



Foreign Source Exclusion in FTS - A Litigation Prone Area

The Indian Income-tax law has laid down the extent to which income of a person, whether resident or non-resident, can be taxed in India.

Non-residents are chargeable to tax in India only in respect of the following incomes:

- Received or deemed to be received in India
- Accrues or arises or deemed to accrue or arise in India
- Section 9 of the Income Tax Act 1961 ('ITA 1961') holds significance in this context.

- One such income which is deemed to accrue or arise in India for a non-resident is Fee for Technical Services¹ ('FTS') covered u/s 9(1)(vii) of ITA 1961. Where government, resident or non-resident pays FTS to non-

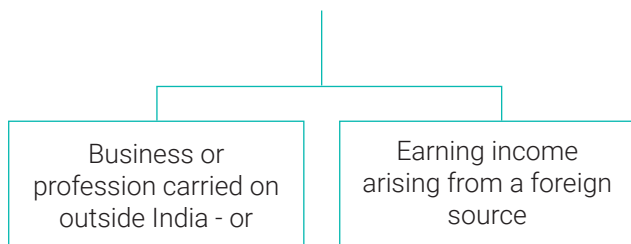
resident, the same is deemed to accrue or arise in India, unless excluded from taxation. The exclusion in this regard is given as under:

- 9 (1) The following incomes shall be deemed to accrue or arise in India :—
-(vii) 'Income by way of fees for technical services payable by —
- (b) a person who is a resident shall be deemed to accrue or arise in India, except where the fees are payable (by R to NR) in respect of services utilized in a business or profession carried on by such person (i.e., by R) outside India or for earning any income (by R) from a source outside India....
- Also, the new Income Tax Act, 2025 continues to preserve this exclusion u/s 9(7)(a)(ii)².

¹ FTS means 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.

² 9(7)(a) Income by way of fees for technical services payable by—
(ii) a resident, except where it is payable in respect of services utilised for—
(A) a business or profession carried on by such resident outside India; or
(B) making or earning any income by such resident from any source outside India; or... shall be deemed to accrue or arise in India;

- The Exclusionary clause hinges on whether the services have been utilized for following purposes



An Illustration - to contextualize this exclusion, consider the following fact pattern:

- **Primary (underlying) Transaction:** I Co., an Indian resident company, is engaged in software development and related services for both Indian and overseas clients. For its Singapore-based customers, I Co. undertakes development of software. Revenue from such Singapore clients constitutes I Co.'s foreign source of income.
- **Secondary Transaction:** To comply with Singaporean regulatory requirements, I Co. engages SG Co., a Singapore-based consultancy firm, for advisory and compliance support in relation to the software being developed for its Singapore clients. For these services, I Co. pays fees to SG Co., a non-resident.
- The two legs of the transaction can be analysed as follows:

1. Underlying Transaction (I Co. – Singapore Clients): The source of income for I Co. here is situated in Singapore, since the revenue arises from its foreign clients.

2. Secondary Transaction (I Co. – SG Co.): Although the consultancy services qualify as FTS in nature, they are directly and exclusively utilized in respect of I Co.'s business carried on outside India (servicing Singapore clients).

- Accordingly, the exclusionary clause under section 9(1)(vii)(b) ought to apply, since at least one of the following conditions is satisfied:
 - the services are utilized for a business carried on outside India; OR

- the fees are paid in relation to income arising from a source situated outside India.

In fact, in the present illustration, both conditions are satisfied.

- Nevertheless, this position is not free from litigation. Indian tax authorities have, in certain cases, even argued that since the relevant activities are performed in India (for instance, I Co. undertaking the software development activity in India, in the instant example), the 'source' of income is effectively located in India. This interpretation narrows the scope of the exclusion and disregards the intention of the law. However, such restrictive reading has been the cause of extensive litigation before various judicial forums.
- The example above therefore illustrates the complexity in interpreting the "foreign source" exclusion and how section 9(1)(vii)(b) can become a matter of serious dispute.

Controversies and Challenges

- The exclusion provided under section 9(1)(vii)(b) lacks precise legislative guidance. This has given rise to multiple controversies, particularly on the interpretation of three critical aspects:

1. What constitutes "place" of utilization of services?

- The wording of section 9(1)(vii)(b) emphasizes the 'purpose' for which the services are utilized, and not the location where they are consumed. Hence, in our view, even if advisory or consultancy services are received within India but are ultimately used for the benefit of a business carried on outside India, one could argue that the exclusion applies.
- Judicial precedents (e.g., Motif India Infotech³ and Hofincons Infotech⁴ rulings) have upheld this view, by recognizing that services availed in India for exclusive application in foreign business activities qualify for the exclusion. The Apex Court in GVK⁵ Industries, applied the same principle differently, thereby denying the exemption where the utilization of services was linked to activities carried on in India.

³ Pr. CIT v. Motif India Infotech (P.) Ltd. [2018] 409 ITR 178 (Gujarat HC)

⁴ Dy. CIT v. Hofincons Infotech & Industrial Services (P.) Ltd. [2014] 52 taxmann.com 232 (ITAT Chennai)

⁵ GVK Industries Ltd. v. Income-tax Officer [2015] 54 taxmann.com 347 (SC)

- Having said the above it would be important to ensure robust documentation demonstrating the nexus of services with foreign operations.

