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Leadership training fees do not qualify as fees for technical services

The Pune Bench of the Income-tax Appellate Tribunal gave its decision that leadership training fees is not taxable as fees for technical service as per Article 12 of the India Sweden tax treaty, read with its protocol and the resultant Article 12(4)(b) of the India-Portuguese tax treaty.

Background:

- The taxpayer[1], a Swedish company, (amongst others) received money from its Indian affiliate company (I Co) towards leadership training services provided to its (i.e. I Co) employees during the Financial Year (FY) 2013-14, corresponding to Assessment Year (AY) 2014-15.
- The taxpayer was of the view that the leadership training services enabled the recipients to manage the affairs of I Co more effectively and hence, were in the nature of managerial services which did not qualify as 'Fees for Technical Services' (FTS) under the India-Sweden tax treaty, read with the India-Portuguese tax treaty.
- The Assessing Officer (AO) did not agree with the taxpayer's contention of limiting the scope of the term FTS as per the India-Portuguese tax treaty and claimed it as receipt towards technical services taxable under Article 12 of the India-Sweden tax treaty.
- In appeal proceedings, the matter reached the Pune Bench of the Income-tax Appellate Tribunal (ITAT).

Certain relevant provisions in brief:

- Scope of FTS under the India-Sweden tax treaty

  Article 12(3)(b) of the India Sweden tax treaty defines FTS to mean payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Articles 14 [relating to taxation of independent personal services (IPS)] and 15 [relating to taxation of dependent personal services (DPS)].

- Protocol to India-Sweden tax treaty

  In respect of Articles 10, 11 and 12 (relating to taxation of dividend; interest; royalties and FTS, respectively), if India has, in a tax treaty with another third State which is a member of the Organisation for Economic Co-operation and Development (OECD), limited its taxation right on dividend, interest,

[1]Sandvik AB vs DCIT (ITA no 2524/PUN/2017) (Pune ITAT)

royalties or FTS at a rate lower or a scope more restricted than that in the India-Sweden tax treaty, then such restricted rate or scope shall apply to the India-Sweden tax treaty.

- Scope of FTS under the India-Portuguese tax treaty

  Article 12(4)(b) of the India- Portuguese tax treaty defines FTS to mean payment of any kind other than Articles 14 (relating to taxation of IPS) and 15 (relating to taxation of DPS) of the said convention, to any person in consideration of the rendering of any technical or consultancy services (including through the provisions of services of technical or other personnel) if such services;

  a. ……; or

  b. make available technical knowledge, experience, skill, know-how processes or consist of the development and transfer of a technical plan or technical design which enables the person acquiring the services to apply the technology contained therein.

Decision of the ITAT:

- The ITAT noted that following issues had emerged for its consideration.
  - Whether benefit of India-Portuguese tax treaty could be allowed in terms of Most Favoured Nation (MFN) clause in the protocol to India-Sweden tax treaty?
  - Whether training fees was a consideration for rendering 'managerial services' as claimed by the taxpayer?
  - Whether training fees was a consideration for rendering consultancy or technical services as held by the Revenue?
  - If training fee was not FTS, did it become immune from taxation?

Issue 1: Benefit of India-Portuguese tax treaty in terms of MFN clause in the Protocol to India-Sweden tax treaty

- The ITAT noted that the Delhi High Court (HC), in an earlier case[2], in the context of India-France tax treaty, had held that protocol is a part of the tax treaty and there was no need for separate notification incorporating the beneficial provisions of the other tax treaty as forming part of the tax treaty (to which the protocol was attached).
- The ITAT concurred with the taxpayer's view that once two sovereigns had added protocol to the India-Sweden tax treaty, which contained the MFN clause, the beneficial provisions of India-Portuguese tax treaty were to be read in the India-Sweden tax treaty.

Issue 2: Training fees as consideration for rendering managerial services

- The ITAT noted the following:
  - Unlike the FTS definition of India-Sweden tax treaty; the word 'managerial' was absent in the FTS definition of India-Portuguese tax treaty.

