maintain and repair the system delivered, and the system manual, technical manuals and other data were furnished to the Authority. After the rendering of the services, the service recipient was able to apply the technology. Referring to the India-United States MoU, the AAR also mentioned that devising and activating an upgraded automation system could also be considered as the transfer of a technical plan.

In *Organisation Development Pte Limited v. DDIT*, Organisation Development Pte. Ltd., a Singaporean company, was engaged in the development of a balanced score card (BSC) management tool to alert managers to areas where performance deviated from expected levels, and to trigger improved performance. This involved the service recipients downloading standard software, which was used by the service provider to develop the tool. The BSC tool was unique to each customer, being dependent upon the latter's business goals, strategies, etc. After it was set up, customers could continue using it in their business for performance checks.

56. [2013] 37 taxmann.com 337 (AAR New Delhi), 20 Sept. 2013.

57. [2010] 190 Taxman 209 (AAR New Delhi), 18 Mar. 2010.

58. [2012] 19 taxmann.com 156 (ITAT Chennai), 9 Feb. 2012.

Organisation Development sent a team of consultants to help an Indian company to implement the standard software required to develop the BSC tool. The tool was developed for the Indian company according to its specific business needs.

Along a similar line of argument to that in the *Airports Authority of India* case, the question of whether the software that was downloaded by the service recipient could be separated from the other service element was answered in the negative. The ITAT Chennai held that the software was a tool that was used for the purpose of developing the BSC tool and, thus, could not be separated. It was not a case of sale of standard software. The BSC tool was customized for the service recipient in accordance with its needs and considerable skill was required for such customization.

With respect to the make available clause, the ITAT held that technical knowledge and skills enabling the service recipient to use the BSC tool for its business purposes (viz. to meet its long-term targets) were made available and that such knowledge and skill remained with the service recipient. The ITAT noted that the BSC tool enabled the clients to acquire the skills necessary for implementing their business strategies more effectively and that the advantage of the service went much beyond the period of the agreement.

In each case, it was argued by the assesseees that the technology for developing the software, or the methodology for developing the BSC tool, was not provided. In *Airports Authority of India*, the AAR held that this fact did not make any difference. The make available clause was held to be satisfied on the basis that the technical knowledge, information and experience, which was required to enable the personnel of the Authority to handle the system by themselves, was transferred. In the *Organisation Development* case, the argument was not addressed by the ITAT and the make available clause was again held to be satisfied on the basis that the technical knowledge and skill for the use of the BSC tool in the business was made available. In any event, development and transfer of customized software or a system or tool (as also illustrated in the India-United States MoU) comes within the scope of “development and transfer of a technical design or a technical plan”, in which case the make available clause is not applicable.

In *DDIT v. IATA BSP India*,^[59] a French company provided BSP link services to Indian airlines and ticketing agents.^[60] The service also included software testing, installation and implementation of the software and the system to make it available for the user group, and training of employees.

The ITAT Mumbai held that there was nothing to show that the French company transferred any technical knowledge, skill, experience, etc. to the user airlines or ticketing agents. Although this case also involved development, delivery and installation of customized software and a customized system, according to the specific needs of the airlines and ticketing agencies, and requisite training was given to IATA's employees, the services were held to be outside the scope of FTS.

The reason for this could be that the service was one that was available to all the airlines and ticketing agencies, which could be used by them if they paid for it. The system was not developed specifically for one airline or ticketing agency on their request, and the developed software and system was not transferred to the airlines and ticketing agencies.

The situation in this case can be compared to subscriptions to online databases, which, in one way, can be viewed as a customized service because it is made keeping in mind the specific needs of a targeted user group, but, in another way, a general service in view of the fact that it is open to all users of the target group.

4.4.2. Data processing services relating to exploration and extraction

In *ACIT v. Paradigm Geophysical Pty. Ltd.*,^[61] *CIT v. De Beers India Minerals (P.) Ltd.*,^[62] *Oil & Natural Gas Corporation Ltd. v. CIT* ^[63] and *PGS Exploration (Norway) AS v. ADIT*,^[64] the services were all held to be technical services per se; however, the make available clause was not satisfied, but for different reasons.

