Consultant doesn't impart any experience to client when he renders consultancy services; not to be treated as royalty

Summary – The Mumbai ITAT in a recent case of GECF Asia Ltd., (the Assessee) held that in case of industrial, commercial and scientific experience, if services are being rendered simply as an advisory or consultancy, then it cannot be termed as *"royalty"*, because the advisor or consultant is not imparting his skill or experience to other, but rendering his services from his own knowhow and experience. All that he imparts is a conclusion or solution that draws from his own experience. If there is no *"alienation"* or the *"use of"* or the "right to use of" any knowhow i.e., there is no imparting or transfer of any knowledge, experience or skill or knowhow, then it cannot be termed as *"royalty"* within the meaning of Article 12 of India-Thailand DTAA. The DTAA between India and Thailand does not include any provision for taxability of Fees for Technical Services.

ORDER

The present appeal has been preferred by the assessee, challenging the impugned final assessment order dated 14th October 2010, passed by the learned Dy. Director of Income Tax (International Taxation) [for short "the learned DDIT(I.T)"], Mumbai, in pursuance of the direction given by the Dispute Resolution Panel–I (DRP), Mumbai, for the assessment year 207–08. The assessee has raised following grounds of appeal:-

"1. The Assessing Officer and the DRP erred in determining the income of the assessee at Rs. 3,83,62,648, as against NIL income returned by the assessee and thereby erred in determining the tax liability at Rs. 2,27,50,035.

2. On the facts and in the circumstances of the case and in law the learned Assessing Officer erred in confirming the proposed addition of Rs. 3,83,62,648, being the amount received by the appellant for services rendered under the Master Service Agreement, 2005 to GE Money Financial Services Ltd. as being in the nature of royalty income and hence, taxable in India.

On the facts and in the circumstances of the case and in law the learned Assessing Officer erred in initiating and the DRP has erred in upholding the initiation of penalty proceedings under section 274 r/w section 271(1)(c) of the Act."

2. Facts in brief:– The assessee is a non–resident company incorporated in Thailand and is a tax resident of Thailand. Accordingly, it has claimed treaty benefit under the India–Thailand DTAA. The assessee

company is engaged in the business of providing services to meet the needs of various G.E. Group companies. It has entered into Master Agreement, 2005 with the G.E. Countrywide Consumer Financial Services Ltd. (GEMFSL), wherein the assessee is required to provide following Services:-

Accounting and Finance Support Services

Human Resources Services

Legal and Compliance Services

Risk Management Services

Quality Consultation and Training

Sales and Marketing

Information Technology and System Support

Strategic Management Assistance

3. During the year, the assessee has received an amount of Rs. 3.84 crores from GEMFSL under the Master Service Agreement for providing the aforesaid services. In the return of income filed for the assessment year 2007-08, the assessee had shown its income at "nil" on the ground that the income accrued to the assessee qualifies as business income and the same cannot be taxed under Article-7 as the assessee has no Permanent Establishment (P.E) in India as defined in Article-5 of India-Thailand DTAA. In the draft assessment order, the Assessing Officer held that consideration received by the assessee from the provisions of services from outside India to GEMFSL is on account of business connection in India and, hence, taxable under the domestic law i.e., Indian Income Tax Act. He also held that services rendered by the assessee would also fall within the definition of "fees for technical services" as envisaged under section 9(1)(vii) of the Act and, hence, the same is taxable in India. Alternatively, he held that the services rendered by the assessee would also fall within the definition of "royalty" under the Article–12(3) of the treaty and, hence, would be taxable in India. Against the said draft assessment order, the assessee filed its objection before the DRP and also the copy of tax residency certificate issued by the Thailand tax authorities. The DRP directed the Assessing Officer to tax the receipts from the services rendered by the assessee as "royalty" under Article–12(3) of the DTAA, without giving any opinion or direction on non taxability as business connection in India or Fees for Technical Services (for short "FTS"). The DRP quoted the conclusion of the Assessing Officer in the following manner:–

"From the above definition it can be seen that the term Royalty includes not only the right to use any copyright payments, trademark, design or any industrial, commercial or scientific equipments. The definition specifically includes any payment for information concerning the industrial, commercial or scientific experience. The use of word experience indicates that the intention of the legislature is to cover any fees paid to any consultant for providing any advice based on his experience, i.e., the knowledge, knowhow and expertise that he has gained over the years. In the assessee's as per Schedule–4 of the Master Service Agreement 2005, clearly indicates that the payments made to the assessee are for consultancy services provided by the Chief Executive Officer, CIO, Legal Service Team, Group Risk Team, Finance Team, etc. In other words one can say that the payments made to the assessee company is for the information/advice given by the aforesaid people/team. These people/team are specialists in their subject matter and have years of experience in the industrial, commercial or scientific fields. Therefore, it is held that the payments made to the assessee company are for providing industrial, commercial or scientific experience and, hence, the receipts are taxed as Royalty in the assessee's hands."