[2] Steria (India) Ltd. v. CIT (2016) 386 ITR 390 (Delhi HC)

- The taxpayer's contention was that since the object of the training was to develop leadership qualities, leading to better management of I Co's affairs, it rendered managerial services. This was not taxable as FTS under Article 12 of the India Sweden tax treaty read with its protocol and the resultant Article 12(4)(b) of the India-Portuguese tax treaty

- The ITAT observed the following:
  - In the case under consideration, crux of the training given by the taxpayer to I Co employees was in the realm of leadership skills.
  - In order to decide whether the training fees was a consideration for managerial services, it was necessary to first comprehend the real nature of services rendered by the taxpayer. The philosophy of equating the nature of training with the rendition of the same nature of service, was unfounded.

    Ordinarily, training was conceived as passing on of some proficiency by the trainer to the trainee. It simply led to honing up the skills of the other in the subject, which patently could not be termed as an equivalent of rendering service in that field.

    For example, acquainting someone in a formal manner with techniques to boost sales did not stand at par with rendering marketing services. Rendition of marketing services took place when marketing activities were actually undertaken for and on behalf of an organisation by practically plunging into the field or doing some activity concerning the marketing.
  - Doing the activity was synonymous with rendering of service of that nature. Simply equipping or enabling the others for doing an activity was a step anterior to rendition of such services.

  In view of the above, the ITAT held that rendering leadership training to employees of I Co were not managerial services, so as to fall outside the ambit of FTS under Article 12(3) of the India-Sweden tax treaty read with its protocol and the resultant Article 12 of the India-Portuguese tax treaty.

Issue 3: Training fees as consideration for rendering consultancy or technical services

- The ITAT noted the following that:
  - Unlike the FTS definition under India-Sweden tax treaty; there was a 'make available' clause in Article 12(4)(b) of the India-Portuguese tax treaty, which required that the services rendered enable the recipient of services to apply the technology contained therein.
  - The terms technical and consultancy services were not defined under the Income-tax Act, 1961 (ITA) or the India-Portuguese tax treaty. Generally, technical services required use of skill and specialised knowledge ordinarily in engineering field and consultancy services were advisory services (i.e. to seek advice from the expert in the field was ordinarily viewed as availing consultancy services).

- In view of the above, the ITAT observed that:
  - The common connotation of consultancy services did not hold good in the context of the language of Article 12 of the India-Portuguese tax treaty. The consultancy services in the current context drew its colour from the items mentioned after the term `make available', more specifically, when these also were comprehended in the sense of making available experience or skill etc. to the recipient for use at his own end. This showed that the technical knowledge, experience or skill etc., must be handed over to the acquirer for its later use by self as a pre-condition for falling within the purview of the said Article.
  - The leadership training provided by the taxpayer did not result in making available any technical knowledge, experience or skill etc. to the employees of I Co, which could enable them to use it later on.

  In view of the above, the ITAT held that the Revenue authorities were not justified in considering training fee as a consideration for rendering consultancy or technical services within the meaning of Article 12 of the India-Sweden tax treaty, read with its protocol and the resultant Article 12(4)(b) of the India-Portuguese tax treaty.

Issue 4: If training fee was not FTS, did it become immune from taxation?

- Since, the training fee received by the taxpayer did not qualify as FTS (as discussed above), the taxability of the same was required to be tested under Article 7 (relating to taxation of business profits), read with Article 5 of the India-Sweden tax treaty (relating to permanent establishment).
- Since the AO (in connection with taxation of other income of the taxpayer) had accepted that the taxpayer did not have a permanent establishment in India, the amount of training fee was also not taxable as business profit, in the absence of a permanent establishment of the taxpayer in India, as per Articles 5 and 7 of the India-Sweden tax treaty.

Comment:

This ruling affirms the following principles:

- One should not simply equate the nature of training with the rendition of the same nature of service but comprehend the real nature of services rendered.
- The common connotation of consultancy services (viz. advisory services) does not hold good in the context of the language of Article 12 of the India-Portuguese tax treaty and technical knowledge, experience or skill etc., must be handed over to the acquirer for its later use by self.

Taxpayers with similar facts, could evaluate the impact of this ruling to the facts of their specific cases.

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