In the *Paradigm Geophysical* case, an Australian company performed seismic data processing services for an Indian mining company. It processed two- and three-dimensional seismic data collected by the Indian company. The processed data was area- and project-specific.

The ITAT held that the services rendered by the Australian company were limited to a specific project and the company did not make available any technical knowledge or experience, nor did the services consist of the development and transfer of any technical plan or design. It was noted that, since the processed data was area-specific, the information could not be used for a new project without reference to the Australian company.

Nevertheless, the fact that the data could not be used for other future projects should not lead to the conclusion that technical knowledge and information is not provided. A better reason to exclude such services from the scope of the definition of FTS is discussed by the Karnataka High Court in *CIT v. De Beers India Minerals (P.) Ltd.*

59. [2014] 46 taxmann.com 150 (ITAT Mumbai), 11 June 2014.

60. A BSP link is a system whereby manual operations, such as issuing debit and credit notes, refunds, billing statements and all information relating to tickets, is carried out electronically.

61. [2008] 25 SOT 94 (ITAT Delhi), 27 June 2008.

62. *Supra* n. 34.

63. [2015] 59 taxmann.com 1 (SC), 1 July 2015.

64. [2016] 68 taxmann.com 143 (High Court of Delhi), 8 Apr. 2016.

In that case, a Dutch company conducted an airborne survey of a particular area for an Indian company engaged in the business of prospecting and mining for diamonds and other minerals. The data collected from the survey was provided to De Beers in a particular format.

The make available clause was held not to be satisfied because the Dutch company did not make available the technology used by it in collecting and processing the data, which De Beers could use independently.

In *Oil & Natural Gas Corporation Ltd. v. CIT*, various foreign companies rendered different services to Oil & Natural Gas Corporation Ltd under separate contracts. They were all related to prospecting for, or extraction or production of, mineral oils. One of the many services was conducting seismic surveys, which were the subject of the case.

The Supreme Court held that a “mining project or like project”^[65] would cover prospecting for, or extraction or production of, mineral oils. Applying the doctrine of pith and substance, the court held that any services that are directly associated, and inextricably connected, with such activities, come within the scope of a mining project or like project and are therefore excluded from the scope of FTS. Consequently, conducting seismic surveys fell outside the scope of FTS.

In *PGS Exploration (Norway) AS v. ADIT*, a Norwegian company provided the services of acquiring and processing two- and three-dimensional seismic data to two Indian companies, which had been granted exploration licences. Here, the Delhi High Court followed the Supreme Court’s judgement in the *Oil & Natural Gas Corporation* case.

4.5. Installation and commissioning services

In the cases dealing with installation and commissioning services,^[66] two principal questions were considered in deciding if the services were technical services:

- Whether the services were a construction or assembly activity.^[67] In all of the cases, it was accepted that the activity of installation and commissioning can be considered as a construction or assembly activity. The real question, therefore, is whether a service provider actually renders the services of installation and commissioning.
- Whether the services are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of the machine or equipment which is being installed or erected.^[68]

Common factors that were considered in the cases to address these questions were whether:

- (1) personnel sent by service providers were performing complete installation and commissioning of machinery or whether they were merely supervising the installation activity, which was actually performed by the service recipient’s staff. In cases of mere supervision of installation activity, exclusion was held to be inapplicable;^[69]
- (2) the supply of machinery and the installation services were provided under the same contract. Provision of the services under the same contract points towards a link between the sale of equipment and the services related thereto;^[70] and
- (3) the machinery is such that it can be installed only by its supplier. This factor may depend upon the complexity of the equipment. In such case,^[71] it was held that the services were inextricably and essentially linked to the sale of the machine and equipment.

4.6. Development and transfer of a technical plan or design

4.6.1. Machinery and equipment plus technical plans and designs

It is possible that a service recipient requests a service provider either:

- only to develop and transfer a technical plan or design; or
- not only to develop a technical design, but also to manufacture a machine or equipment according to the developed design.

