

14 December 2011

EY Tax Alert

AAR rules on taxability of service fees under India-Netherlands DTAA



Executive summary

This Tax Alert summarizes a recent ruling of the Authority for Advance Rulings (AAR) [AAR No. 869 of 2010] in the case of Perfetti Van Melle Holding B.V. (Applicant) on taxability of service fees under the India-Netherlands Double Taxation Avoidance Agreement (Netherlands DTAA). The AAR observed that the services such as accounting, budgeting, marketing and sales support etc. are technical in nature and also made available technical knowledge, skill, experience etc., to the recipient of the services. The AAR also observed that the services are ancillary and subsidiary to royalty paid by an Indian company, pursuant to a separate Trademark Technology License Agreement (TTLA). Accordingly, the service fees are taxable as Fees for Technical Services (FTS) under the Netherlands DTAA. The term FTS is defined in the Netherlands DTAA on similar lines as the term Fees for Included Services (FIS) in the India-US DTAA (US DTAA). The US DTAA also contains a Memorandum of Understanding (MOU) which provides a detailed explanation of the definition, along with examples. The AAR, however, ruled that the US DTAA MOU cannot be relied upon to interpret a similarly worded term in the Netherlands DTAA.

Background and facts

- ▶ The Applicant, a company resident in the Netherlands, is engaged in the business of manufacture and sale of sugar confectionery and gum. It provides operational and support services to its group companies, situated in various countries.
- ▶ The Applicant had entered into a service agreement (SA) with Perfetti Van Melle India Pvt. Ltd. (PVM India), a group company, resident in India. As per the SA, the Applicant provided various operational and other support services to PVM India for assistance in the use of proprietary knowledge and processes belonging to the PVM Group.
 - ▶ Services were in the field of accounting, budgeting, sales, marketing, foreign exchange management, loans, HR, legal support etc., and were provided on a continuous basis.
 - ▶ Services were rendered by using its own resources as well as those available from other group companies/third parties. No employees and other personnel engaged by the Applicant visited India for the purpose.
- ▶ Prior to the SA, PVM India had entered into a TTLA with another group company for provision of technology know-how to PVM India for carrying on its business operations, subject to the quality standard fixed by the group company. In the TTLA, it was agreed that the Applicant will provide the specified services to PVM India to ensure the quality standards, pursuant to which the SA was executed.
- ▶ Article 12(1) of the Netherlands DTAA allows India to levy a withholding tax of 10% on the gross amount of FTS paid by an Indian resident to a Netherlands resident. Under Article 12(5) of the Netherlands DTAA, FTS means payments of any kind to any person in consideration for the rendering of any technical or consultancy services, if such services, (a) are ancillary and subsidiary to the application for enjoyment of the right, property or information for which a payment qualifies as 'royalty' (ancillary and subsidiary test); 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 (make available test).
- ▶ The Applicant approached the AAR seeking a ruling on taxability of the payments made under the SA.

Applicant's contentions

- ▶ Services provided to PVM India are managerial and not technical or consultancy in nature. Hence, they fall outside the purview of FTS under the Netherlands DTAA.
- ▶ Even assuming services fall within the meaning of 'technical' or 'consultancy', the make available test is not fulfilled.
 - ▶ The term 'make available' is not defined in the Netherlands DTAA. Under the US DTAA MOU, 'make available' means that the person acquiring the services is enabled to independently apply the technology and that there should be transfer of technical knowledge, skill etc. from the service provider to the recipient in order for the services to qualify as making available technical knowledge or skill etc. Reliance was placed on earlier decisions of the AAR as well as the Income Tax Appellate Tribunals (ITAT) [Intertek Testing Services India (P) Ltd. (307 ITR 418); National Organic Chemicals Ind. Ltd. (96 TTJ 765); CESC v. CIT (80 TTJ 806)].

- ▶ Reliance was placed on the decision of the Mumbai ITAT in Raymond Ltd. (86 ITD 791) which observed that the 'make available test' envisages some sort of durability or permanency of the result of the rendering of services which will remain at the disposal of the person utilizing the services. The fruits of the services should remain available to the person utilizing the services in some concrete shape such as technical knowledge, experience, skills, etc.
- ▶ PVM India will not get equipped with the knowledge or expertise and would not be able to apply it in future independently.
- ▶ Services are not ancillary and subsidiary to any 'royalty' payments for Article 12(5)(a) to apply. The scope of the SA and TTLA are totally different and cannot be combined. The TTLA is for providing technical know-how to PVM India in relation to its manufacturing and sales of brands owned by the licensors and the SA is for providing operational services to help PVM India in improving its profitability and efficiency.

such as technical knowledge, experience skill etc. Such benefits are available to PVM India in the shape of market research reports, accounting policy manuals and procedures etc.

