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Article

Satisfaction of the 'make available' condition in services of short duration – An analysis

By **Shalini Maheshwari**

The interpretation of the 'make available' clause in respect of Fees for Included Services (FIS) in the India-US DTAA had been matter of much debate, more so since certain other treaties like India-UK also incorporate the same terms for Fees for Technical Services (FTS) and reliance is often placed on the Memorandum of Understanding (MoU) which forms part of the India US DTAA. While specific facts in each case could lead to a different conclusion, the common understanding of various High Courts and Tribunals is that the service recipient must be able to apply the technical knowledge or skill without recourse to the service provider (foreign entity) to satisfy the make available test.

In the recent ruling[1] on the taxability of reimbursement received by the -Assessee from its Indian affiliates for providing support services, ITAT Delhi held that the same is taxable as FIS as it has made available the services to the Indian-recipient.

The assessee entered into the Service Agreement with its affiliates across the globe including the Indian entity, wherein it agreed to provide the HR, strategic planning, marketing and information system on commercial level. The cost incurred for providing such services by the assessee was to be allocated between all the affiliates to whom the services are being provided by the Assessee, on the basis of pre-decided allocation keys with zero mark up.

Assessee's contention: Reimbursement of cost received without mark-up is not taxable and "make available" test not satisfied

The assessee contended that there was only recoupment of expenses and no element of income and hence the sum cannot be taxed in India. Secondly the assessee relied on the various decision wherein it was held that 'make available' is not satisfied if the services provider does not make available the know-how or technology to the recipient to apply the same on its own in future. The assessee also relied on the various judicial precedents wherein it was held that since support services are rendered by the assessee on year to year basis, they do not satisfy the make available test and hence, cannot be taxed as FIS.

Assessee also contended that amount received for providing support service will not fall under the provision of Article 12(4)(a) of the India US DTAA as the same cannot be considered as ancillary and subsidiary to the payment of royalty as such license agreement and service agreement are two different agreements. – The Technology Transfer Agreement (TTLA) aims to provide license to use technology under which royalty was being earned. On the other hand, the aim of SA was to provide uniformity, consistency and international standards across the group by providing these support services. Also, services were not only for the license products covered under the license agreement but for the company as a whole whereas royalty paid in terms of license agreement was for the license granted to

[1] H. J. Heinz Company USA v. ADIT,ITA No. 6252/DEL/2012 (A.Y 2009-10)

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Indian entity to manufacture, distribute, market and sell only the Licensed products. The assessee argued that the Indian entity was engaged in manufacture and sale of many other products which were not 'licensed products' of the assessee and hence, the services were not ancillary to the use of the intellectual property.

Revenue's contention: Services were ancillary to use of IP and the services continued to be at disposal of the recipient

Firstly, revenue argued that contention of zero mark-up cannot be considered as no evidence was placed by the assessee before the revenue authorities that no profit is embedded in the fees charged for services. It also referred to the clauses in the TTLA and the SA to contend that the assessee was providing training to the employees of the licensee (Indian entity) and hence, the employees developed managerial and technical skills. Thus, the make available clause was satisfied.

The revenue contended that payment received by the assessee is clearly are in relation to and ancillary and subsidiary to the application or enjoyment of the right, property or information for which royalty is paid and hence covered under Article 12(4)(a) of the India-USA DTAA. The revenue further contended that the SA was only an extension of the TTLA. In case the employees of the licensee developed any new method of marking or manufacturing the product, the assessee would be entitled to the same and hence, the employees were enabled to acquire new managerial and operational skills which satisfies the 'make available' clause.

ITAT Ruling

ITAT held that the concept of make available requires that the fruits of the services should remain available to the service recipient in some concrete shape such as technical knowledge, experience, skills, etc., which is met in the instant case as can be reflected from the nature and duration of the contract. The service recipient has to make use of such technical knowledge, skills, etc. by itself in its business and for its own benefit. Thus, the consideration qualifies as FTS both under the Income Tax Act and under the India-USA DTAA. The ITAT distinguished various decisions cited by the assessee on the aspect of "make available" including the decision in case of *Guy Carpenter* on certain factual aspects. Further, the ITAT distinguished various decisions on holding reimbursement of expenses to be non-taxable and holding support services as not being ancillary to use of intellectual property.