4. Thereafter, the DRP confirmed the aforesaid conclusion of the Assessing Officer and directed the Assessing Officer to tax such payment as royalty after giving following directions:–

"The assessee has also claimed the benefit of Indo–Thailand DTAA and has submitted a copy of TRC placed in the paper book–I, is seen that the arguments of the A.O. shall be applicable even in the case of the definition as given in article 12(3) of Indo–Thailand DTAA. The ground of objection, therefore, deserve to be dismissed.

The A.O. is therefore directed to examine the Tax Residence Certificate and in case the assessee is liable to tax in Thailand the beneficial rate as Indo–Thailand DTAA shall be applicable."

5. Accordingly, the Assessing Officer, in pursuance of such direction held that the payments received by the assessee are for providing industrial, commercial or scientific experience and, hence, the receipts are taxable as "royalty" within the meaning of Article–12(3) of the Indo–Thailand DTAA and tax the said receipts @ 15%.

6. Before us, the learned Counsel, Shri Rajan Vora, on behalf of the assessee, submitted that the India–Thailand tax treaty does not have any separate Article for FTS and, accordingly, the income from the services rendered by the assessee would be governed by Article–7. Since the assessee does not have any P.E. within the meaning of Article–5, therefore, the said receipts cannot be taxed in India. The fact that the assessee does not have a P.E., has not been disputed by the Assessing Officer. He also pointed out that in the assessment year 2006–07, the Assessing Officer had taxed the similar receipts from GEMFSL as being in the nature of FTS under the Act, however, in the first appeal, the learned Commissioner (Appeals) held that in the absence of any FTS clause under the India Thailand treaty and in the absence of P.E. of the assessee in India, the said receipts could not be taxable in India. Thereafter, no further

appeal has been preferred by the Department. Regarding taxability of the said receipt as "royalty" under the Article–12, he submitted that the services rendered by the assessee are not in respect of the "use of" or the right to use of any patent, invention, model, design, secret, formula, process or trademark, etc., as defined in Para–3 of Article–12. It will also not fall under imparting of any information concerning technical, industrial, commercial or scientific knowledge or experience or skill, because there is no transfer of any knowledge, skill, or experience. He further referred and relied upon Para–11 of OECD commentary on Article–12, wherein the term "industrial, commercial and scientific experience" has been explained. He specifically drew our attention to Para–11.2 and 11.3 of the commentary. He submitted that the crucial point to see is, whether such services fall within the ambit of "royalty" or whether there is any imparting of knowhow. If knowhow has not been transferred then the services rendered on account of industrial, commercial and scientific cannot be held as royalty. In support of his contention, he strongly relied upon the following case laws:–

1. *M/s. McKinsey & Co. (Thailand)* v. *DDIT*, ITA no.7624/Mum./2010, order dated 10th July 2013
2. *DDIT* v. *Preroy AG*, [2010] 39 SOT 187 (Mum.)
3. *Diamond Services International Pvt. Ltd.* v. *UOI & Ors*., [2008] 304 ITR 201 (Bom.)
4. *JDIT* v. *Harvard Medical International, USA*, [2012] 13 ITR (Trib.) 623 (Mum.)
5. *Spice Telecom* v. *ITO*, [2008] 113 TTJ 502 (Bang.)
6. *KPMG India Pvt. Ltd.*, v. *DCIT*, [2012] 17 ITR (Trib.) 569 (Mum.)
7. *Bharati AXA General Insurance Co. Ltd. In re*, [2010] 326 ITR 477 (AAR)
8. *Anapharn Inc., In re*, [2008] 305 ITR 394 (AAR)
9. *Kotak Mahindra Primus Ltd.* v. *DDIT*, [2006] 105 TTJ 578 (Mum.)
10. *DDIT(IT)* v. *Euro RSCG Worldwide Inc.* [2013] 153 TTJ 378 (Mum.).

7. The learned Departmental Representative, on the other hand, submitted that, whether the services rendered by the assessee are in the nature of "royalty" depends upon the terms and conditions of the agreement and the nature of transactions. All the services which have been enumerated in the agreement can only be rendered by a person of an experience in various fields. He also drew our attention to certain services like accounting and final support services for which lot of experience is required and not only that, while rendering such services, there is parting of knowhow also. The services rendered by the assessee fall within the ambit of giving information concerning industrial, commercial or scientific experience as appearing in Para–3 of Article–12. He also referred to Para–11.6 of OECD commentary, which deals with the practically of the situations in the contracts which cover both

knowhow and the provisions of technical assistance. If one part of the services fall within the ambit of imparting of knowhow and other part falls within the services, then it should be construed as royalty only. In the case of assessee also, some of the services can be classified as "royalty".

