Installation and commissioning of the equipment is an assembly activity, not taxable as FTS in India. Training to Indian company’s employees by a foreign company for operation of the equipment is taxable as FTS

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Background

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Bennet Coleman & Co. Ltd. (the taxpayer) held that the installation and commissioning of the units/components of the mailroom equipment is an ‘assembly’ activity. The consideration paid to the Swiss company in relation to such assembly will not fall within the purview of ‘Fees for Technical Services’ (FTS) under the provisions of the Income-tax Act, 1961 (the Act) and therefore such payment is not taxable in India.

The services rendered by the Swiss company, towards training of the employees of the taxpayer cannot be considered as ‘assembly’ activity and therefore, taxable as FTS under the provisions of the Act. Article 14 of the India-Swiss tax treaty (tax treaty) includes independent activities of engineers but does not cover training given to the employees of the taxpayer. Accordingly, training activities fall within the ambit of Article 12 of the tax treaty and therefore, taxable as FTS under the tax treaty.

Facts of the case

- The taxpayer is an Indian company engaged in the business of printing and publishing of newspapers.
- The taxpayer needed a sophisticated plant and machinery (mail room equipment) that could collate the various pages of the newspaper, which assisted in printing, picking and stacking them and pack the newspapers for timely delivery.
- To acquire such a plant and machinery, the taxpayer called for global bids for supply, delivery and installation of the plant and machinery and training of its staff. The bid was closed in favour of FERAG AG, a company registered in Switzerland.
- The taxpayer entered into two contracts with FERAG AG, of which one was for the supply of the various components/units of the mail room equipment, and second was for installation and commissioning of the components/units of the mail room equipment in the premises of the taxpayer and training of the staff of the company for operation of this equipment to be supplied.
- In relation to the work done as mentioned in the second contract, the taxpayer made payment to FERAG, without deduction of tax at source.

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• The Assessing Officer (the AO) held that the payments made by the taxpayer, were liable to tax deduction at source (TDS) as ‘Fees for Technical Services’ (FTS) in the hands of FERAG AG. Accordingly, the AO directed the taxpayer to pay the TDS with the interest thereon.

• The Commissioner of Income-tax (Appeals) [CIT(A)] held that 75 per cent of the remittance was made by the taxpayer was towards installation and commissioning and therefore was not FTS as per Explanation 2 to Section 9(1)(vii) of the Act and therefore, not chargeable to tax in the hands of FERAG AG. However, the balance 25 per cent of the remittance was towards training of the taxpayer’s staff, was chargeable to tax as FTS.

Tribunal’s ruling

The activity of installation and commissioning of the equipment is ‘assembly’ hence not taxable

• The mailroom equipment comprised of various units and was hence a complex equipment. The bid document stipulated that the units/components of the mailroom equipment would have to be installed and commissioned by trained and qualified personnel of the supplier, who shall, then provide training to the taxpayer’s employees, on the operation and maintenance of mailroom equipment. The price quoted included installation, commissioning and training.

• The price for supply was separately indicated in the contract for supply and that for the services in the contract for services. The obligations under the contract for services were distinct.

• The contract for supply stipulated that the warranty can be claimed by the taxpayer only if the mailroom equipment were installed and put into operation by Vendor Certified Personnel. In other words, the person who installs the equipment should be certified by the vendor. This condition was not the same which required qualified personnel of the vendor to install the equipment which was indicated in the bid document and not in the contract signed by the taxpayer.

• Accordingly, the services rendered by FERAG AG, by way of installation, commissioning of the mailroom equipment and the training of the taxpayer’s employees were not inextricably and essentially linked to the sale of the mailroom equipment.

• The services mentioned in the agreement for services indicated that the scope involved, was bringing and positioning various components, properly aligning them, connecting the individual units, etc. with a view to ensuring that all the components are working in unison, at maximum capacity and that the power consumed is as prescribed.

• FERAG AG, had, in fact, supplied a pickup station, a gripper conveyor, stacker and automatic bundle addressing system, etc. All these units and components had to be fitted together in a manner that they were properly positioned, aligned and, connected to ensure optimum functioning, in the shortest duration. This activity can be called as ‘assembly’.

• The definition of the word ‘assembly’ does not appear in the Act and hence the word has to be interpreted as understood in common parlance.

• Consequently, the consideration paid to FERAG AG, related to installation and commissioning of the units/components of the mailroom equipment, will not fall within the purview of FTS as defined in Explanation 2 to Section 9(1)(vii) of the Act and therefore, not taxable.

• The consideration paid towards these services was only taxable in Switzerland in the hands of FERAG AG, by virtue of the provisions of Article 14 of the tax treaty.

The activity of training taxpayer’s employees is not ‘assembly’ hence taxable

• The services rendered by FERAG AG, towards training the employees of the taxpayer cannot fall within the ambit of the expression ‘assembly’.

• Article 14 of the tax treaty refers to ‘residents of a contracting state’ and hence it is not restricted to individuals as was the case in the India-Denmark tax treaty that came up for consideration before the Tribunal in the case of Christiani & Nielsen².

• Article 12(4) of the tax treaty defines FTS as including the services rendered by FERAG AG, towards installation and commissioning and training. Article 12(5) of the tax treaty provides that services covered under Article 14 of the tax treaty will not qualify for FTS.

• Article 14 of the tax treaty, while defining the term ‘Professional Services’, includes independent activities of engineers which does not cover training given to the employees of the taxpayer. Though a training activity that may be connected to an engineering concern, it would not constitute an engineering activity so as to fall within ‘professional services’ under Article 14 of the tax treaty.

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² Christiani & Nielsen Copenhagen v. ITO [1991] 39 ITD 355 (Bom)
• The CIT(A)’s estimation of 25 per cent of the consideration, attributable towards training the employees of the taxpayer, was on a higher side and also against the facts and therefore, the break-up of the cost as provided by the taxpayer was accepted.

• The training period would not have been substantial and that too not essentially shop floor training, as to how to operate the mail room equipment, which would have been training on the machine and therefore, Article 12 of the tax treaty shall apply on class room training. Accordingly, an estimate of 25 per cent of the training cost, as attributable to income from training would be reasonable.

Our Comments

This is a welcome ruling where the Tribunal has held that the definition of the word ‘assembly’ does not appear in the Act and hence the word has to be interpreted as understood in common parlance. In this case, all these units and components, supplied by the Swiss Company, had to be fitted together in a manner that they were properly positioned, aligned and connected to ensure optimum functioning. Based on such facts, the Tribunal held that these activities shall be considered as ‘assembly’ activity. The assembly activity will not fall within the purview of FTS as defined in Explanation 2 to Section 9(1)(vii) of the Act and therefore, not taxable in India.

In this decision, the Tribunal held that as per Article 14 of the tax treaty, training given to the employees of the taxpayer does not fall within the ambit of ‘Professional Services’ specified therein. However, such services rendered were considered in nature of FTS and taxable under the tax treaty.