Supreme Court decision on meaning of Technical Services

The Supreme Court ("SC") has, in a recent decision, ruled on the requirement for human intervention, in order for services to be considered as Fees for Technical Services ("FTS") under the provisions of the Income-tax Act, 1961 ("the Act").

Facts of the case

The respondents (cellular companies such as Bharti, Escotel, etc) were engaged in the business of providing cellular telephone services. As per the license agreements entered into by these service providers with the Government, where calls were to be routed to/from networks in which these service private providers were not present, the calls had to be routed to/from the networks of MTNL/BSNL (Government owned companies). For providing the interconnection, the service providers were required to pay MTNL/BSNL interconnection charges, access and port charges under an agreement. In certain cases, the interconnection was provided by other service providers. As was the practice in the cellular services industry, the seeker of the interconnection facility had to pay the charges to the provider of the interconnection facility (another service provider) such that the subscriber (individual customer) receives seamless connectivity for the calls made/received.

The Revenue Officer ("AO") treated the above payments by the cellular services companies to MTNL/BSNL towards interconnection charges, port charges, etc as being in the nature of FTS and accordingly held that tax that ought to have been deducted at source. The cellular companies contended that the consideration paid related to provision of a standard facility and did not involve rendering services which are technical, managerial or consultancy in nature. The Commissioner (Appeals) upheld the views of the AO, whereas, the Tribunal allowed the appeal in favor of the taxpayers. The Revenue Authorities ("RA") preferred an appeal before the Delhi High Court ("Delhi HC").

The Delhi HC observed that the interconnection, port and access charges were paid for using the already existing network of other cellular service providers.
Accordingly, the above services did not involve rendering assistance / aid in managing, operating and setting-up of infrastructure facility to the cellular companies. Though the provision of interconnection and access facilities involved use of sophisticated technology, the same could not be considered as a “technical service” in the context of section 9 of the Act. For determining the meaning of the term “technical” as used in section 9, since the same is not defined in the Act and since the same has been used in the company of two other words namely “managerial” and “consultancy”, the word “technical” will draw its meaning from the meaning of the words “managerial” and “consultancy”. This is as per the principle of noscitur a sociis. From an analysis of the meaning of the words managerial and consultancy, it is clear that both these services are provided by humans. Accordingly, the expression “technical service” would also require the presence of a human element in the course of providing services.

Since the payments towards interconnection, port and access charges are towards services that do not involve any human intervention, the same would not be “technical services” and accordingly the payments would not be subject to withholding as per the provisions of section 194J of the Act.

The Revenue was on appeal before the Supreme Court against the decision of the Delhi HC.

**Arguments of the RA before the SC**

- The provision of interconnect/port access facility was itself a service
- The agreement between the parties themselves described the arrangement as providing telecommunication services
- The services were of technical nature in the sense that it was connected with the use of sophisticated machinery involving expertise, skill and technical knowledge

**Arguments of the Cellular companies**

- Collection of fee is for use of a standard facility (as is the practice in the industry) and does not amount to FTS. In fact, the agreement is more of a revenue sharing agreement and the payments are of this nature and not fees for services
- The definition of FTS has been defined in Explanation 2 to section 9(1)(vii) of the Act. In defining FTS, the phrases used are “consideration for the rendering of any managerial, technical or consultancy services…”. Since managerial and consultancy services involve human interface/ element, the same was required in case of technical service as well
• The entire process was automated and did not involve human intervention. Until and unless there is an element of human interface, the facility of interconnection/port access cannot be regarded as a technical service

Decision of the SC

• The SC noted that right from the year 1979, various High Courts and Tribunals have taken the view that the words "technical services" have to be read in the narrower sense by applying the rule of noscitur a sociis, particularly, because the words "technical services" appear in between the words "managerial and consultancy services"

• The SC observed that in this case there is no expert evidence or finding from the RA to suggest that human intervention is involved in the interconnection process. The SC also observed that this is a critical aspect that will assist the Courts and Tribunals in deciding whether the subject payments were in the nature of “technical services” and if it accordingly had to suffer withholding tax. The SC also observed that the argument of the cellular companies that this is a revenue sharing agreement was not examined by the RA or by the Tribunal.

• The SC held that in these cases the cellular companies were not at fault because the aspect of human intervention was not brought up by the RA before the lower authorities.

• Observing that a technical expert’s views are important in these cases, especially in the case of contracts between Indian companies and multinational corporations, the SC remanded the matter back to the AO to obtain the views of a technical expert and to decide the matter accordingly. The cellular companies were also permitted to obtain an expert’s views and provide it to the AO.

• The SC also directed the Central Board of Direct Taxes (“CBDT”) that in such cases having large revenue implications, the RA should not conclude merely on the basis of the contracts, but also on the basis of views of technical experts.

BMR Comments

In remanding the matter to the AO for examining the aspect of human intervention, the SC has clearly laid down that human intervention is a pre-requisite for services to be considered as FTS.

The observations of the SC would have great persuasive value in deciding on the
need for withholding tax on domestic payments and more importantly in the case of cross-border remittances (since under section 195 of the Act, the same definition under section 9 applies). The SC's decision would especially be of significance to the subsidiaries of multinational corporations in India in deciding on the withholding requirement for the various payments made to the overseas parent or affiliates. The observations and directions of the SC on the need for expert views on technical matters should hopefully reduce litigation and prod the CBDT to prescribe guidelines to deal with matters in emerging areas of technology.

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BMR Advisors has a new address in the National Capital Region.

BMR Advisors | 22nd Floor | Building No. 5 | Tower A | DLF Cyber City | DLF Phase III | Gurgaon 122 002
Tel: +91 124 339 5000 | Fax: +91 124 339 5001

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