



## Consultancy charges on account of construction activity are not taxable as fees for technical services under Section 44D but business income under the provisions of the Income-tax Act

### Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of MSV International Inc<sup>1</sup> (the taxpayer) held that the payment received on account of consultancy charges in the areas of highways, transportation, water supply, waste management, etc. is not taxable as Fees for Technical Services (FTS) under Section 44D of the Income-tax Act, 1961 (the Act). The Tribunal observed that the consultancy services provided by the taxpayer fall within the exception carved as 'construction activity and like projects' in Explanation 2 to Section 9(1)(vii) of the Act. The act of providing services to various clients in India is the business of the taxpayer. Therefore, the consultancy income is taxable as business income under the provisions of the Act.

### Facts of the case

- The taxpayer is a foreign company incorporated in the U.S.A. and engaged in the business of providing consultancy services in the areas of highways, transportation, water supply, waste management, etc. The taxpayer has set-up several projects offices in India to carry on its activities in India.

- During the Assessment Year (AY) 2006-07, the taxpayer had entered into contracts with various parties, mainly state governments, to provide them consultancy services as required under such agreements. The taxpayer disclosed consultancy charges of INR33.76 million after deducting expenses of INR28.88 million. The taxpayer showed a profit before tax of INR4.88 million.
- The Assessing Officer (AO) taxed consultancy charges at 20 per cent under Section 44D read with Section 115A of the Act.
- The Commissioner of Income-tax (Appeals) [CIT(A)] after considering the provisions of Section 9(1)(vii) of the Act, Section 44D and Section 44DA inserted with effect from 1 April 2004, held that the gross receipts of the taxpayer were covered by the exclusion provided in the definition of FTS, and therefore, the same can not be taxed as FTS.

### Tribunal's ruling

- It has been observed that to determine the nature of receipt, it is imperative to examine the scope of the work to be carried out by the taxpayer. In the present case, the taxpayer is engaged in the consultancy services, but that is the taxpayer's business in India.

<sup>1</sup> DDIT v. MSV International Inc [2016-TII-34-ITAT-DEL-INTL]

- The AO has made an irrelevant analysis of disclosure in the return of income as well as the nomenclature described in TDS certificate when AO himself agrees that the taxpayer is engaged in the business of services with respect to highways, transport, etc. Therefore, it cannot be said that taxpayer is not carrying any business in India.
- Any consideration which is for the rendering of any managerial, technical or consultancy services is characterised as FTS. However, some exceptions are carved out where such managerial, technical or consultancy consideration is for any construction, etc. or like projects undertaken by the recipient. The AO has failed to consider these exceptions carved out in the definition of FTS. Therefore, the attempt made by the AO was on an incomplete reading of that Explanation ignoring exceptions.
- From the nature of work carried on by the taxpayer it was apparent that it had got the consultancy work related to laying down of roads, etc. which was for construction activity or a like project. Undisputedly the services rendered by the taxpayer were technical in nature but merely because the services were technical in nature they do not qualify as FTS in accordance with the provision of Explanation 2 to Section 9(1) (vii) of the Act.
- It was observed that the services provided by the taxpayer fall in the exceptions carved as construction activity and like projects.
- On a perusal of the decision in the case of Agland Investment Services Inc.<sup>2</sup> it has been observed that the case of the taxpayer stands on stronger footings than the case relied upon by the tax department.
- On a perusal of Section 44D of the Act, it indicates that the FTS should have the same meaning as provided in Explanation 2 to Section 9(1)(vii) of the Act. Since receipt of the taxpayer is not FTS as defined in the above

Explanation as it relates to construction activity, such receipt is out of the purview of presumptive taxability under Section 44D of the Act.

- It is also not controverted that taxpayer was carrying on similar activities in the preceding years as well, and the income earned from the said activities have been accepted by the tax department as business income and assessment made under Section 143(3) of the Act. Principle of consistency has been accepted by the Indian courts in many judicial precedents<sup>3</sup>.
- Accordingly, it was held that consultancy charges were not taxable as FTS under the provisions of Section 44D read with Section 9(1)(vii) of the Act but were taxable under the provision of Act as business income.

### Our comments

A particular payment is to be characterised as FTS or business income has been a matter of debate before the Courts.

The Delhi Tribunal dealt with a case of a taxpayer engaged in providing of the consultancy services in the areas of highways, transportation, water supply, waste management, etc. The Tribunal held that the payment received on account of consultancy charges in the areas of highways, transportation, water supply, waste management, falls within the exceptions carved as 'construction activity and like projects' provided in Explanation 2 to Section 9(1)(vii) of the Act. The act of providing services to various clients in India is the business of the taxpayer. Therefore, the consultancy income is taxable as business income under the provisions of the Act.

<sup>2</sup> Agland Investment Services Inc. v. ITO [1985] 22 TAXMAN 9 (Del)

<sup>3</sup> Radhasoami Satsang v. CIT [1992] 193 ITR 321 (SC), CIT v. Lagan Kala Upwan [2003] 259 ITR 489 (Del), Saurashtra Cement & Chemical Industries v. CIT [1980] 123 ITR 669 (Guj), CIT v. Paul Brothers [1995] 216 ITR 548 (Bom), CIT v. Modi Industries Limited [2010] 327 ITR 570 (Del)

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