To conclude

The issue with respect to taxability of reimbursement of expenses without any mark up has been a matter of debate before various courts/tribunal. The ruling in the present case does not throw any light on why the amount received by the assessee in nature of recoupment of expenses is taxable as income. Moreover, there is no discussion on how the entire gamut of services provided relate to the licensed technology/ licensed products, when the sale of licensed products was less than 5% of the total sales of the Indian entity. On the issue of "make available", the reasoning adopted by the ITAT is that provision of services including training to employees of the recipient to enable them to apply the licensed technology is sufficient to satisfy 'make available'. The ruling seems to be influenced by the facts and the reasoning in *Centrica*[2] judgment of Delhi High Court. In the said judgment the employees of the Indian entity were given training in the initial stages of the setting up of the business. The High Court concluded that post the initial phase, the employees were able to apply the knowledge and

[2] (2014) 364 ITR 336

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skill by themselves and hence, 'make available' was satisfied. However, given that the ITAT did not analyse the characteristics of the services rendered and did not accord any weightage to the fact that services in question were being provided every year, it remains to be seen whether this order of the Tribunal will be sustained by the higher courts and whether its ratio will be widely applied in other cases.

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Notification and Circular

Domestic companies provided with option to pay tax at lower rates

By way of The Taxation Laws (Amendment) Ordinance dated 20-9-2019, domestic companies have been provided an option to pay corporate tax rate at 22%. While computing the total income, the exemptions and incentives for instance, weighted deduction for research and development or benefits under Section 10AA to SEZ units will not be allowed. Further, newly set up manufacturing companies which are set up or registered on or after 1-10-2019 and commence manufacturing on or before 31-3-2023 would have an option to pay tax at 15%. Section 115BAA and 115BAB have been inserted in this regard. Also, the provisions of MAT shall not apply to companies who opt to pay tax at lower rates as per the new sections.

E-assessment Scheme 2019 notified

CBDT has issued Notification 61/2019 and 62/2019, both dated 12-9-2019 to notify and give directions regarding the E-assessment Scheme, 2019 made under Section 143(3A) of the Income Tax Act, 1961 and also the directions to effect the same. In e-assessment the assessment will be undertaken in a centralised manner. A National E-assessment Centre will be setup along with regional e-assessment centres. The assessment under this Scheme shall be made in respect of territories and / or class of persons as may be specified. Four different units, namely, assessment, verification, technical and review units will undertake the process of e-assessment. The e-assessment procedure as notified does not require personal appearance of parties from the stage of notice till passing of the assessment order. In case an opportunity of personal hearing is provided to the assessee at the stage of review of draft order, the same would be done exclusively through video conferencing. For recording of statements in the course of survey also, the mode would be video conferencing. By way of Circular No. 26/2019 dated 26-9-2019, it has been clarified that e-assessment for Financial Year 2019-20 shall not be mandatory in cases of assessment framed in cases where no PAN is available, on account of administrative difficulty in certain cases of assessment under Section 147 (reopening), best judgement, assessment framed in cases without PAN and where books of account have to be examined, witnesses have to be examined. Also, where the assessee requests for a personal hearing through the e-filing account after a show cause notice contemplating any adverse view is issued by the Assessing Officer, personal hearing or attendance can take place.

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Ratio Decidendi

Communication of orders, follow up by branch office creates PE of non-resident engaged in trading activity

The assessee- a non-resident company was engaged in trading operations in ASEAN countries. It had a liaison office in India which was later converted to a branch office. The revenue department contended that the branch office constituted a permanent establishment (PE) of the assessee. However, the assessee argued that the office was engaged only in preparatory and auxiliary activities like being a channel of communication, follow up for delivery, advertising, logistic support etc., which cannot be classified as core activities of carrying on a business. It placed reliance on Article 5(7)(e) of the India Singapore DTAA which contains the list of exclusions for activities having preparatory or auxiliary character and reads as ' *the maintenance of a fixed place of business solely for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise*.'. However, the ITAT held that only activities which are similar in character to advertising, scientific research etc., would qualify as preparatory or auxiliary. The ITAT held that since the branch office was involved in activities relating the core business of trading; namely logistic support, delivery follow up etc., it would constitute a permanent establishment of the non-resident entity. [*Hitachi Hi Technologies Singapore Pte* v. *DCIT*, ITA Nos. 2683 to 2688/DEL/2015, Order of ITAT, Delhi dated 17-9-2019]

