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26 May 2020

### Taxation in absence of fees for technical services Article under India-Philippines tax treaty

The Vishakhapatnam Bench of the Tribunal has held that in the absence of fees for technical services Article under the India-Philippines tax treaty and in the absence of a permanent establishment of the taxpayer in India, the consideration for services is not taxable in India

#### Facts of the case:

- Paramina Earth Technologies Inc (the taxpayer)<sup>1</sup> is a company incorporated in the Philippines and has expertise in mining activity.
- The taxpayer was engaged by Teknomin Construction Ltd. (TCL), an Indian company, to recruit skilled and experienced employees for mining activities (at the mines of Hindustan Zinc Ltd. situated at Rajasthan). The services of identifying suitable employees (for employment by TCL) were performed in the Philippines.
- The taxpayer was remunerated on a monthly retainer basis by TCL at the rate of 10% of the salary of certain specified employees. The payment for recruitment services (i.e. retainer fee) was received in the Philippines.
- With respect to the employees:
  - Their salaries were paid partly in India and partly in the Philippines through the taxpayer on a monthly basis. The taxpayer raised bill on TCL for the salary paid in the Philippines through the taxpayer;
  - The taxpayer deducted amounts towards social security in the Philippines, loans due from employees (if any), expenses incurred in the Philippines on behalf of the employees at the time of recruitment and other statutory dues;
  - The tax on salary of the employees was borne by TCL.
- The employees were under the supervision and control of TCL and were not the employees of the taxpayer. The entire salary of the employees was borne by TCL.
- The taxpayer was of the belief that the retainer fee was not taxable in India due to the following factors and accordingly, filed its return of income declaring 'Nil' income:
  - There was no fees for technical services (FTS) article under the India-Philippines tax treaty;
  - The taxpayer did not have a permanent establishment (PE) in India and therefore, income was not taxable as business income as per Article 7 of the India-Philippines tax treaty;
  - As per Article 23 of the India-Philippines tax treaty, other income was taxable only in Philippines.

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<sup>1</sup> 116 taxmann.com 347

- The Assessing officer (AO) held that the retainer fee was taxable in India as FTS under section 9(1)(vii) of the Income-tax Act, 1961 (the ITA). In this regard:
  - The AO relied on Circular number 333 of 1982<sup>2</sup> which provides that where a tax treaty provides for a particular mode of computation of income, the same should be followed (irrespective of the provisions of the ITA). Where there is no specific provision in the agreement, the ITA will govern the taxation of income.
  - The case of IBM India<sup>3</sup> relied on by the taxpayer was distinguishable based on facts, since in the case of IBM India, no employees travelled to India.
- On appeal by the taxpayer, the Commissioner of Income-tax Appeals [CIT-(A)] upheld the order of the AO and also held that the taxpayer had a PE in India.
- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal with the Vishakhapatnam Bench of Income-tax Appellate Tribunal (ITAT).

### **Decision of the ITAT:**

- The ITAT noted that:
  - In the case of ABB FZ-LLC<sup>4</sup> it was held that once an income chargeable to tax is excluded under the tax treaty as FTS, then the income cannot be brought to tax under the ITA;
  - In the case of IBM India<sup>5</sup> it was held that if an income is covered under Article 6 to 22 of the India-Philippines tax treaty, then Article 23 relating to Other Income, was not applicable.
- Further, the ITAT relied on the principle laid down in the cases of IBM India<sup>5</sup> and ABB FZ-LLC<sup>5</sup> that:
  - In the absence of an Article in a tax treaty to tax FTS, an income earned in the course of business was taxable as business income under Article 7;
  - In the absence of a PE in India, the income was not chargeable to tax in India.
- The ITAT held that Circular No. 333 of 1982<sup>6</sup> was in relation to computation of income and not in relation to classification of income.
- Given the above, the ITAT in the case under consideration held that:
  - The retainer fee received by the taxpayer was in the nature of FTS;
  - In the absence of a separate FTS Article under the India-Philippines tax treaty, the retainer fee was to be taxed as business profits under Article 7 of the India-Philippines tax treaty;
  - The AO had not made out a case that the taxpayer had a PE in India. In the absence of a PE of the taxpayer in India, the retainer fee was not taxable as business profits;
  - Revenue authorities had erred in taxing the retainer fees as FTS under section 9(1)(vii) of the ITA.

<sup>2</sup> Circular No. 333 [F. No. 506/42/81-FTD] dated 2 April 1982.

<sup>3</sup> DCIT (International Taxation) v. IBM India (P.) Ltd. [2018] 100 taxmann.com 230 (Bang ITAT)

<sup>4</sup> ABB FZ-LLC vs ITO (International Taxation) [2016] 75 taxmann.com 83/[2017] 162 ITD 89 (Bang ITAT)

<sup>5</sup> DCIT (International Taxation) vs IBM India (P.) Ltd. [2018] 100 taxmann.com 230 (Bang ITAT)

<sup>6</sup> Circular No. 333 [F. No. 506/42/81-FTD] dated 2 April 1982.

**Observations:**

- Taxability of services in the absence of an FTS Article under the tax treaty (i.e. either as business income or as other income) has been a litigative issue. In the current case, Revenue authorities had contended that the income was taxable as FTS under the ITA.
- This ruling affirms the principle that in the absence of an FTS Article under the tax treaty, the income is to be classified as business income, if earned in the course of taxpayer's business.



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