8. We have heard the rival submissions and perused the impugned order and the material placed on record. The assessee has been rendering various services, as highlighted above, to foreign G.E. Group companies and in India to GEMFSL. Admittedly, the assessee does not have a P.E. in India and, therefore, if any receipt which is to be taxed, would be in accordance with Article–7, only and in that case, the same will not be taxable in India. The only issue of dispute which remains to be adjudicated after the direction of the DRP is, whether the payment received by the assessee in lieu of services rendered to GEMFSl is taxable as "royalty" under Article–12(3) or not. If it is a "royalty", then the same would be taxable in India as per the rates prescribed under the treaty. Article–12(3), under India–Thailand Tax DTAA reads as under:–

"Article–12(3)

The term "royalties" as used in this article means payments of any kind received as a consideration for the alienation or the use of, or the right to use, any copyright of literary, artistic or scientific work (including cinematograph films, phonographic records and films or tapes for radio or television broadcasting), any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience."

9. The Revenue's case is that the services rendered by the assessee are in the nature "of information concerning industrial, commercial or scientific experience". The OECD commentary on model convention on Article–12, has explained the term "industrial, commercial or scientific" experience in the following manner:–

11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 alludes to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how which do not differ intrinsically. One such definition, given by the ''Association des Bureaux pour la Protection de la Propriete Industrielle" (ANBPPI), states that "know-how is all the undivulged technical information, whether capable of being patented or not, that is necessary for the industrial reproduction of a product or process, directly and under the same conditions; inasmuch as it is derived from experience, knowhow represents what a manufacturer cannot know from mere examination of the product and mere knowledge of the progress of technique".

11.1 In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is

recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.

11.2 This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party. Payments made under the latter contracts generally fall under Article 7.

11.3 The need to distinguish these two types of payments, i.e. payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:

Contracts for the supply of know-how concern information of the kind described in paragraph 11 that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.

In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge skill or expertise to the other party.

In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material. On the other hand, a contract for the performance of services would, in the majority of cases, involve a very much greater level of expenditure by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.

11.4 Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:

- payments obtained as consideration for after-sales service
- payments for services rendered by a seller to the purchaser under a guarantee, payments for pure technical assistance,
- payments for an opinion given by an engineer, an advocate or an accountant, and
- payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with non-confidential information in response

t frequently asked questions or common problems that arise frequently. "emphasis supplied".

10. From the above, it can be gathered that the royalty payment received as consideration for information concerning industrial, commercial, scientific experience alludes to the concept of knowhow. There is an element of imparting of knowhow to the other, so that the other person can use or has right to use such knowhow. In case of industrial, commercial and scientific experience, if services are being rendered simply as an advisory or consultancy, then it cannot be termed as "royalty", because the advisor or consultant is not imparting his skill or experience to other, but rendering his services from his own knowhow and experience. All that he imparts is a conclusion or solution that draws from his own experience. The eminent author Klaus Vogel in his book "Klaus Vogel On Double Tax Convention" has reiterated this view on difference between royalty and rendering of services in the following manner:-

"Imparting of experience: Whenever the term "royalties" relates to payments in respect of experience (knowhow) the condition for applying art. 12 is that the remuneration is being paid for "imparting" such knowhow…. In contrast, the criterion used to distinguish the provisions of know-how from rendering advisory services is the concept of imparting. An advisor or consultant, rather than imparting this experience, uses it himself (BFH BStBI.II 235 (1971); Minister des Relations exterieures, Reponses a M. Bockel, 36 Dr. Fisc. Commn. 1956 (1984). All that he imparts is a conclusion that he draws inter-alia from his own experience. His obligation to observe secrets, or even his own interest in retaining his "means of production' will already prevent a consultant from imparting his experience. In contrast to a person using his own know-how in providing advisory services, a grantor of know-how has nothing to do with the use, the recipient makes of it."

11. The thin line distinction which is to be taken into consideration while rendering the services on account of information concerning industrial, commercial and scientific experience is, whether there is any imparting of knowhow or not. If there is no "alienation" or the "use of" or the "right to use of" any knowhow i.e., there is no imparting or transfer of any knowledge, experience or skill or knowhow, then it cannot be termed as "royalty". The services may have been rendered by a person from own knowledge and experience but such a knowledge and experience has not been imparted to the other person as the person retains the experience and knowledge or knowhow with himself, which are required to perform the services to its clients. Hence, in such a case, it cannot be held that such services are in nature of "royalty". Thus, in principle we hold that if the services have been rendered de– hors the imparting of knowhow or transfer of any knowledge, experience or skill, then such services will not fall within the ambit of Article–12. Since neither the Assessing Officer nor the DRP has examined the nature of service rendered by the assessee from this angle therefore, we are of the opinion that the matter should be restored back to the file of the Assessing Officer to examine the nature of services in line of the principles discussed above. If such services do not involve imparting of knowhow or transfer of any knowledge, experience or skill, then it cannot be held to be taxable as royalty. Since the issue of FTS is

not the subject matter of dispute after the direction of the DRP, hence, we are not expressing any opinion on FTS. Thus, ground no.1 and 2, are treated as partly allowed for statistical purposes.

12. Ground no.3, relates to initiation of penalty proceedings under section 271(1)(c), which is not only pre–mature but has also become infructuous in view of our findings given above. Consequently, ground no.3, is dismissed as infructuous.

13. In the result, assessee's appeal is partly allowed.