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Cost of technical personnel deputed to Indian subsidiary is taxable as fees for included services under India USA DTAA

Transfer of deputationist with technical expertise shall fall under FIS and will be charged on gross basis

The Tribunal[1] has held that services provided from one entity situated in one tax jurisdiction to another entity situated in another tax Jurisdiction, through the transfer on deputation of its experienced/ expert technical employees, shall fall under the ambit of fees for included /technical services. Further, no deduction of expenses shall be allowed relating to income earned as per Article 7(3) of the India US DTAA read with section 44D of the Act.

Facts of the case:

General Motors Overseas Corporation (taxpayer) is a tax resident of United States of America and is in the business of providing management and consulting services solely to the group entities worldwide. The taxpayer entered into a Management Provision Agreement (MPA) dated 26 December 1995, effective from 16 April 1994, with General Motors India Limited (GMIL). GMIL is engaged in the business of manufacture, assembly, marketing, sale of motor vehicles and other products in India. GMIL had a separate 'technical information and assistance agreement' with M/s Adam Opel AG.

Under the MPA, the taxpayer provided executive personnel in connection with development of general management, finance, purchasing, sales, service, marketing and assembly/ manufacturing activities to GMIL. The taxpayer charged salary and other direct expenses related to such personnel, to GMIL.

To ascertain the tax liability, if any, on amounts receivable, the taxpayer filed an application before the Authority of Advance Ruling (AAR)[2]. Based on the facts then available, AAR ruled vide order dated 19 August 1997 that, the services of the nominees of "XYZ" (taxpayer) are "managerial" and not "technical or consultancy" services within the meaning of Article 12 and so the amounts received are taxable as business profit under Article 7 as the taxpayer has Permanent Establishment (PE) in India as per Article 5(2)(1) of the India-US DTAA.

During the subject year, two expatriates – President and Managing Director and Vice President Manufacturing were assigned to GMIL. President and Managing Director will be Chief Executive and Operating Officer of GMIL and will be responsible for the overall management and direction of GMI operations. The President and Managing Director will be formally appointed to such office by GMIL and will discharge his or her powers and duties from that office. Vice President Manufacturing will be responsible for the overall management of GMIL facilities to manufacture and assemble products according to required standards and for production of such products, according to those standards.

The taxpayer raised invoices and disclosed the amount received as business receipts in return of income. Salary paid to the expatriates were after deduction of tax at source, under section 192 of the Income tax Act, 1961 (the Act). As the invoices raised were on cost-to-cost basis, no business

[1] TS-134-ITAT-2020(Mum)

[2] 242 ITR 208

profit was disclosed in return of income filed. The Assessing officer (AO) had issued notices under 143(2) and 142(1) of the Income tax Act, 1961 (the Act) and the assessee was called upon to file the copy of the service agreement of the deputationist. However, the representative of taxpayer did not file the service agreement of the employees.

The AO, left with no option, taxed the entire receipt as business income as per Article 7 of India US DTAA as income of Permanent Establishment (PE) in India, on gross basis since the income is to be computed in accordance with restrictions / limitation of the domestic tax law as provided in Para 3 of Article 7 of India US DTAA. Aggrieved by the order of AO, taxpayer preferred an appeal before the CIT(A).

Decision of CIT(A):

After considering the AAR ruling, the CIT(A) held that services rendered by the Managing Director are managerial services and cannot be held in the nature of fees for included services, as per Article 12 of India US DTAA. Fees received for such managerial services were taxable as business income on gross basis.

Further services of Vice President (Manufacturing), who is a qualified and well experienced technical personnel, will come under the purview of fees for included services under Article 12 of the India-USA DTAA and will be taxed on gross basis.

Aggrieved by the order of CIT(A), taxpayer preferred an appeal before the ITAT.

Decision of ITAT:

Whether the findings recorded by AAR are binding in Nature.

ITAT discussed Section 245S of the Act and stated that the ruling of AAR is binding on Commissioner and Income tax authorities subordinate to commissioner. However the same is not binding on the Tribunal and only has persuasive value. Further, any dispute in relation to ruling would reach to the Tribunal only when authorities bound by the ruling do not follow the ruling for valid reasons / invalid reasons.

The Tribunal held that, based on the findings of AAR (as mentioned above), it is abundantly clear that the ruling of AAR was not an absolute and unqualified ruling. It gives mandate to income tax authorities to examine factual situation in appropriate proceedings.

