Fee for service which is inextricably linked to sale isn't treated as fee for included services under Indo-US DTAA

Summary – The Mumbai ITAT in a recent case of Raytheon Ebasco Overseas Ltd., (the Assessee) held that Fee for included services (FIS) would not include amounts which are inextricably and essentially linked to sale of property

Facts

- The assessee, a foreign company had entered into a contract with JTPCL to set up a power plant in India. The nature of services rendered to JTPCL included providing of engineering and designing work, providing material based on overall design, providing quotations based on specifications developed by the assessee for the power plant, supplying drawing review to enable integration of the equipment and undertaking document of design. The services were split up under the head technical services, start-up services and overall responsibilities. The assessee submitted before the Assessing Officer that the overall responsibility and management of the project was carried out by the assessee from outside India, that no Permanent Establishment (PE) was created in India; and thus, the amounts received by the assessee for undertaking overall responsibility did not amount to transfer of technology/technical knowhow to JTPCL, and thus, no technical services/included services were provided by the assessee to JTPCL as envisaged by the Act/DTAA.
- The Assessing Officer held that income received by the assessee for technical services, start-up and overall responsibility were clearly chargeable to tax both under the Act and the Treaty, as fee for 'included services', that the assessee was supplying drawings/designs relating to construction of the power plant, and, thus, it was involved in the operation, maintenance, training of Indian employees, He further held that the assessee had also made available technical plans and designs and, that same was to be assessed as fees for included services.
- The First Appellate Authority held that income had accrued and arisen in India to the assessee as per the amended provisions of section 9(2), and since that FIS had been defined in the tax treaty to mean payments of any kind to any person in consideration for the rendering of any technical or consultancy services, the payment made by Indian company to the assessee for obtaining engineering and design work fell within the definition of FIS under article 12(4)(b). He further held that the technical plant/designs made available by the assessee helped JTPCL to apply the technology for generation of power, and that under paragraph 4(b) of the agreement the assessee had made available technical and consultancy services to JTPCL.
- On appeal:

Held

Whether services rendered by assessee were FTS?

- As per the contract following technical services were provided to JTPCL: Engineering and design work relating to conceptualisation of the power plant; Providing specification regarding the material

required for the power plant; Providing suppliers quotations and reviewing documents to enable compliance with specification developed by the assessee for the power plant; Previewing drawings to enable integration of the equipment to be supplied to JTPCL and; Undertaking preparation of final document of the design of the plant and equipment necessary for the power plant

- The start-up services provided by the assessee, under the contract, included the following: Development of packages thereby the various instrumentation, electrical, mechanical and equipment listing were drawn up and were further broken down into sub-systems for the purpose of commissioning by the start-up contract and; Laying out of test procedures for the various sub-systems equipment and components.
- The technical services or the start-up services provided by the assessee did not include any construction, assembly, mining or like projects and, therefore, the payment received by it would not constitute FTS as per the provisions of the Act.

Whether services rendered by assessee could be termed FIS as per provisions of Article 12 of DTAA?

- Start-up services were carried out on site by the start-up contractors. All the services were provided from overseas and that no part of it was carried out in India. Though some of the employees of the assessee visited India, but there is no proof that there was any transfer of technology or technical know-how to the JTPCL. As per article 12(4) for a payment to be considered as FTS following conditions have to be fulfilled: The payments has to be in consideration for services of a managerial/technical/consultancy nature; The services should fulfil the condition set out in any of the clause (a) or (b) of the article.
- It will be useful to refer to the memorandum of understanding dated 15-5-1989 to the DTAA. As per the MOU, technical and consultancy services are considered included services only to the following extent:

  (i) If they are ancillary and subsidiary to the application or enjoyment of right/property/information for which a royalty payment is made or
  (ii) If they make available technical knowledge/experience/skill/know-how or process or consists of development and transfer of technical plan/technical design.

- In short, under paragraph 4(b) consultancy services which are not of technical nature cannot be treated as included service. To be classified as FTS the services should enable the service receiver to carry out services by obtaining the technical knowledge/experience/skill possessed by the service provider. It is possible that service provider may utilise its own technical knowledge in providing the services but that in itself would not render the services being treated as making available to the service receiver. It has to be held that perusal of the contracts, entered into by the assessee with JTPCL, reveal that the services provided by it under the contracts did not in any way make available

technical knowledge and experience skill or know-how to the Indian company. It had supplied the equipments to Indian company outside India, so the payments made by JTPCL to the assessee would not constitute FIS, as per article 12 of the Treaty. Services mentioned in Examples 4 and 7 of the MoU are more or less similar to the services rendered by the assessee. Article 12(5) of the Treaty stipulates that FIS would not include the amounts if same are inextricably and essentially linked to the sale of property. In the case under consideration, the services provided by the assessee were linked inextricably and essentially to the start-up services and sale of equipment to JTPCL. Therefore, the payment received by it cannot be treated as FIS and payment received by the assessee under the contract constituted business profit within the meaning of article 7. As per article 7(1) business profit of any assessee can be taxed in India only if it has a PE in India. In the case under consideration the assessee is not having PE in India - whether fixed or otherwise.

- Considering the above, the order of the FAA cannot be sustained.