

TAX FLASH NEWS

22 December 2020



The Indian legal firm can claim foreign tax credit in India with respect to taxes deducted on professional fees in Japan

Recently, the Mumbai Bench of Income-tax Appellate Tribunal (the Tribunal) in the case *Amarchand & Mangaldas & Suresh A Shroff & Co*¹ (the taxpayer) dealt with the claim of Foreign Tax Credit (FTC) in respect of taxes deducted on professional fees paid by the taxpayer's clients in Japan. The Tribunal observed that the provisions of Independent Personal Services (IPS) under Article 14 of the India-Japan tax treaty (tax treaty) are required to be read along with the provisions of Fees for Technical Services (FTS) under Article 12(4)² of the tax treaty. The exclusion clause under Article 12(4) for IPS is applicable only to individuals, however; the taxpayer in the present case is a partnership firm. The taxes are correctly deducted at the rate of 10 per cent on gross amounts treating the same as professional fees earned in Japan under Article 12 of the tax treaty. Accordingly, the taxpayer was eligible for tax credit.

Facts of the case

The taxpayer is a law firm assessed to tax in the status of a partnership firm. During the Assessment Year 2014-15, the taxpayer claimed FTC in respect of taxes withheld by its clients in Japan. The taxes were deducted at the rate of 10 per cent on gross amount treating the same as professional fees under Article 12³ of the tax treaty. The Assessing Officer (AO) observed that FTC for such taxes deducted in Japan was not allowable to the taxpayer since the income so earned by the taxpayer could only be taxed under Article 14 as Independent Personnel Services (IPS). As the taxpayer did not have any fixed place in Japan, the condition precedent for taxability even under Article 14 was not satisfied. The AO observed that the taxes have been wrongly withheld in Japan, and, therefore, the taxpayer

was not entitled to FTC in respect of the same. Therefore, the FTC claim was declined. The CIT(A) confirmed the addition made by the AO.

Tribunal's decision

Under the provisions of the tax treaty where any income of an Indian resident is taxed in Japan, FTC is available in respect of the taxes paid in Japan whether paid directly by the taxpayer or whether taxes were withheld in Japan. The Tribunal observed that there are overlapping areas in the definition of FTS under Article 12(4), which covers 'technical, management and consultancy services vis-à-vis the definition of professional services income' which can be taxed under Article 14 as IPS. This overlapping is recognised in exclusions provided in royalty and FTS provisions under Article 12(4) of the tax treaty.

It has been observed that when a particular type of income is specifically covered by the tax treaty provision, the taxability of that type of income is governed by the specific provisions so contained in the tax treaty. However, it is equally well settled a legal position that the tax treaty is to be read as whole and, therefore, different Articles cannot be read on a standalone basis *dehors* the scheme of the tax treaty.

In view of the above, it has been observed that Article 14 (IPS) will come into play for the taxation of professional services. However, exclusion under Article 12(4) for IPS applies to individuals alone. The taxpayer in the present case was partnership firm. Therefore, on the peculiarities of the tax treaty, the legal fees paid to a partnership firm of lawyers can indeed be subjected to levy of tax under Article 12 as the exclusion clause under Article 12(4) does not get triggered for payments to persons other than individuals. The provisions of Article 14 are required to be read in harmony with the provisions of Article 12(4) of the tax treaty. Accordingly, the taxpayer is eligible for tax credit in India.

¹ *Amarchand & Mangaldas & Suresh A Shroff & Co v. ACIT* (ITA No. 2613/Mum/2019, AY- 2014-15) – Taxsutra.com

² Exclusion for IPS covered under Article 14 from the purview of 'Fees for Technical Services'

³ Royalties and Fees for Technical Services

Our comments

The issue with respect to the allowability of FTC has been a matter of debate before the Courts/Tribunal.

The Courts/Tribunal⁴ in some of the cases have held that taxpayer is entitled to claim tax credit in the home country with respect to taxes paid in a foreign source country. The Delhi Tribunal in the case of Uniparts India Limited⁵ held that a resident taxpayer is eligible to claim the credit of the taxes withheld outside India on foreign-sourced income, subject to substantiation of the provisions under which the said taxes were withheld.

In the present case, the Tribunal observed that the provisions of IPS under Article 14 are required to be read along with the provisions of Article 12(4) of the tax treaty. The exclusion clause under Article 12(4) does not get triggered for payments to persons other than individuals. The taxpayer in the present case is a partnership firm. The taxes are correctly deducted at the rate of 10 per cent on gross amounts treating the same as professional fees earned in Japan under Article 12 of the tax treaty. Accordingly, the taxpayer was eligible for tax credit.



⁴ Dr. Rajiv I. Modi v. DCIT (ITA No. 1285 [AHD] 2014, dated 21 September 2017), Tata Consultancy Services v. ACIT (ITA No. 5713/Mum/2016), Bhavin Shah v. ACIT (ITA No. 933/Ahd/2013)

⁵ Uniparts India Limited v. CIT (ITAs. No.201, 202, 203, 204 & 205/DEL/2015)

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