Assessee cannot invoke bar of limitation in case of continuing default in deduction of tax

The assessee had given a loan to one of its major shareholders and director of the company and did not deduct tax at source in terms of Section 194 of the Income Tax Act, 1961 which is applicable in case of deemed dividends under Section 2(22)(e). The AO referred to Section 194 of the Act and held that the assessee was to be deemed to be 'assessee in default' under Section 201, and raised a demand for tax and also interest under 201(1A). CIT(A) held in favour of the assessee due to bar of limitation without going into the alternative claim of the assessee on merits towards applicability of Section 2(22)(e) of the Act.

The assessee relied upon decision of Gujarat High Court in the case of *Tata Teleservices* [66 Taxman.com 157] wherein it was held that increased limitation period of 7 years under Section 201(3) as amended by the Finance (No. 2) Act, 2014 w.e.f. 1-10-2014 shall not apply retrospectively to orders which had become time-barred under old time-limit set by unamended Section 201(3) and no order under Section 201(1) deeming assessee to be in default could have been passed if limitation had already expired as on 1-10-2014. On the other hand, Revenue distinguished the facts of the present case from the aforesaid case. Revenue contested on two primary grounds, namely, (a) that no TDS return was filed by the assessee and the observations of CIT(A) is factually incorrect in this regard; and (b) the show-cause notice for default committed by the assessee under Section 201(1)/201(1A) was issued on 27.01.2016 which is within 6 years from the end of the financial year

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in which the default was committed and continued by the assessee in non-deduction of TDS as contemplated under Section 194 of the Act.

The ITAT held in favour of the Revenue that the show cause notice in the instant case was duly issued within the period of 6 years at which time the default in deduction of TDS was both committed as well as continuing and therefore the assessee cannot seek immunity from the applicability of Section 201(1) for alleged default where the order has been passed within seven years as provided in the amended law. [*ITO (TDS)* v. *Shri Rang Infrastructure (P) Ltd*., I.T.A. No. 2266/Ahd/2017, ITAT, Ahd, Order dated 4-9-2019]

Carry forward of MAT credit is to be allowed to assessee and is not qua unit – Assessee eligible for credit of tax paid prior to date of demerger

The scheme of demerger proposed by the assessee was sanctioned by the High Court of Bombay. However, the Assessing Officer did not allow to carry forward and set off of MAT credit against the tax liability to the extent, it pertained to the SEZ units of the assessee that were demerged. pursuant to the scheme of reorganization with effect from AY 2014-15. CIT(A) passed an order in favour of the assessee.

Revenue submitted that Ld. CIT(A) erred in directing the AO to allow carry forward and set off of MAT credit to the assessee company under the IT Act, 1961 by relying on a portion of the High Court order sanctioning the scheme of demerger and without appreciating the totality of the facts and circumstances of the case and law and further that the units, in respect of which MAT credit was available were no longer part of the assessee company.

Following the decision in *DCIT v. Brandon & C. (P) Ltd.* [ITA No. 1972/Mum/2017], the Tribunal held that the credit of MAT paid by the assessee would be available after demerger. It quoted with approval the decision in *Brandon* wherein it was reasoned that the MAT credit is that of the assessee itself and not of the demerged company and there are no provisions under Section 115JAA of the Act that on demerger, the brought forward MAT Credit of the assessee itself cannot be carried forward. It was noted that the specific bar on claim of MAT credit is only in case of conversion of a private or unlisted public company into a LLP and the successor LLP cannot claim the credit of MAT. Also, as per the High Court order sanctioning the scheme of demerger, all taxes paid prior to demerger would be on account of the assessee company. In the light of the above the ITAT ruled in favour of the assessee company allowing carry forward and set off of MAT credit. [*DCIT* v. *TCS E-Serve International Limited,* I.T.A. No.2779/Mum/2018, ITAT Mumbai, Order dated 28-8-2019]

Notional rent cannot be added under Section 23 for a company's registered office, part of which is let out

The Assessing Officer made an addition under the head income from house property in respect of the property which was the registered office of the assessee, a part of which had been let out. Assessee submitted that it carried various statutory functions and regulatory compliances from the property and only a portion of it was let out while the remaining property was in its possession throughout the year as its registered office and was being used for business purposes and accordingly no addition can be made.

