FEES FOR INCLUDED SERVICES, TECHNICAL SERVICES AND PREPARATORY ACTIVITIES EXPLAINED

Financial, legal and risk management services not "Included Services"

In the case of *US Technology Resources Private Ltd v. DDIT,* the Kerala High Court (the "**KHC**") has held that management, financial, treasury and risk management services, and advising on legal matters or undertaking public relations activities (collectively, the "**Services**") provided by a non-resident to an Indian entity are not covered within the meaning of "fees for included services," under Article 12 of the India-USA double tax avoidance treaty (the "**US Treaty**"). In this case, the taxpayer made payments to a company based in the USA (the "**Non-resident**") for providing the Services and did not withhold tax in India, claiming that the payments were not chargeable to tax under the US Treaty. After referring to the terms of the agreement, the KHC noted that although the Services were in the nature of "fees for technical services" as defined in the Income-tax Act, 1961 (the "**Act**"), the definition of the term "fees for included services" as provided in the US Treaty was much narrower due to the additional condition that services have to made available to the recipient. The KHC observed that the services were merely advisory in nature, and there was no transfer of technology, plan or strategy that was made available to the taxpayer by the Non-resident. The KHC held that the mere fact that the provision of a service may require technical input by the service provider does not *per se* mean that the technical knowledge, skills, etc., are made available to the person availing the Services. This ruling lays down the fact that there should be a transfer of technology and that technology should be made available to the transferee/service recipient in order for the services to be considered to have been "made available" for the imposition of tax under the US Treaty.

Fees paid for training, management services and access to computerised system not technical service fees

In the case of *Renaissance Services BV v. DDIT*, the Mumbai Income-tax Appellate Tribunal (the "**Mumbai Tribunal**") has held that the consideration received by a Dutch company for providing training services, management systems and access to computerised reservations to Indian hotels does not qualify as fees for technical services under Article 12 of India-Netherlands double tax avoidance treaty. The Mumbai Tribunal observed that the taxpayer had only provided core training programs for managerial personnel, which were in the nature of general managerial and leadership guidance, and that the services did not "make available" or transfer technology. Technology is generally considered "made available" when the person acquiring the service is enabled to apply the technology. On this basis, the Mumbai Tribunal held that the consideration received from the Indian hotels by the Dutch company was to be treated as non-taxable business receipts in India in the absence of a permanent establishment of the Dutch company in India.

Capital gains tax on the indirect transfer of shares applies only if "substantial value" criteria fulfilled

In the case of *GEA Refrigeration Technologies GmbH*, India's Authority for Advance Rulings (the "**AAR**") has held that the indirect transfer of shares of a German company by a German tax resident to a third party will not be taxable in India if the "substantial value" test specified under the Act is not met. A

German company (the "**Applicant**") entered into a share purchase agreement to acquire an unrelated German company ("**GCo1**") that held shares in entities in different jurisdictions, including an indirect shareholding of 100% shares of an Indian company. As per the fair market valuation report submitted by the Applicant to the AAR, the ratio of the assets of the Indian company as compared to the global assets of GCo1 was only 5.4%. As the "substantial value" test under the Act (which mandates that for capital gains tax to apply: (a) the value of assets should exceed an amount of INR100,000,000 (approximately US$1,379,310); and (b) should represent at least 50% of the value of the global assets owned by the company (i.e., GCo1 in this case)) was not met, the AAR held that the Applicant cannot be subjected to capital gains tax in India.

Preparatory activities performed prior to entering into a contract cannot be added to determine an installation permanent establishment

In the case of *Bellsea Limited*, the Delhi Income-tax Appellate Tribunal (the "**Delhi Tribunal**") has held that the activities carried out by the taxpayer's employee in India prior to execution of an installation contract cannot be taken into account to determine the threshold for an installation permanent establishment (an "**Installation PE**") under the double tax avoidance treaty between India and Cyprus (the "**Cyprus Treaty**"). The taxpayer, a Cyprus-based company, engaged in the business of dredging and pipeline-related services for oil and gas installations, was awarded a contract for placement of rocks on the seabed in Indian waters. Before entering into the contract, an employee of the taxpayer visited India to collect data and information necessary for tendering purposes. The Indian tax authorities took into account the time spent by the taxpayer's employee in India in asserting that, all told, the taxpayer had breached the twelve (12) month threshold provided under Article 5(2)(g) of the Cyprus Treaty and had triggered an Installation PE in India. However, after reviewing the agreements, the Delhi Tribunal observed that the twelve (12) month period provided in the Cyprus Treaty was to be interpreted as in relation to the actual project, site, construction, assembly or installation work. The Delhi Tribunal noted that the time taken for an activity related or incidental to a project carried offsite cannot be taken into account in calculating the threshold time period to determine the existence of an Installation PE. The threshold period has to be reckoned as having commenced from the date on which the enterprise starts performing its activities in connection with the installation project and not from a prior date.

Credit for foreign taxes withheld are allowable

In another recent case, the Delhi Tribunal has held that a resident taxpayer is eligible to claim credit for taxes withheld outside India on a foreign-source income. The taxpayer, an Indian tax resident, had advanced certain amounts to its wholly owned subsidiary in the USA (the "**US Sub**") and had earned interest income (which was remitted by the US Sub after withholding taxes). In its corporate tax return, the taxpayer offered the interest income to tax in India and claimed a credit for taxes withheld by the US Sub under Article 25 of the US Treaty. The tax officer denied the credit of taxes withheld by the US Sub. The Delhi Tribunal analysed the provisions of the US Treaty and held that: (a) Article 11 of the US Treaty mandates the US Sub to withhold taxes at the rate specified in that Article; (b) Article 25 of the US DTAA provides that if an Indian resident derives income that may be taxed in the USA, then India will have to grant a credit of the taxes withheld in the USA. The Tribunal held that, as it was not in dispute that tax had been deducted by the US Sub on the interest income earned by the taxpayer, the taxpayer should be allowed the credit of the taxes withheld in USA if the taxpayer furnished the withholding tax certificates in this regard.

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