2. Determination of “source” of income

- Perhaps the most litigated aspect of section 9(1)(vii)(b) is the meaning of “source”. Courts have distinguished between “source of income” and “source of receipts”, with the former referring to the originating economic activity or business that generates the income stream.
- In Havells India Ltd.⁶, the Delhi High Court held that the source of income was the Indian manufacturing activity rather than the foreign buyers, thereby adopting a restrictive approach. Subsequent rulings involving similar issues have either not discussed Havells (despite being cited by revenue) or have distinguished on the facts and ruled in favour of the taxpayer (e.g., QAI India Ltd.⁷, Motif India Infotech (P) Ltd.⁸, IMG UK Ltd.⁹) holding that services utilized exclusively for foreign projects constitute a foreign source of income. Having said that, it seems that, Courts are yet to make any legal distinction affirming or overruling the principle laid down in Havells, leaving the issue open to interpretation and further judicial scrutiny.
- An important point of legal construction must also be highlighted: section 9(1)(vii)(b) is drafted in the alternative - i.e., it uses an “or” condition, not an “and” condition. Thus, even if one limb (e.g., services utilized for business carried outside India) is satisfied, the exclusion should apply, irrespective of whether the second limb (source of income situated outside India) is also satisfied. The failure of courts in certain cases to give due weight to this drafting leads to anomalous results and increases uncertainty.

3. Services utilized for generating income – pre-existing or future source?

- The section does not restrict the exclusion only to services linked to existing sources of income. The legislative intent appears broad enough to cover situations where services are availed for creating or expanding a future income source outside India.
- Case law supports this wider interpretation. For instance, in Bajaj Hindustan Ltd.¹⁰, advisory services were availed for acquisition of sugar mills in Brazil.

The ITAT held that such payments were covered under the exclusion, even though the income source (i.e., the mills) had not yet come into existence at the time of availing the services.

- On the other hand, rulings such as Shriram Capital Ltd.¹¹ have taken a restrictive approach, holding that in the absence of any existing foreign business activity, the exclusion cannot apply. Such negative rulings highlight the risks taxpayers face in situations involving proposed acquisitions or exploratory business ventures abroad.

Conclusion

- Section 9(1)(vii)(b) was intended to carve out a clear exclusion for payments towards technical or consultancy services utilized in respect of a foreign business or foreign source of income. In practice, however, the provision has become one of the most litigation-prone areas in India’s international tax law regime.
- The challenges primarily arise from:
 - Lack of statutory clarity on what constitutes **“Business or profession carried on outside India” and “source of income”**;
 - Divergent judicial interpretations, some supportive of taxpayers, others restrictive; and
 - Aggressive positions taken by Indian tax authorities in narrowing the exclusion.
- From a taxpayer’s perspective, the key risks lie in the possibility of tax authorities contending that the income source is in India, or that services used for prospective foreign ventures do not qualify. Negative rulings like Havells India Ltd.¹⁰ and Shriram Capital Ltd.⁷ reinforce this exposure, while favourable jurisprudence such as Motif India Infotech³, Hofincons Infotech⁴, and QAI India Ltd.⁸ offer important support to taxpayers.
- Way forward for taxpayers:
 - 1. Documentation is critical** – establish a clear nexus of the services with foreign projects or clients, including contractual agreements, correspondences, and work papers.
 - 2. Adopt a conservative approach** – where facts are mixed, evaluate treaty benefits (which often provide

⁶ CIT v. Havells India Ltd [2012] 21 taxmann.com 476 (Delhi HC)

⁷ QAI India Ltd. v. DCIT [2024] 165 taxmann.com 118 (ITAT Delhi)

⁸ Principal Commissioner of Income Tax v. Motif India Infotech (P) Ltd. [2018] (Gujarat HC)

⁹ International Management Group (UK) Ltd. v. CIT [2024] 164 taxmann.com 225 (Delhi HC)

¹⁰ Income-tax Officer (IT)-TDS-3 v. Bajaj Hindustan Ltd. [2011] 13 taxmann.com 13 (ITAT Mumbai)

¹¹ Shriram Capital Ltd. v. Director of Income Tax (International Taxation), Chennai [2020] 115 taxmann.com 388 (Madras HC)

broader exemptions for FTS) and assess withholding obligations carefully.

3. Be prepared for scrutiny – anticipate the arguments likely to be raised by the tax authorities and prepare rebuttals grounded in jurisprudence and statutory construction.

4. Recognize the “or” test – highlight in submissions that the two limbs under section 9(1)(vii)(b) are alternatives; satisfying even one should be sufficient to avail the exemption.

- In conclusion, while the foreign source exclusion under section 9(1)(vii)(b) remains a valuable safeguard for Indian businesses engaged in global operations, its application is fraught with interpretational challenges. Taxpayers must adopt a well-documented, cautious,

and legally defensible position to mitigate risks and ensure preparedness for inevitable scrutiny. A proactive approach - aligning business records, contracts, and tax positions with the statutory exclusion and judicial trends, will be crucial in navigating this litigation-prone area of Indian taxation.

Disclaimer

This article is intended as a general guide on the subject and is not an opinion. For advice tailored to your specific circumstances, please consult a specialist. The jurisprudence cited is not exhaustive and may vary depending on specific circumstances. Additional cases or considerations may be relevant.

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