In the latter case, the service provider would develop a technical design and a machine based on the design, and transfer or sell both the design and the machine to the service recipient. Such cases have been held to fall within the scope of FTS.^[72]

65. As used in an exclusion from the definition of FTS in section 9(1)(vii) of the Act.

66. *ITO v. National Mineral Development Corporation Ltd* [1992] 42 ITD 570 (ITAT Hyderabad), 30 Apr. 1992; *DCIT v. ITC Ltd* [2002] 82 ITD 239 (ITAT Kolkata), 28 Dec. 2001; *Aditya Birla Nuvo Ltd. v. ADIT* [2011] 44 SOT 601 (ITAT Mumbai), 30 Nov. 2010; *DCIT v. M/s Dodsai Pvt. Ltd.*, ITA No. 2624/Mum/2006 (ITAT Mumbai), 29 Aug. 2012, Tax Treaty Case Law IBFD; *ITO v. Bennet Coleman & Co.*, *supra* n. 55; and *Mahindra Forgings Ltd v. ADIT* ITA Nos. 2563, 2564 & 2565/PN/2012 (ITAT Pune), 27 Feb. 2014, Tax Treaty Case Law IBFD.

67. Which is excluded from the definition of FTS under section 9(1)(vii) of the Act.

68. Which is present in many treaties under the exclusion clause and thus is excluded from FTS.

69. *Aditya Birla Nuvo Ltd. v. ADIT* and *DCIT v. M/s Dodsai Pvt. Ltd.*, *supra* n. 66.

70. *DCIT v. M/s Dodsai Pvt. Ltd.*, *supra* n. 66. See also *supra* n. 68.

71. *Mahindra Forgings Ltd v. ADIT* *supra* n. 66.

72. See, for example, *Bajaj Holdings & Investments Ltd. v. ADIT* [2013] 30 taxmann.com 176 (ITAT Mumbai), 16 Jan. 2013.

This situation can be distinguished from one where Person X asks Person Y to manufacture a customized machine for X. In this case, Y would develop a technical design in accordance with X's requirements and manufacture a machine based on that design, and then transfer or sell only the machine to X. In simple terms, here Y is selling a customized machine to X. In such a case, as in cases of electronic machines which are complex to install or operate, Y may provide X with technical designs of the machine, together with the machine, for the sole purpose of its proper installation or efficient operation. Such a case has been held to be the purchase of customized machinery, along with its documentation, and not the provision of a technical service.^[73]

Such situations are different from those where a person simply buys a product and the supplier provides technical designs thereof along with the product. In such cases, firstly, the sale of the machine is the main transaction and technical designs are supplied primarily to enable the buyer to install and operate the machine in a proper manner without allowing the buyer to use such designs for any commercial purpose. Secondly, such designs are already developed and available with the seller of the machine, and thus are not developed for the buyer.

4.6.2. Engineering, architectural and design services

A technical plan or design can be developed and transferred in two ways:

- (1) Service recipient X procures services of service provider Y to develop a technical plan or design in accordance with X's requirements, and it is agreed that all of the IP in the plan or design vests in X. In other words, there is an outright sale of the plan or design.
- (2) Service recipient X procures services of service provider Y to develop a technical plan or design in accordance with X's requirements, and it is agreed that all of the IP in the plan or design vests in Y, and limited right to use the plan or design is granted to X for a particular project or for a limited number of years. In other words, the transfer of the plan or design to X is merely for X's use.

In *Gentex Merchants (P) Ltd. v. DDIT*,^[74] a United States based company provided designs and drawings for the purpose of developing water features at particular premises in India. The designs were tailor-made for the premises and especially developed for Gentex.

The ITAT Kolkata held that article 12(4) of the India-United States treaty could be invoked even in situations where a technical plan or design is transferred for the purpose of mere use by the transferee.