Whether services provided by Vice President (Manufacturing) will fall under 'Make Available' clause to be chargeable as Fees for Technical / Included Services.

The Tribunal upheld the order of CIT(A) after discussing following points:

- The Vice President was not an ordinary engineer but was having sufficient experience, exposure and knowledge about the technology. The experience of an expert lies in the mind of an expert and if an expert having knowledge and expertise is transferred from one tax jurisdiction to another tax jurisdiction, then it cannot be said that only the employees were per se transferred and not the technology. In other words, technology is made available by one entity situated in one tax jurisdiction to another entity situated in another tax jurisdiction, through the transfer on deputation of its experienced/ expert technical employees. In the automobile industry, assembly of product and standards of company are patented/ protected technology and owner of the standards, charges Royalty for sharing the standards and assembling of products. But in the present case, no Royalty had been charged by the taxpayer to the Indian group entity. Under the garb of sending technical experts to India, it cannot be permitted to say that they were

merely employees and the cost is reimbursed by the Indian counterpart to the Assessee for the services rendered by such employee.

- The Tribunal distinguished the decision in the case of Rolls-Royce Indl Power (I) Ltd.[3] on the facts of the case. In that case, there was no transfer of technology in the form of sending expert technical employees. However in the present case, employees with technical expertise are not only managing but also ensuring due adherence to the standards of the assessee, by continuously monitoring and mentoring the production.
- As there was no examination of the fact by the AO in earlier years, there cannot be consistency for no-decisions taken by the AO in the earlier years.

Whether business income should taxed on gross basis or net basis.

The Tribunal upheld the order of CIT(A) of taxing business income on gross basis and discussed Article 7(3) of India-US DTAA wherein it is provided that in determination of profits of a permanent establishment, there shall be allowed deduction of expenses in accordance with the provisions of and subject to the limitations of the taxation laws of that state. As per Section 44D (b) of the Act, no deduction in respect of any expenditure or allowance shall be allowed under any of the said sections in computing the income by way of fees for technical services. From the above two provisions, it is abundantly clear that the benefit of Article 7(3) is subject to the limitation provided under the domestic law (Section 44D of the Act). As the domestic law prohibits allowing any deduction for the purpose of calculating fees for technical services/fees for included services', then, the same is taxable on gross basis.

The Tribunal discussed the decision of Rolls-Royce Indl Power (I) Ltd. relied by taxpayer wherein Article 26, read with article 13(4)(c) of India-UK DTAA does not permit revenue authorities to discriminate against the UK registered company and accord it less favourable treatment than a domestic company. Therefore, section 44AD cannot be invoked. The Tribunal distinguished the decision as it had not discussed "subject to limitation of domestic law under the India UK treaty".

Transfer Pricing Adjustment

The CIT(Appeals) had confirmed the action of the AO in invoking transfer pricing provisions under Section 92 of the Act and adding 10 percent mark-up on the invoices billed by the appellant to GMIL.

The Tribunal allowed the ground of appeal of the taxpayer as the lower authorities had not benchmarked the transactions on the basis of any comparable instances or otherwise by using any of the prescribed methods in Rule 10B of the Rules.

Whether Interest under section 234B of the Act can be levied on foreign company

The Tribunal deleted the interest under section 234B of the Act relying on the decision of Ngc Network Asia LLC[4] and GE Packaged Power Inc[5].

Observations:

It appears from the reading of the Tribunal order, that the receipt for MD salary is taxable as business income attributable to PE in India on gross basis without deduction of expenses in view of Article 7(3) read with section 44D of the Act i.e. at 40 percent plus surcharge and cess. The Tribunal has held that the fees for VP Manufacturing is fees for included services taxable on gross basis, so

[3] 42 SOT 264
[4] [2009] 222 CTR 85 (Bombay)
[5] 56 taxmann.com 190 (Del)

would the rate of tax be 15% as per Article 12 of the India USA DTAA as the ground raised by the taxpayer that CIT(A) erred in ignoring Article 12(6) [such fees attributable to PE is taxable as business income under Article 7] has been dismissed.

The taxpayer is resident of USA. However, the provisions of non-discrimination under the India-USA DTAA which is different from India-UK DTAA, had not been discussed in the ITAT order. The non-discrimination Article under the India-USA DTAA does not prevent the Contracting State from imposing the limitations described in paragraph 3 of Article 7 (Business profits) and has carved out paragraph 3 of Article 7 as an exception for non-discrimination.