Tax Hotline

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MAKING AVAILABLE 'MOST FAVORED NATION' BENEFITS

EXPANSION OF FEES FOR TECHNICAL SERVICES ARTICLE IN THE INDIA- FRANCE TAX TREATY

EXPANSION OF FEES FOR TECHNICAL SERVICES ARTICLE IN THE INDIA- FRANCE TAX TREATY

In a recent ruling in the case of Mersen India Private Limited ("**Applicant**"), the Indian Authority for Advance Rulings ("**AAR**") has applied a most favored nation clause contained in a protocol to the India-France tax treaty ("**Treaty**") to expand the scope of the fees for technical services article in the Treaty. The Applicant was a private limited Indian company which is the wholly owned subsidiary of a company registered under the laws of France ("**French Company**"). A service agreement was entered into whereby the French Company rendered certain services in the nature of assistance, professional and administrative consultation and training to the Applicant. The application to the AAR was in relation to the taxability of the service fees paid by the Applicant to the French Company.

CONTENTIONS OF THE PARTIES

Parties were in agreement that the said fees would be considered fees for technical services under the Indian Income Tax Act, 1961 ("**ITA**"), and taxable under Article 13(4) of the Treaty dealing with fees for technical services. The primary contention of the Applicant was in relation to the protocol annexed to the Treaty ("**Protocol**"), which was signed on 29.9.1992 with a preamble that it would form an integral part of the Treaty. The specific part of the Protocol that was relied on is contained in Clause 7 and states as follows:

"7. In respect of articles 11 (Dividends), 12 (Interest) and 13 (Royalties, fees for technical services and payments for the use of equipment), if under any Convention Agreement or Protocol signed after 1.9.1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payment for the use of equipment to a rate lower or a scope more restricted than the rate of (?) scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention, with effect from the date on which the present Convention or the relevant Indian Convention, Agreement or Protocol enters into force, which ever enters into force later. [Emphasis supplied]"

It was contended by the Applicant that the term "rate of scope" should in fact read as "rate OR scope" and that Article 13 of the Treaty should accordingly be limited both in terms of rate OR scope, if a treaty with a third country provided a more beneficial rate or scope. In this case, reference was made to the beneficial scope of the India-US tax treaty which considers fees for technical services to be taxable only where such services are "fees for included services" i.e. where they are a) technical or consultancy services which b) "make available" technical knowledge or c) are ancillary to services in relation to which royalty is paid. It was submitted that in this case, the said services should not be considered "fees for included services" within the terms of the beneficial article in the India-US tax treaty, on account of such services being managerial in nature (and not within the purview of the article in the US tax treaty) or on account of such consultancy services not "making available" technical knowledge to the Applicant. Accordingly it was argued that payments for services should be considered the business income of the French Company and not taxable in the absence of a permanent establishment ("**PE**") of the French Company in India.

RULING

It was held by the AAR that, "on reading the clause as a whole, it would be appropriate to read the expression "rate of scope" as "rate or scope". The AAR therefore applied the fees for included services

article from the India-US tax treaty to the instant case. However, it was held on the basis of the article of the India-US tax treaty that the French Company provided services in the nature of consultancy services which made available technical knowledge, payment towards which would be taxable in India. It was also held by the AAR that as "managerial" services are not covered by the "fees for included services" article, the make available requirement should not apply. The AAR observed that the managerial services appear to make available technical knowledge in any case. Therefore, it was held that withholding tax requirements should accordingly apply.

OBSERVATIONS & ANALYSIS

The AAR ruling is a welcome clarification on the ambit of Clause 7 of the Protocol, which was also recently discussed in favor of the applicant in the AAR ruling of Poonawala Aviation Limited.1 However, on the issue of taxability of "managerial" services as fees for included services are only taxable if they are consultancy or technical services making available technical knowledge, it should be clear that managerial services should not be taxable under this article.

In any case, this ruling and the applicability of the Protocol to rate and scope should provide significant relief to French taxpayers, banks, pharmaceutical companies and other taxpayers who expect to receive income from India in the nature of interest, royalties and fees for technical services.

– Vishwanath Kolhar & Shreya Rao
You can direct your queries or comments to the authors

[1] A.A.R. No. 953 of 2010

June 01, 2017

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