In *Abhishek Developers v. ITO*,^[75] Abhishek Developers entered into a contract with a Singapore company for the development and transfer of designs and drawings in connection with real estate development. The designs and drawings were tailor-made and customized. All of the rights in the designs and drawings were transferred absolutely to Abhishek Developers.

Here, the ITAT Bangalore held that cases of outright sale of a technical plan or design do not fall within the scope of FTS.

In *In re. HMS Real Estate (P) Ltd.*,^[76] a United States based company provided architectural design services to HMS Real Estate (P.) Ltd. The design development services included: (i) development of a programme and master plan concept design, (ii) development of schematic design concepts, and (iii) preparation of designs and development drawings. The designs were developed by the United States company and sold to HMS Real Estate, including all of the IP in the designs.

The AAR New Delhi did not accept the argument that the outright sale of a technical plan or design fell outside the definition of FTS, and held that the true scope and dominant object of the contract was to provide architectural services, and the provision of designs to the client was just a part of the services.

Thus, it may be said that to fall within the scope of FTS, the transfer of plans or designs may take place either by way of outright sale or absolute transfer or by mere use by the service recipient.

In *Mannesman Demag Sack AG v. ACIT*,^[77] a German company entered into a contract with an Indian company to supply various technical services (including development of the design and engineering of all of the service recipient's plant and equipment on a fully integrated and coordinated basis), supervision of civil engineering work, construction, commissioning, performing guarantee tests and demonstration of performance guarantees.

The ITAT Delhi held that the development and transfer of technical designs and drawings constituted technical services. Whether ownership of the designs and drawings was absolutely transferred or transferred subject to limitations was not discussed in this case.

In *Hindustan Shipyard Ltd. v. ITO*,^[78] Hindustan Shipyard entered into two contracts with a Russian company, which had expertise in carrying out repairs of submarines. The first contract was for the purpose of the development and transfer of technical repair documents, i.e. the transfer of technical knowledge and expertise regarding the repair activity. The second contract was for the purpose of obtaining expert technical advice from the Russian company regarding augmentation of Hindustan Shipyard's infrastructural facilities. Reports were provided in the form of hardbound manuals.

73. See *Hindustan Aeronautics Ltd. v. ITO* [2010] 123 ITD 575 (ITAT Bangalore), 31 Mar. 2008.

74. [2005] 94 ITD 211 (ITAT Kolkata), 18 Feb. 2005.

75. [2008] 24 SOT 45 (ITAT Bangalore), 31 Oct. 2006.

76. [2010] 190 Taxman 22 (AAR New Delhi), 18 Mar. 2010.

77. [2009] 32 SOT 5 (ITAT Delhi), 8 July 2008.

78. [2012] 18 taxmann.com 89 (ITAT Visakhapatnam), 17 Dec. 2011.

Hindustan Shipyard argued that the technical reports, having been provided in the form of hardbound manuals, came under the category of “goods”, the sale of which took place outside India; i.e. this was a case of sale of goods and not the provision of a technical service.

The ITAT Vishakhapatnam held that a technical service would not lose the character of a service merely because the final reports were provided in the form of books. It was noted that the reports were tailor-made for HSL and thus were customized. The services were therefore held to be within the scope of the definition of FTS.

In *Gera Developments (P.) Ltd. v. DCIT*,^[79] a United States based company provided architectural services to an Indian company, which included concept designs, drawings and a final site plan indicating the main building, open space, parking, gateways, utilities and infrastructure support.

The ITAT Pune held that the designs and drawings provided by the United States company did not involve making available any technical knowledge, skills or experience and that this was not a case of transfer of technical plans or designs. It was also noted that the designs were project-specific and were not absolutely transferred.