Revenue placed reliance on provisions of Section 23 of the Act which were amended by the Finance Act, 2001 where a property or any part of the property was vacant during the whole or

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any part of the previous year then the AO is entitled to compute the actual rent on the basis of the annual letting value.

The Tribunal held that since the assessee occupied the property for its own purposes, no notional rent can be added. It relied on the judgment of Coordinate Bench of the ITAT Delhi in the case of *Palos Verdes Estate Pvt. Ltd., v. ACIT* [ITA No. 4235/Del/2015], wherein it was held that when assessee filed its return of income by mentioning the address of the said property which has been accepted by the AO, then no addition on account of deemed annual lettable value is to be made, as the said property was used for the purpose of business. [*Ideal Hitech Engineering Equipment (P) Ltd.* v. *ITO,* I.T.A. No. 3316/Del/2017, ITAT, Delhi, Order dated 13-8-2019]

Compensation received for breach of contract is not taxable as windfall gain

The decree holder sought release of the amount awarded in arbitration proceedings, which was being retained to ascertain the whether the sum would be taxable in India and whether there would be liability to withhold the tax on the sum. The Income-tax department contended that all four limbs of the aforementioned awards, namely, (a) award of monies to the decree holder in respect of breach of contract, (b) costs of arbitration, (c) legal costs; and (d) interest, were taxable in India. It submitted that compensation received by the decree holder towards breach of contract was liable for taxation in India as it was a "windfall gain" and hence is covered under Article 22(3) of the Double Taxation Avoidance Agreement ("DTAA") between India and Switzerland.

The High Court ruled that even a plain reading of Article 22(3) of the DTAA shows that the amounts received by the decree holder as compensation, towards breach of contract cannot fall within the ambit of Article 22(3) which covers only income received from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or gambling or betting of any nature. It is only such income which can be taxed, if at all, in India.

The High Court also held that assessment proceedings, if any, can only commence against the judgment debtor i.e. the Indian entity. The Court enunciated that once a claim merges into a decree of the Court it transcends into a judgment-debt and, therefore, only those adjustments and deductions can be made which are permissible under the Code of Civil Procedure, 1908. It stated that various judgements have held that a decree should be executed according to its tenor unless modified by statutes like the Income Tax Act. [*Xstrata Coal Marketing AG (Decree-holder)* v. *Dalmia Bharat (Cement) Ltd (Judgment-debtor),* Ex.P.No. 334/2014, Delhi High Court Judgement dated 31-7-2019]

Non-rejection of assessee's response to specific query in scrutiny proceedings amounts to accepting the submission

The assessee was aggrieved by the notice issued under Section 148 of the Act seeking to reopen the assessment within the time limit of four years on account of non-addition to book profits, of depreciation on certain intangibles. The query regarding the same had been raised by the Assessing Officer (AO) in the notice issued under Section 142(1) and assessment under Section 143(3) completed, though there was no mention of the said issue in the order. The assessee contended that the reopening was sought to be done on mere change of opinion and the AO could not have 'reason to believe' that income escaped assessment when the specific query was raised and responded to. The revenue contended that reopening of assessment within four years is permissible even if there was no

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failure on part of the assessee to disclose full particulars. Also, it was contended that since there was no discussion as regards the assessee's response to specific query, the AO had not formed any opinion and thus the assessee could not allege reopening on the basis of change of opinion. The High Court held that even in absence of specific discussion of the assessee's response, so long as there was no rejection, the submissions can be deemed to be accepted by the Assessing Officer when he completed the regular assessment under Section 143(3) of the Act. Hence, it was held that the reopening of the assessment by recording a different view on the same issue, was without jurisdiction. [*Marico Industries* v. *ACIT*, WP 1917/2019, High Court of Bombay, decision dated 21-8-2019]

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