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TAXABILITY OF RECEIPTS AS FTS – ILLUMINATING FINDINGS ON 'MAKE AVAILABLE' & 'SOURCE RULE'

In a recent judgment in the case of *International Management Group (UK) Ltd vs CIT, International Taxation*, the Delhi High Court has rendered detailed findings regarding taxability in India of receipts of the non-resident assessee for advisory and managerial services. The High Court has dealt with intricacies arising under section 9(1)(vii) of the Income-tax Act, 1961 as well as under the India-UK Double Taxation Avoidance Agreement ("**DTAA**") qua, *inter alia*, attribution of receipts to Permanent Establishment ("**PE**") in India, taxability of receipts remaining after attribution to PE and interpretation of the 'make available' clause contained in the article in the DTAA dealing with Fees for Technical Services ("**FTS**").

Factual background

International Management Group (UK) Ltd ("**IMG**") was engaged by the Board of Control for Cricket in India ("**BCCI**") for advisory and managerial service for establishment, commercialization and operation of the Indian Premier League ("**IPL**"). The receipts arising to IMG for assessment years ("**AY**") 2010-11 to 2018-19 under the agreements with BCCI were treated as 'business income' and offered to tax in India under Article 7 of the DTAA, to the extent the same were attributable to self-admitted Service Permanent Establishment ("**PE**") of IMG in India as contemplated under Article 5(2)(k) of the DTAA. The receipts remaining after attribution were treated as non-taxable in India by IMG and thus, not offered to tax.

The assessing officer as well as the Income-tax Appellate Tribunal ("**the Tribunal**") held said balance receipts to be taxable as FTS under Article 13 of the DTAA.

Proceedings before the Delhi High Court

In further appeal before the Delhi High Court, it was argued on behalf of IMG that:

(a) the receipts from BCCI were purely in the nature of business profits, taxable in India only to the extent the same were attributable to the Service PE in India;
(b) once the Revenue had accepted existence of Service PE and *suo motu* attribution of receipts to said PE, the Revenue was estopped from treating balance receipts as FTS inasmuch as Article 5(2)(k) is applicable *qua* services other than those falling within the ambit of FTS under Article 13 of the DTAA;
(c) receipts flowing from one singular contract envisaging furnishing of composite services could not be bifurcated between business profits and FTS; and
(d) the receipts were, even otherwise, not taxable as FTS under the Act as well as under the DTAA in light of 'make available' clause in Article 13 thereto.

Judgment rendered by the Delhi High Court

In a detailed judgment, the High Court has dealt with various niceties arising under the Act and the DTAA and rendered the following pertinent findings:

Re: <u>Characterization of balance receipts as FTS, once part receipts held attributable to Service PE & treated as business profits</u>

The contention that the Revenue having once accepted the attribution of income to the Service PE constituted under Article 5(2)(k), stood precluded from treating the residual revenue as FTS taxable under Article 13, was rejected by the High Court holding that DTAA characterises profits and income under various independent Articles which form part of the Convention; Article 5 neither serves as a head of taxation nor does it concern itself with categorization or classification of income.

Re: <u>Bifurcation of amount received from single composite contract</u>

The High Court acknowledged the inherent complexities of contracts having more than one facet; that a single contract may have potential of generating multiple streams of revenue, which may require separate consideration for tax characterisation purposes. Referring to paragraph 9 of Article 7, the High Court noted the expression *"where profits include items of income which are dealt with separately in other Articles of this Convention …"*, and held that the same reflects that distinct items of income may form part of total revenue of a non-resident entity and that the structure of the DTAA ensures that each type of income is governed by the specific Article, thus, preventing an overlap or conflict.

The High Court concluded that the Revenue was empowered and obliged to accurately determine the real nature and true character of income of IMG, including the balance receipts from BCCI.

Re: <u>Taxability of receipts as FTS under Article 13 of the DTAA</u>

The High Court delved into the meaning of 'technical' and 'consultancy' and observed that 'technical' can no longer be understood in its archaic sense as being confined to traditional sciences; application of specialized knowledge, skill or expertise with respect to any art, science, profession or occupation would be covered within the expression 'technical' services. As regards 'consultancy', it was observed that the same would imply the provision of advice or service of a specialized nature. However, owing to the fact that the litigating parties had accepted that services fall within the scope of 'technical and consultancy services' and that the dispute only revolved around taxability of the same under Article 13(4)(c) of the DTAA, the High Court did not render any conclusive findings on the interpretation of the two terms.

