

Fees for Technical Services or Professional Services - Differentiation Essential for TDS provisions

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The Finance Act, 2020 made an amendment in section 194J (TDS on fees for professional fees and fees for technical services ('**FTS**')) of the Income tax Act, 1961 ('**IT Act**'), thereby reducing the tax deduction rate from 10% to 2% on fees characterized as FTS.

The Explanatory notes to the Finance Act 2020 clarified that the intention of the said amendment is to reduce litigation in cases where the assessee deducts tax under section 194C, while the tax officers claim that tax should have been deducted under section 194J of the Act.

Needless to say, the amendment recognizes the overlap between the 'work' and 'technical services', namely that 'carrying out any work' could involve rendering of 'technical services'. To remove this uncalled differentiation, the amendment proposes a tax deduction rate of 2%^[1] for 'technical services', which brings it on par with section 194C. The rate for other services covered under the provisions of section 194J of the IT Act would remain as 10%^[2].

Though the amendment has been introduced to reduce litigation arising out of the overlap between section 194C and section 194J, it is likely to bring into focus the distinction between 'professional services' and 'technical services', which was not relevant till now, but would henceforth attract different rates for tax withholding.

Before moving ahead, it may be necessary to refer to the amendment which provides for the reduced rate of 2% to fees for technical services (not being a professional services, or royalty where such royalty is in the nature of consideration for sale, distribution or exhibition of cinematographic films and ten per cent of such sum in other cases). Thus, in order to deduct tax at the rate of 2% on FTS, it first needs to be established that the said services are not 'professional services'.

Definition of FTS and Fees for 'professional services'

The expression 'professional services' is defined under section 194J of the IT Act as *services rendered by a person in the course of carrying on legal, medical, engineering or architectural profession or the profession of accountancy or technical consultancy or interior decoration or advertising or such other profession as is notified by the Board for the purposes of section 44AA or of this section.*

The expression 'FTS' is defined in Explanation 2 to section 9(1)(vii) as *any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel), but does not include consideration for any construction, assembly, mining or like project undertaken by the recipient or consideration which would be income of the recipient chargeable under the head 'Salaries'.*

Distinction between FTS and Professional services

• It will be observed from the definition of FTS that it refers to managerial, technical or consultancy services. The emphasis seems to be on the nature of services, rather than, on who is rendering the services or whether they have any specialized knowledge or qualification for rendering these services.

On the other hand, as per the definition of 'professional services', many of the professions referred to therein, require possession of professional qualification or membership of a professional body, be it legal, medical, engineering, architectural or accountancy or technical consultancy. The profession of interior decoration, sports persons, umpires and referees, coaches and trainers, team physicians and physiotherapists, event managers, commentators, anchors and sports columnists, being notified professional services, is a mix bag. Some would certainly require professional qualification while some may not (the inclusive definition of 'profession' in section 2(36), which includes a 'vocation', has resulted in inclusion of professions not necessarily requiring possession of a professional qualification).

There is a well-known distinction between a 'contract of employment' and a 'contract of agency'. In a 'contract of employment', one can tell the employee, what to do and how to do. One can exercise a supervisory control in respect of the work entrusted. On the other hand, an agent may not be subject to direct control or supervision; he enjoys greater degree of independence.

Perhaps it is possible to adopt this approach to distinguish between 'technical services' and 'professional services'. While one can exercise greater direct control over a person rendering technical services, being in the nature of managerial, technical or consultancy services, on the other hands, a professional such as a lawyer, engineer and the like, could be said to enjoy greater freedom in the execution of the services.

This could be one way of distinguishing between 'technical services' and 'professional services', especially when there is an overlap.

• Another noticeable difference is that while in the case of 'technical services', the requirement is mere rendition of such services, in the case of 'professional services', the requirement is that such services ought to have been rendered in the course of carrying on of notified 'professional services'. If any services are not rendered in the course of carrying on of notified 'professional services', such services may not answer the description of 'professional services'.

• On reading of the definition of 'professional services', generally, a perception develops that the 'professional services' are intellectual or artistic in nature, which can be provided by an individual or a firm of individuals. Thus, where any engineering or technical services are provided by a corporate entity, the same ought not to be covered by the definition of 'professional services'. However, the Hon'ble Delhi High Court^[3] and Bombay High Court^[4] have held that 'professional services' can be provided by a corporate entity, having required professionals. In view of these decisions, it appears that the class of payees rendering professional services is immaterial.