- ▶ The services rendered by the Applicant would equip PVM India to manage its business efficiently, based on the market research reports, accounting policies manuals and procedures etc. without further help from the Applicant. It is not required that PVM India should know how such reports, codes, procedures are prepared.
- ▶ Payments made for services to the Applicant would be FTS under Article 12(5)(a) of the Netherlands DTAA, the same being connected with the royalty paid by PVM India under the TTLA. The SA is entered pursuant to the TTLA and it provides details of the services agreed to be provided by the Applicant under the TTLA.

modalities of procuring loans shall be regarded as technical and consultancy service.

- ▶ The services of the Applicant for giving knowledge and experience of the confectionery industry to PVM India are technical in nature. This is also supported by the intention of the SA to assist PVM India in applying the experience of its group entities.

Make Available Test

- ▶ To fulfill the 'make available test', services should be such that they make the recipient able or wiser in the subject matter and this is evident as it is PVM India which applies the knowledge/skill and the Applicant only supports PVM India with such knowledge/skill.
- ▶ Services provided by the Applicant are in the nature of assistance to PVM India which enables PVM India to carry out its day- to-day business operations.
- ▶ The fact that the services are 'continuous' does not, by itself, imply that they do not enable PVM India to independently apply the knowledge/skill that is provided. Services are continuous to ensure that the knowledge provided and applied by PVM India can be reviewed and continuous experience that is being gained globally can be supplied to PVM India.
- ▶ 'Make available' is used with reference to 'technical knowledge, experience, skill, know-how or processes' and not to 'development and transfer of a technical plan or design'. It does not

Tax Authority's contentions

- ▶ Under the SA, services are managerial and consultancy in nature and unlike for technical services, the 'make available test' would have no application.
- ▶ Alternatively, the services also fulfill the 'make available test' which requires that the fruits of the services should remain available to the person utilizing the services in some concrete shape,

Ruling of the AAR

Nature of services

- ▶ Reliance was placed on the AAR ruling in Intertek Testing Services (*supra*) which observed that the term 'technical services' cannot be construed in a narrow sense. The term 'technical' ought not to be confined to technology relating to engineering, manufacturing or other applied sciences. Professional services, imbued with expertise, could also be regarded as technical service. In G.V.K. Industries [228 ITR 564], it was held that advice given by a financial consultancy firm on the

mean that the person for whom a technical plan or design is developed is also enabled to develop such a plan on his own volition. Mere development and transfer of a technical plan or technical designs should be the sufficient compliance.

- ▶ A Treaty is a contract between two sovereign countries and any diversion from it would need the consent of both the contracting states. Also, a contract with a certain country cannot be used to interpret a separate independent contract with another country. Hence, no inference/conclusion/support as to the meaning of 'make available' can be drawn from the US DTAA MOU.

Ancillary and subsidiary test

- ▶ Payments under the TTLA are considered as 'royalty' under the Netherlands DTAA. It is only in furtherance to the application or enjoyment of rights under the TTLA that the services are provided under the SA. Thus, the TTLA gave the right to manufacture and the SA brought the efficiency in such manufacture. The two agreements are inextricably attached to each other or at least complimentary to each other.
- ▶ The services provided by the Applicant are taxable as FTS in India under Article 12(5)(a) of the Netherlands DTAA as such services are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment of royalty is received. The payments are also subject to withholding tax obligations and transfer pricing provisions under the Indian Tax Laws.

Comments

In order to constitute FTS, covered by Article 12 of the Netherlands DTAA, a payment must be for either a technical or a consulting service. Once it is determined that services rendered are either technical or consulting in nature, payments for such services will constitute FTS and, therefore, be taxable in the source state only if the payments fall into one of the two categories. The services must either (a) be ancillary and subsidiary to the application or enjoyment of an intangible property for which royalty 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. It may be noted that there is no requirement to satisfy the 'make available' test if the services satisfy the 'ancillary and subsidiary' test. The AAR, in its ruling, seems to have concluded that the service fee is taxable as it satisfies the 'ancillary and subsidiary' test. Hence, it is unclear as to why the AAR had to examine the 'make available' test as well. Even though the question as to whether services are technical or consultancy in nature and whether they satisfy the 'ancillary and subsidiary' test or the 'make available' test would depend upon the facts and circumstances, the broad interpretation given by the AAR could cause some uncertainty in application of some general principles.

This ruling also raises an issue that concerns interpretation of DTAA's - the extent to which reliance can be placed on parallel DTAA's and whether any aid to the interpretation of a particular term in a DTAA could be derived from the definition of that term in another DTAA or its protocol. While a number of rulings support parallel DTAA interpretation in the

context of the FTS definition and reference to the US DTAA MOU, the views expressed by the AAR in this ruling could result in some ambiguity for taxpayers.

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