Sum paid to foreign co. for production of 2D and 3D animated films wasn't fees for technical service

Summary – The Hyderabad ITAT in a recent case of DQ Entertainment (International) (P.) Ltd., (the Assessee) held that where assessee, engaged in production of 2D and 3D animation films, having received orders from various companies for production of animation films, outsourced a part of projects to overseas clients on contract basis, since there was no element of any technical services in production of animation films, provisions of section 9(1)(vii), did not apply to payments made by assessee to foreign sub-contractors.

Facts

- The assessee company was in the business of production of 2D and 3D animation films. It got orders from various companies for production of animation films at their requisition of scheduled deliverables. During the relevant years, the assessee gave some episodes or part of an episode on sub-contract to foreign sub-contractors or rather outsourced a part of the project out of the orders it received from some of the overseas clients.
- In said process, the assessee made payments to foreign companies as per agreement named as 'Outsourcing Facilities Agreement'.
- The Assessing Officer opined that the payments made to foreign companies fell under 'fees for technical services' and thus said payments were taxable in India. Since the assessee had not made TDS before making aforesaid payments, it was to be treated as assessee in default under sections 201 and 201(1A).
- The Commissioner (Appeals), however, held that there was no technical services involved in the production work or material delivered by foreign companies to the assessee in some episodes or parts of episodes as the same could have been done either by the assessee itself or by any sub-contractor.
- The Commissioner (Appeals) thus set aside order passed by the Assessing Officer.
- On revenue's appeal:

Held

- After considering the material on record, the findings of the Commissioner (Appeals) are to be upheld for the following reasons:

1. The payments received by the assessee from foreign clients for exactly the similar work executed by it have not been subjected to withholding tax nor was it called upon to file its return by the several countries from the residents of which assessee received payments for services rendered by it.

2. There was no element of any technical services in the production of animation films nor in the production of a part or certain episodes of an animation film so to attract the provision of section 9(1) (*vii*), read with section 5(2)(*b*) of the Act.
3. Just because such expertise, knowledge, technology and experience is possessed by the said party and the same has been utilized for rendering the services, it cannot be said that the services so rendered are in the nature of technical and consultancy services without making any technology available to the other party. The payment in question paid by the assessee-company or any part thereof could not be treated as 'fees for included services' within the meaning of 'fees for technical services' defined in section 9(1)(*vii*).
4. It was never the case of the Assessing Officer that there was Permanent Establishment of foreign companies in India, instead it was his case that though services were rendered by said companies only in Hong Kong/ China, yet the same were utilized by the assessee in its business in India and as such the Assessing Officer stated that irrespective of the situs of the services, income is deemed to accrue or arise in India in the hands of foreign companies and consequentially the assessee is liable to deduct taxes under section 195.
5. The assessee's business with its Overseas Clients undoubtedly constitute a business carried on by resident outside India, making the assessee to satisfy the first category of income referred to in the sub-clause (*b*). However, the Assessing Officer laid emphasis only on the second category of income to say that originating cause of the income of the assessee is located in India and as such he held that the assessee is not making or earning income from the source outside India. The Assessing Officer failed to examine the provisions of sub-clause (*b*) of section 9 (1) (*vii*) in a proper perspective in the aforesaid manner;

- Based on above findings it is clear that Assessing Officer's attempt to raise demands under section 201 is not correct. Even *Explanation 1* to section 9(1) excludes the income pertaining to operations carried out outside India. The foreign parties have not done any activity in India nor they have any PE in India. As there is no liability to deduct tax on the amounts paid under section 195, it is not correct on the part of Assessing Officer to raise demands.
- The revenue appeals are accordingly dismissed.