However, reference may also be made to the Articles of the Double Taxation Avoidance Agreement ('DTAA'). The DTAA generally has Articles dealing with taxation of 'fees for technical services' and 'independent personal services'. The Article dealing with 'independent services' includes 'professional services' provided by an individual or a firm of individuals, including services of physicians, surgeons, lawyers, accountants, etc. Thus, the 'professional services' provided by an individual, being a professional are differentiated with fees for technical services. Similar analogy can be adopted even for the purpose of interpreting domestic provisions. Thus, any services provided by a professional or through a firm of such professionals could be said to be Fees for professional services. And rest of the services could fall within the definition of Fees for Technical Services.

• The amendment was introduced in order to avoid litigation, while applying provisions of section 194C

or section 194J. Therefore, when any specific services were held by the Courts to be in the nature of FTS or covered under section 194C, it is expected that the tax authorities would not change its stand of treating such payments as fees for 'professional services', merely because there was some overlapping in the nature of services.

• Where mere technical skills are involved, but the work is not done by or on behalf of a person engaged in the carrying on any profession, tax deduction should be at lower rate of 2%, either for the reason that this is a 'technical service' and not 'professional services' or because it is a case of 'carrying out work', attracting the provisions of section 194C.

Illustrative Services, which are overlapping

Following illustrations may be considered to understand the overlapping of the services under both the definitions:

Sr. No.	Nature of Services	Tax Deduction at Source
1	Drawing & Designing	<p>If these are engineering or architectural or interior designing related drawings or designs, provided by a person carrying on any of the concerned professions, these would in the nature of 'professional services'.</p> <p>If these are provided by any 'other person', these could be contended to be in the nature of FTS, because, undoubtedly, these would require technical skills. The second category of services would have to be treated as FTS under section 194J and the applicable TDS rate would be 2%.</p> <p>It would be important to note that in the past, the Courts have treated similar payment for technical design as FTS.</p>
2	Testing (e.g. radiography, chemical, etc.)	<p>The Hon'ble Pune ITAT in the case of Bharat Forge Ltd. v. ACIT [2013] 36 taxmann.com 574, has held that payment towards testing and inspection charges are subject to TDS under section 194C of the IT Act. It was so held considering the fact that there was no human intervention while providing such services.</p> <p>Thus, where the testing charges are towards technical testing, involving services of experts and requires technical assistance, one may contend that the payment is in the nature of FTS.</p> <p>However, the tax authorities could contend that the services are provided by engineers in the course of carrying on such profession and would therefore fall within the definition of 'professional services' and subject to TDS of 10%.</p>
4	Inspection	<p>If the services are provided through a technical personnel, which would usually be supported by a technical report, the same could be considered as FTS.</p> <p>However, the Department may contend that where the services are provided by a professional during the course of engineering profession (if that is the case) defined under 'professional services', then the same may get covered under the definition of 'professional services'.</p>
5	Service engineer visit and	Payment could be characterized as FTS, as technical

	valuation services	services are rendered. However, since the services are provided by an engineer, during the course of carrying on engineering profession, the fees are for 'professional services'.
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The above tabulation is also reflective of the likely overlapping nature of the services and hence the potential for litigation.

Conclusion & Action Points for Deductor

It would be noted from the above, for the purpose of tax recovery, the tax authorities may treat the payment as fees for 'professional services', which could then involve undue litigation. Thus, the deductor may want to adopt the following approach:

- Where there is a legal precedence to treat any particular nature of services as FTS, the beneficial rate of 2% may be adopted;
- In case there is no such precedence and there is overlapping of the services under both the definitions, the deductor may adopt a conservative position and deduct tax at the higher rate of 10% by treating the payment as fees for 'professional fees';
- Where there is no prima facie ambiguity as to the nature of services, appropriate rate may be applied.
- Thus, in matters of tax deduction at source, one is expected to act in a bonafide manner and to err in favor of caution.

[\[1\]](#) Rate reduced to 1.5 % in view of Press Release dated May 13, 2020

[\[2\]](#) Rate reduced to 7.5% in view of Press Release dated May 13, 2020

[\[3\]](#) Vipul Medcorp TPA (P.) Ltd. v. CBDT [2011] [\[TS-579-HC-2011\(DEL\)\]](#)

[\[4\]](#) Dedicated Health Care Services TPA (India) (P.) Ltd. v. ACIT [2010] (TS-5373-HC-2010(Bom))