Relying on the decisions of the Karnataka High Court in the case of *De Beers*[1], the Kerela High Court in the case of *US Technology Resources*[2] and the Delhi High Court in the case of *Bio Rad*[3], the High Court rendered pertinent findings as to when the 'make available' condition can be said to have been satisfied. Much emphasis was made on the aspect of technical or

[1] [2012] 346 ITR 467 (Kar)
[2] [2018] 407 ITR 327 (Ker)
[3] [2023] 459 ITR 5 (Del)

consultancy service being rendered along with transfer of knowledge/ skill or expertise to the recipient of such services. The High Court held that the real test would be skills and expertise of the service provider being absorbed by the recipient who would then have the capability to deploy that knowledge or skill without reference to the original service provider. The transfer of capabilities and not just temporary use of the provider's knowledge, skill or expertise was held to be the decisive factor for satisfaction of 'make available' clause.

Applying the above tests to the facts of the case at hand, the High Court held that there was no expertise, skill or know-how which could be said to have been made available by IMG to BCCI, inasmuch as various functions to be discharged by IMG were aided by its expertise and special knowledge in curation and management, administration of sporting leagues, there was no evident intent on the part of BCCI to absorb IMG's skills and knowledge in the curation of sporting leagues and no part of knowledge or skill stood transferred to BCCI which would enable or equip it with the special knowledge underlying the service provided. The relatively long tenure of 10 years of the agreement also weighed with the High Court to hold that there was a continued engagement and ongoing reliance on IMG's expertise and it was not a case of transfer of knowledge or skill to BCCI.

Re: <u>Applicability of exceptions contained in section 9(1)(vii)(b) of the Act to the receipts of IMG for the years in which IPL was held outside India</u>

As regards AY 2010-11 and AY 2015-16, the High Court held that the relocation/ geographical shift of IPL event outside India in these years would mean that services rendered by IMG were utilised by BCCI outside India and that payment made by BCCI was for the purpose of earning income from a source outside India.

The High Court noted and affirmed the findings of the DRP that the 'source rule' provided in section 9(1)(vii) of the Act by creating a legal fiction seeks to bring to tax, *inter alia*, FTS even in cases where services are rendered outside India so long as they are utilized in India. It, therefore, means that the situs of the rendering of services is not relevant and it is the situs of the payer and the situs of the utilization of services which will determine the taxability of such services in India.

With regard to Explanation inserted in section 9(1) by virtue of Finance Act, 2010 with retrospective effect, which *inter alia* provides that payments for services would be FTS irrespective of the same being rendered in or outside India, the High Court held that the receipts would still be outside the ambit of 9(1)(vii) in terms of clause (b) to the said section in cases where services are utilized in connection with business carried out by the payer outside India.

Conclusion/ VA Comments

Regarding receipts which were not attributable to the PE, it is significant to note the findings of the High Court that the same can also be subject matter of taxation in India and that Revenue had the power to examine the nature/ character and taxability thereof on an independent basis, irrespective of the treatment accorded to it by the assessee.

As regards payments satisfying the 'make available' clause in the FTS Article under Article 13 of the DTAA, qualifying test has been laid down, viz., that services cannot be said to 'make available' knowledge, skill, process, know-how, etc. where the mere rendering of service does not put the service recipient in a position to absorb the skills and expertise of the service provider and assume the capability to deploy that knowledge or skill in the future without the assistance of the service provider. The long tenure of the agreement for provision of services also played a decisive role in holding that the 'make available' condition was not satisfied.

Another noteworthy ratio emanating from the judgment is regarding the interpretation of 'source rule' contained in section 9(1)(vii)(b) of the Act. The High Court has expounded on the words 'such person' appearing therein and firmly held that what is important to be considered is the situs/ location of the business activity of the 'resident payer' and not the 'non-resident recipient'. Similar view was taken by the Delhi High Court in the case of *Havells India Ltd*[4] wherein it was held that 'source of income' was tied to the situs of business activity of the payer, viz., manufacturing operations in that case and not to the source of receipt for the payer, i.e., where the customers are situated. The said principle has also been followed by the Delhi bench of the Tribunal in the case of *Chander Mohan Lall*[5] and *HCL Singapore Pte Ltd*[6].

[4] [2013] 352 ITR 376 (Del)
[5] ITA No.1869/Del/2019
[6] ITA No.537/Del/2021

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