This decision appears to be wrong in principle in view of the fact that (i) architectural services are specifically mentioned in the India-United States MoU as a typical example; (ii) the make available clause should not be applied in the cases of transfer of technical plans or designs; and (iii) there is a contrary decision in *In re. HMS Real Estate (P.) Ltd.*^[80]

4.7. Concluding remarks

The journey of the FTS provisions through the Indian cases analysed above shows that there is much litigation in India revolving around the scope of this provision. The majority of cases involves interpretation of the definitions falling under the second and third categories discussed in [section 3.2.3.1.](#) above, i.e. the make available rule and the development and transfer of technical plans or designs. The fact that these definitions have been more prone to litigation than the first category of definition mentioned under [section 3.2.3.1.](#) (i.e. those along the lines of section 9(1)(vii) of the Act – without a make available clause) implies that either:

- (1) technical services are mainly procured from a limited number of countries and India’s treaties with those countries have definitions similar to the second and third category definitions or apply such definitions by virtue of an MFN clause; or
- (2) taxpayers and revenue authorities interpret the second category definitions differently, resulting in litigation.

As far as interpretation and application of the make available rule is concerned, different ITATs and the AAR have been very consistent in their findings. In general, different cases with similar facts have been decided the same way by different ITATs and the AAR. The following points have been consistently applied in all the cases analysed to determine whether the rule is satisfied:

- (1) whether service recipients are enabled to apply the technology on their own, without the help of service providers, or
- (2) whether service recipients are enabled to perform the same activity using the technical know-how on their own, without the help of service providers.

As far as services consisting of the development and transfer of technical plans or designs are concerned, initially there were varying views on their inclusion where technical plans or designs were sold to service recipients. However, different ITATs and the AAR have more recently taken a consistent view that such services are included within the scope of the definition of FTS, even if the plans or designs developed by the service provider are sold to the service recipient.

5. Conclusion and Suggestions

The problem that was noted at the beginning of this article was that the provisions of the OECD and UN models make it very easy for service providers performing technical or non-technical services to avoid taxation in the state where the services are received, by rendering such services without creating a PE, service PE or fixed base. Moreover, the loss of tax revenue to the source state is exacerbated because payments for such services are deductible from the income of service recipients, reducing their taxable income.

We might ask whether the inclusion of a provision allowing for source taxation of FTS by India, without requiring such services to be performed through a PE, service PE or fixed base, has really solved this problem.

An answer to that question could be that section 9(1)(vii) of the Act solves the problem only to the extent that technical services are concerned. However, the wide scope of that provision covers the most important category of services which are performed outside India and which, being high-value services, causes the greatest base erosion.

It seems that it is acceptable to India if non-technical services escape taxation in India. This might be so because they are low-value services and imposing source state taxation on service providers in cases where they do not have a PE, service PE or fixed base in the source country would create a disproportionate compliance burden on service providers and tax authorities, in turn creating a hurdle for

79. [2016] 72 taxmann.com 238 (ITAT Pune), 29 July 2016.

80. *Supra* n. 76.

cross-border trade in services. Further, in the cases of treaties, wherein the scope of technical services is restricted to cases of transfer of technology, the problem is solved only to the extent that the services involve the transfer of a technology.

There are four ways of addressing these problems:

- (1) changing the taxation regime for all kinds of services that are not dealt with by income-specific types of articles, such as articles 8, 15, 16, 17, and 19; or
- (2) changing the taxation of technical services that require expertise in industrial or applied sciences and technology only (narrow scope); or
- (3) changing the taxation of a wide range of technical services (broad scope); or
- (4) changing the taxation of transfer of technology by way of service contracts.

If the first option is considered (i.e. a solution that encompasses all kinds of services), a separate provision for service income allowing shared taxation rights between residence and source states – without requiring actual performance of services in the source state – may be feasible. It may be made applicable to all service income of both individuals and enterprises. However, this approach would cover extremes of different kinds of services. On one hand, there are services that are rendered in a traditional fashion by creating a physical presence in the service recipient's country. Take, for example, food catering. If there is no requirement for physical presence, a food caterer of Country X can be subject to tax in Country Y on income from a single catering event, which might last for only a few days. On the other hand, there are services that do not require any physical presence in the country of the service recipient. For example, a subscription to an online database, where the service provider does not need to be present in the recipient's country at all. Thus, a common threshold – be it a no-presence or a minimum-presence requirement – would not be apt for one or another.

