

News Alert*

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Fees paid for the transfer of architectural designs and drawings constitute Fees for Technical Services

Background

The Authority for Advance Rulings (“AAR”) in a recent ruling in case of HMS Real Estate Pvt.Ltd.¹ has held that a holistic view should be taken in analysis of an agreement based on the scope, dominant object and predominant features of that agreement. Accordingly, payment for the transfer of designs and drawings, being part of a package of architectural services, would constitute Fees for Technical Services (“FTS”) and would not be regarded as consideration for sale of a product.

Facts

- HMS Real Estate Pvt. Ltd. (“the applicant”), an Indian Company, is engaged in the business of development and management of commercial real estate.

- The applicant entered into an agreement with a limited partnership (“the Architect”), a resident of USA, for the provision of architectural design services in connection with establishment of an international quality commercial office/hotel complex in India.
- Under the agreement, the scope of the Architect can primarily be classified into the following activities:
 - Development and sale of designs,
 - Consultancy for construction documentation,
 - Construction administration services i.e. technical consultancy and supervisory services.
- The consideration for each of the above mentioned activities was separately mentioned in the agreement.



¹ HMS Real Estate Pvt. Ltd. *In re* [2010-TIOL-17-ARA-IT]

- The agreement also stated that the Architect would be responsible for contracting with international or US based consultants and would coordinate all the design activities of those consultants. Furthermore, it was mentioned that the compensation payable by the Architect to the consultant would be reimbursed by the applicant to the Architect on an actual basis.

Issues

- Could the amount of compensation payable to the Architect be split into different parts and the fees paid for sale of designs then be taxable in India, in view of the fact that the Architect has no permanent establishment (“PE”) in India?
- Would payment of fees for technical advisory/supervisory services to the Architect during construction documentation and construction administration phase be taxable as Fees for Technical Services (“FTS”) under the Article 12(4) of the tax treaty entered between India and United States of America (“tax treaty”)?
- Would reimbursement of expenses actually incurred by the Architect on account of the compensation payable to the consultant in the USA without any mark up be subject to the provisions of section 195 of the Income-tax Act, 1961 (“the Act”)?

Applicant’s contentions

- The designs and drawings developed by the Architect are sold to the applicant; therefore the receipts arising to the Architect are in the nature of business profits. Since the Architect does not have any PE in India, the receipts cannot be taxed as business profits.
- The applicant relied on the decision of the Calcutta High Court in the case of Davy Ashmore India Ltd.² in which it was held that the consideration paid for an outright transfer of the drawings and designs by the non-resident company cannot be termed as royalty.

² CIT v. Davy Ashmore India Ltd [2003] 190 ITR 626 (Kol.)

- However, the applicant agreed that the payment made for consultancy administration in relation to the supervisory and technical services to be performed by the Architect in India are liable to be taxed as FTS.
- Furthermore, the applicant relied on the ruling pronounced in the case of International Tire Engg. Resources LLC,³ wherein the transfer of know-how of technology for the manufacture of radial tyres and the transfer of ownership of tread and side wall design were dealt with separately in the agreement. It was held that consideration paid for transfer of ownership of tread and side-wall design cannot be brought within the scope of Article 12(3) of the relevant tax treaty.
- Even if the contract has to be viewed as a composite one without disintegrating it, the dominant nature and object of the agreement is the outright sale of designs and technical documents (including the copyrights over those designs) to the applicant delivered through the website from outside India. On such delivery, the applicant becomes the owner as the entirety of rights over those designs were conveyed to the applicant. Therefore, the payments made to the Architect (excepting those at the construction administration phase) do not fall within the definition of royalty and FTS under Article 12(3)(a) and Article 12(4) of the tax treaty.
- Furthermore, the receipts cannot be taxed as FTS under the Act since the Architect used its technical expertise for preparing and selling chattels, which are designs. Thus, being a case of sale, there could be no question of transfer of use or right to use any plant or equipment.

Revenue’s contentions

- This case was not contended by the Revenue.

AAR ruling

- The AAR, while denying the contentions of the applicant that the predominant objective of the agreement is outright sale of designs and drawings, held that the

³ International Tire Engg. Resources LLC, *In re* [2009] 319 ITR 228 (AAR)

transfer of designs and drawings is a part of the package of architectural services undertaken by the Architect under the agreement in light of the following observations:

- The Architect provides services and expert advice to the applicant at every stage from the conceptual stage through to construction,
 - The Architect acts in close collaboration with the applicant and the consultant,
 - Development of designs by the Architect is carried out by means of bi-weekly teleconferencing and videoconferencing with the applicant,
 - The applicant's role in the project is all-pervasive and does not end at the sale of drawings and designs, and,
 - The fact that there is separate specification of price for convenience of payments and adhering to schedules or that a major portion of the amount is payable at the design development stage is not conclusive.
- The compensation to be received by the Architect is in the nature of FTS or included services and is squarely covered under the second limb of clause (b) of Article 12(4) of the tax treaty i.e. 'development and transfer of a technical or technical design' as the technical services rendered by the Architect result in the development and transfer of a technical plan and design to the applicant.
 - The AAR distinguished the ruling of the High Court in case of Davy Ashmore India Ltd. (above) on the following premises:
 - The case did not consider the applicability of the FTS clause on the subject payments,
 - The rendition of services was not involved as there was outright transfer of designs and drawings that were required by the purchaser for the purpose of preparing detailed drawings, and

- The transaction of sale involved in the case was stand alone and not connected with any service and was not a case of tailor-made design and drawings.

- In relation to ruling in the case of International Tire Engg. Resources LLC, (above), the AAR observed that factual position of the case was different and the transfer of ownership of tread and side wall design and the transfer of know-how of technology for the manufacture of radial tyres were dealt with separately in the agreement and were not incidental to each other. Separately, in that case, the contention of the assessee that the sale of technical know-how has taken place outside India and not liable to tax under the Act was also rejected.
- Furthermore, in respect of remittances made, on the actual basis, to the Architect on account of payments to the consultant under the agreement, Article 12(4)(b) of the Tax Treaty cannot be implemented as the ultimate beneficiary was the consultant and not the Architect. Accordingly, such receipts would not be taxed in India in the hands of the Architect under the Act.

Conclusion

The AAR has held that the consideration for supply of designs and drawings, which involves preparation of conceptual designs, drawings, construction documents and construction administration, constitutes FTS within the meaning of Article 12(4)(b) of the tax treaty and hence cannot be regarded as consideration for the sale of product. Furthermore, the AAR stated that receipts towards reimbursement of expenses in terms of fees payable to other non-residents on actual basis cannot be considered to be income taxable in India and also does not fall under Article 12 of tax treaty.

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