

Tax Hotline

October 07, 2016

TEACHING SERVICES PROVIDED IN INDIA BY US NON-PROFIT EDUCATIONAL INSTITUTE(UCLA) IS NOT TAXABLE IN INDIA: AAR

- Teaching services provided by a United States' non - profit body in India does not constitute FIS by virtue of Article 12(5)(C) of the India- US DTAA.
- Lacking a profit motive, teaching activities performed by the professors of a US non-profit body in India does not constitute a business activity and hence remuneration for such activities is not taxable as business income.
- The activities performed for conducting classes did not constitute a fixed PE in India since the classes were not conducted in a fixed place.

Recently the Authority for Advance Rulings ("AAR") in the case of *Regents of the University of California (UCLA) Anderson School of Management Executive Education, USA¹* ("Regents"/"Applicant") held that teaching services provided by a US non- profit body in India is not taxable. It reached this conclusion on the basis that such activities do not constitute Fees for Included Services ("FIS") or business profits under the India-US Double Tax Avoidance Agreement ("DTAA/treaty"). It also held that such an arrangement would not result in the creation of a Permanent Establishment ("PE") in India as there was no fixed place of business for conduct of such activities

BACKGROUND

Regents is a non-profit public benefit corporation incorporated in the USA. Northwest Universal Education Private Limited ("Northwest") is a private company in India which entered into an agreement with Regents for teaching management techniques ("Programmes") by the professors of Regent. The Programmes were organised for senior executives having work experience over 8 years and lasted between 4-12 days. Further they were conducted on premises provided by Northwest depending on their convenience and no fixed place was assigned. No payments were made directly to Regents by any of the executives or participants who participated in the Programmes. Only Northwest paid Regents consideration for the teaching imparted during the Programmes.

In this context, the applicant had approached the AAR to determine the taxability of the sum paid by Northwest to Regents. The ruling was sought on the following two issues –

1. Whether the consideration by Northwest to Regents constituted FIS as per Article 12 of the DTAA and hence subject to withholding under section 195 of the Income Tax Act ("ITA")?
2. Whether the sum paid for the teaching activities conducted by Regents in India was taxable under Article 7 of the DTAA since such activities constituted a PE of the applicant in India under Article 5 of the DTAA?

RULING

Since Article 12(5)(C) of the DTAA specifically excludes teaching from its ambit the Revenue conceded that the consideration did not constitute FIS under the DTAA. However, the Revenue argued that the teaching activities would create a PE under Article 5 read with Article 7 of the DTAA and hence the consideration ought to be taxed as business income. Rejecting this contention, the AAR held that the consideration payable for teaching activities could not constitute business income. The tribunal reached this conclusion in view of the fact that the Applicant is registered as a non-profit entity in the US, lacking a profit motive and is involved in the conduct of educational activities.

The AAR further negated the argument that conduct of Programmes constituted a PE of Regents reasoning that Regents had no control over the organisation of such Programmes. Further, Northwest could arrange different locations for different Programmes and hence it could not be considered as a fixed place as required under Article 5.

The additional claim of the revenue of the payment constituting royalty was also rejected on the ground that the Applicant makes available the Programmes of Harvard Publishing University which are publishing material for all over the world. In other words, for consideration to fall under Royalty, there shall be a transfer of Intellectual Property ("IP"). However, since the techniques taught in the Programmes were public information, there was no question of Regent licensing its IP.

ANALYSIS

Over the past few years, higher educational institutions in the US have been increasingly exploring and catering to students and professionals in India, either with / without an Indian partner, especially in relation to courses which are not regulated by education-specific authorities in India. Similarly, there has also been increasing involvement by US and other global non-profits in sectors other than education in India. In this context, the AAR's ruling in this case is a welcome development for US educational institutions and global non-profits providing services to Indian organisations. Having said that, it needs to be noted that the conclusion arrived at in this ruling is specific to the nature of facts and circumstances involved. We outline below the various aspects that need to be factored in and