Another negative aspect of this approach is the hurdle that it might create for international trade in low-value non-technical services, as noted above.

Therefore, the downsides of the first possible solution appear to make it inappropriate.

If a solution is considered only for technical services that require expertise in a technology or an industrial or applied science, the problem might remain unsolved because it is limited to a narrow range of technical services: many other kinds of services can be performed from a location different from the service recipient's location. Again, this approach also does not appear to be appropriate.

If a solution is considered only for technical services broadly (i.e. not limited to science- or technology-related services), the problem might be remedied in a better way. This approach would target the majority of services that create the problem and, at the same time, would not create a hurdle for international trade in low-value, non-technical services. A special rule may be made for income from technical services, allowing shared taxation rights between residence and source states without requiring performance of the services in the source state. Like section 9(1)(vii) of the Act, technical, managerial and consultancy services may be covered, as these three categories of services constitute the most important categories of services that do not require physical presence in service recipient's country, and they are also high-value services.

A special rule for technical services may either be added as a completely separate article, or included by way of amendment to articles 7 and 14 (in case of the UN Model) and article 7 alone (in the case of the OECD Model), or by recommending alternative provisions as part of the commentaries to the relevant articles.^[81]

In addition to making a special rule for technical services, another provision may also be considered especially dealing with services involving transfer of a technology or technical know-how or consisting of the development and transfer of technical plans or designs. Otherwise, if a particular country is concerned only about the import of technology by way of service contracts, then this provision alone may be a solution. Such a rule may provide for taxation of income from such services in the same way as royalty income is taxed, i.e. gross taxation in all the cases. This is because such service contracts are just another manner of transferring IP or technical knowledge and skills. The wording used in the India-United States treaty, being "fees for included services", seems to be most appropriate. However, drawing upon Indian jurisprudence the commentary on such a provision may be more detailed than the India-United States MoU, by noting the following points:

- (1) *Testing services* – Merely providing test reports or reports of a similar nature after an analysis should not mean that technical knowledge of the testing agency or the technology used for the purpose of testing has been made available to a service recipient. However, if testing techniques are shared with service recipients by way of documentation or training, the technology should be considered as made available.
- (2) *Training services* – From the discussion under [section 4.3](#), it is apparent that training is the most common way of transferring technical know-how, skills and knowledge. However, every sort of training does not result in the transfer of technology, technical knowledge or skills: it depends on the nature of training and the content being taught.

81. In United Nations Committee of Experts on Cooperation in International Tax Matters, *Follow Up note on taxation of fees for technical services and comments on that note*, UN, 2012, the Committee discusses issues to be taken into consideration in the design of a new provision, including the scope of the rule, the (gross or net) basis of taxation, a source rule and the relationship of the new provision with other treaty articles.

- (3) *Installation and commissioning services* – In most cases, suppliers of complex machines also install, commission and test the machines. Such services, being ancillary and subsidiary to the sale of goods, may be excluded from the scope of the rule. Different factors to be considered include:
- whether there is one single contract or two independent contracts and, if there are two different contracts, whether they are interrelated or interdependent; and
 - the nature of the machinery and whether only the supplier is capable of installing it or whether anyone can install it.
- (4) *Customized software* – Whether the cost of standard software, which has been customized especially for a service recipient, should be included or excluded from the service cost.
- (5) *Technical plans or designs* – The meaning of the term “transfer” should be explained, especially whether it covers only limited transfers (i.e. those restricted to only the right to use plans or designs) or only absolute transfers (i.e. the outright sale of plans or designs), or both.

It is clear that a change in the treaty rules for services is needed. In the light of the OECD’s base erosion and profit shifting project and the discussion in the UN regarding technical services,^[82] the time is right for the OECD and UN to consider appropriate changes to the taxation of FTS. To avoid further divergent rules, and their interpretations, the OECD and UN need to develop a common solution.

82. *Supra* n. 20.