Support and service fees not taxable as FTS as it didn't satisfy make available clause

Summary – The Mumbai ITAT in a recent case of Spencer Stuart International BV., (the Assessee) held that where assessee foreign company had entered into two agreements with Indian company (SSIPL), namely, License Agreement (LA) and Service Agreement (SA) and it received a certain sums towards licence fees and search fees, since license fees and search fees were governed by separate and distinct agreements entered into by assessee and SSIPL and they would constitute different sources of its income, search fee and license fee were distinct from each other and search fee received under SA was independent of LA and was not taxable in India as FTS under article 12(5)(a) of India Netherland DTAA

Facts

- The assessee, a Netherland based company, was engaged in the business of executive search service as well as providing technology, software and related support services to its group companies.
- The Assessing Officer found that the assessee had entered into two agreements with Indian company (SSIPL) namely (i). License Agreement (LA) and (ii). Service Agreement (SA) and it received Rs. 5.39 crores towards ESF under the SA, and that the same was not offered for taxation claiming that the receipt was not taxable in absence of a permanent establishment (PE) of the assessee in India. It was claimed that ESF was not taxable as Fee for Technical Services (FTS) in view of article 12(5) of the DTAA. However, the Assessing Officer did not agree with the assessee. He passed a draft order on 14-03-2014 taxing ESF.
- DRP noted that the terms and conditions in the SA relating to education of search assignment and payment of such fees to the assessee was part and parcel of the LA, that the same were ancillary and subsidiary to the application or enjoyment of the right/property/information for which royalty was received by the assessee and, thus, the search fee of Rs. 5.39 crores received from Indian entity by the AE was nothing but fee for services which were ancillary and subsidiary to the application or enjoyment of the right/ property /information for which a payment, described in article 12 of the tax treaty was made.
- On appeal:

Held

- License fees and search fees are governed by separate and distinct agreements entered into by the assessee and SSIPL and they would constitute different sources of its income for the year under consideration. In other words, receipt of search fee by the assessee was independent of earning the license fee. As per the SA search fees was to be determined on the basis of relative contribution of each party, which means in a given situation, SSIPL could also receive search fees from the assessee. But, same was not true for licence fee. The assessee had not to pay anything to SSIPL as licnece fee. ESF were independent services and were not provided for the purpose of enjoyment/application of

right, property etc. governed by the LA. Services, ancillary and subsidiary to the use of license/trademark/software, are provided for in the LA and same had no correlation with the SA. It is safe to say that the DRP had wrongly held that SA was originating from LA. Core business of the group was to identify, to evaluate and to recruit of senior personnel for a fee. It is found that to carry out the search function, SSIPL would employ consultants, who were supported by researchers, knowledge managers and support staff. As per the Memorandum of Association (MOA) of SSIPL the principal business of SSIPL was to carry out or execution of executive searches and therefore, the ESF cannot be treated as ancillary/subsidiary to the LA. In fact, license fees was a percentage of the search fees earned by SSIPL from the executive searches done during the year.

- For a service to be categorised as FTS it should make available technical knowledge, experience, skill, know-how, or processes, or it should consist of the development/transfer of a technical plan or a technical design, in terms of article 12(5)(b) of the DTAA. It is also observed that the DRP had relied on the inclusion of the sharing clause (clause (bb) to article 3) in the LA to arrive at the conclusion that the terms and conditions of the SA are part and parcel of the LA. But, the departmental officers have not given any reasoning that could lead to the fact that SA was ancillary in nature to the LA. The FAA his orders, for the assessment years. 2012-13 to 2014-15, in context of the proceedings under section 201 of the Act, has decided the identical issue in favour of SSIPL and has held that search fees remitted by SSIPL to the assessee did not represent fees for technical services under article 12(5)(a) of the India-Netherlands DTAA and was not subject to TDS under section 195. The FAA has referred to the APA entered between SSIPL and the Government of India. As per the APA, a separate benchmarking has been laid down for the international transaction of License fee and ESF. As per paragraphs 5 & 6 of the APA, the Most Appropriate Transfer Pricing Methods for the covered transactions shall be Profit Split Method (PSM) for payment and receipt in relation to cross-border executive search transaction and Comparable Uncontrolled Price (CUP) method for Payment of License fees transaction.
- Considering the above, the search fee and license fee were distinct from each other and that the search fee received under the SA was independent of the LA and was not taxable in India as FTS under article 12(5)(a) of the DTAA. It is a fact that in earlier years the Assessing Officer himself had held that fees under both the agreements were separate and that only licence fees was taxable. So, the search fee could not be treated to be ancillary and subsidiary to LA, that the same did not in any way aid, promote or supplement the application or enjoyment of the right, property, or information, and that the search fee received under the SA was independent of the LA and was not taxable in India.