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March 19, 2025

- In determining tax liability of an offshore entity in India, determining availability of relief under the relevant tax treaty is important as the scope of source-based taxation under domestic law is generally much wider in nature. Several factors are involved in evaluating whether non-profits, which are generally exempt from tax in their state, are entitled to relief under a tax treaty. For entitlement to treaty relief, Article 1 of the DTAA provides that the convention shall apply to persons who are *residents* of either contracting states. The expression '*resident of a contracting state*' has been defined in Article 4 of the treaty as a person '*liable to tax*' under their own laws. Based on judicial precedents, the term '*liable to tax*' means liable to comprehensive taxation². In other words, the person must be subject to the tax laws of the jurisdiction of which he claims to be a resident. Being subject to comprehensive taxation does not necessarily require the person to be 'subject to tax' (i.e. actually paying tax). Article 4 only requires a person to be *liable to tax* and not *subject to tax*, except in case of certain types of entities like trust, partnership and estate (which also need to satisfy the '*subject to tax*' test – i.e., the income of such entity should be actually taxed in its state either in its hands or in the hands of its partners / beneficiaries). Therefore, it needs to be examined as to whether the entity would normally be subject to tax in the absence of specific exemption provisions, whether the entity is required to file tax returns, etc.
- In relation to determining tax liability of an offshore entity in India under any tax treaty, particularly non-profits, the characterisation of activities of an entity as '*business*' is crucial. Such characterisation could lead to imposition of a very high corporate tax rate (40% excluding surcharge and cess) on the profits to the entity (net of permissible deductions), to the extent such activities are attributable to its PE in India. In this case, the reasoning adopted by the AAR for coming to the conclusion that the activities undertaken did not constitute *business* under Art. 7 was based on the fact that Regents is a non-profit body providing educational activities. The AAR did not specifically examine the meaning of the term "business" either under the DTAA or the ITA. The definition of "business profits" under the ITA includes the expression *income derived from any trade or business*. Since the term *business* has not been defined in the treaty, the definition under the ITA may be looked at by virtue of Art. 3(2) of the DTAA. The definition of *business* under section 2(13) of the ITA includes activities other than those conducted for charitable purposes. These include purposes such as relief for poor, preservation of environment, preservation of monuments, educational activities etc., unless such charitable activity has a profit motive. In which case it will be considered as business income. Judicial precedents make a distinction between activities which generate a surplus and activities which have a profit motive. To the extent any generation of surplus is intended for re-investment / utilization for charitable objectives such as relief for poor, etc., the activities are generally not considered to have a profit motive. However, as per recent amendments to the definition of the term "charitable purpose" under the ITA, in case of entities engaged in advancement of any object of general public utility not specifically identified³, if the activities of the entity involves provision of any service for a consideration, there are two tests which are required to be satisfied: (i) such activity is undertaken in the course of actual advancement of the entity's object of general public utility; and (ii) the aggregate receipts from such activities do not exceed 20% of the total receipts. Therefore, even though this ruling may appear to conclude that rendering any charitable activity by a foreign not for profit body is non-taxable in India, each situation needs to be analyzed on a case-by-case basis. The conclusion in this ruling may not apply in case of: (a) charitable activities which are not specifically identified under the ITA and which do not satisfy the tests outlined above, (b) charitable activities which qualify as Fees for Technical Services ("FTS")/ **Royalty** under the applicable tax treaties.
- In addition to characterisation as 'business', existence of a PE is also important in determining tax liability of an offshore entity in India. As outlined above, the profits earned from *business* activities of a Non-Resident in India are taxable in India as business income if and only to the extent they are attributable to a PE in India. In this case, AAR only considered the formation of a *fixed place* PE. However, depending on the facts and circumstances, there may also be other factors that lead to existence of a PE, for instance a Service PE (which may have to be examined when faculty travel to India). For example, even the India- US DTAA provides in Article 5(2)(i) that PE includes - '*the furnishing of services, other than included services as defined in Article 12 (Royalties and FIS), within a Contracting State by an enterprise through employees or other personnel.*' Further there is an additional condition that the services (by employees or other personnel) have to be provided continuously for an aggregate period of more than 90 days within a 12 month period.
- Finally, in relation to determining whether teaching services provided by an educational institution qualifies as FIS / FTS under a tax treaty, it should be noted that this ruling's conclusion may be limited in its applicability to educational institutions in US and few other countries such as UK, Canada, Singapore, Portugal, Switzerland and Netherlands. India's tax treaties with these countries have an exclusion for "teaching in or by educational institutions" in relation to taxation of FIS / FTS. In case of other tax treaties which do not contain such an exclusion, teaching services could qualify as FIS / FTS. However, if the definition of FIS / FTS in the relevant treaty includes the 'make available' test, the nature of courses taught may also have to be considered. This test stipulates that the provision of services should enable the recipient of services to apply the underlying technical knowledge, experience, skill, know-how, processes, etc. on its own. Therefore, only courses which are technical in nature, such as medical courses, engineering courses, etc., may satisfy the 'make available' test. To clarify, what is considered 'technical' in a tax treaty may differ from what it is considered from an Indian regulatory perspective. For instance, in the context of tax treaties, courses on management, leadership, etc., have been held to be non-technical in nature. However from a regulatory perspective, management courses may be included under the ambit of being *technical* in nature and therefore, subject to applicable regulatory approvals, compliances, etc. Hence while evaluating similar scenarios, such nuances need to be borne in mind.

– Afaan Arshad & T.P. Janani

You can direct your queries or comments to the authors

¹ AAR No. 1656 of 2014

² In *Union of India v. Azadi Bachao Andolan* [2003] 263 ITR 706(SC) it was held "*Liability to taxation is a legal situation; payment of tax is a fiscal fact. For the purpose of application of Article 4 of the DTAC, what is relevant is the legal situation, namely, liability to taxation, and not the fiscal fact of actual payment of tax. If this were not so, the DTAC would not have used the words liable to taxation, but would have used some appropriate words like pays tax.*"

³ i.e., other than relief for the poor, education, yoga, medical relief, preservation of environment and preservation of monuments or places or objects of artistic or historic interest.

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