

The US entity is a beneficial owner of FTS and eligible for the benefit of a concessional tax rate under the India-USA tax treaty

Executive Summary

Beneficial owner is one of the most important concepts used in tax treaties. As an anti-abuse measure, it provides the benefit under tax treaties on specific income like dividend, interest, royalties and Fees for Technical Services (FTS) only to recipients who are beneficial owners of such income.

Recently, the Delhi High Court, in the case of Fujitsu America Inc.¹ (the taxpayer) held that the taxpayer was a beneficial owner of FTS and eligible for the benefit of the concessional tax rate provided for FTS under the India-USA tax treaty (the tax treaty). There was no back-to-back arrangement between the taxpayer and its holding company for passing on the fees received to the holding company. The taxpayer was playing the role of a service provider after procuring the same from other group companies and it had dominion over the fees received by it.

Facts of the case

- The taxpayer, a US entity, is a subsidiary of the Japanese entity. It received branding and management services fees from the Indian entity. The taxpayer offered the fees received from the Indian entity on a gross basis at a concessional rate of 15 per cent under Article 12 of the tax treaty.
- The AO held that the US entity had a back-to-back arrangement of passing on the fees to its holding company. The US entity merely serves as a conduit or channel for the said income and the beneficial owner of the fees was the Japanese entity. Therefore, the AO denied the tax treaty benefit and taxed the fees at 25 per cent on a gross basis under the Income-tax Act, 1961 (the Act).

High Court's decision

- In order to deny the taxpayer the beneficial owner status, the AO had to find that the taxpayer was either an agent or conduit for the holding company.
- The CIT(A) had observed that there was no back-to-back arrangement between the taxpayer and its holding company.
- Further, the CIT(A) had held that the taxpayer was playing the role of a service provider after procuring the same from other group companies and that it had dominion over the fees received by it.
- In view of above, the taxpayer was entitled to the status of a beneficial owner and eligible for the benefit of Article 12 of the tax treaty.

Our comments

Determination of 'beneficial ownership' is a facts-driven exercise. The High Court, in this case, treated the taxpayer as a beneficial owner based on various factors like the nature of the arrangement and control of the taxpayer on income. To fulfill the 'beneficial ownership' conditions under tax treaties, it is imperative that the taxpayers should have robust documentation, commercial substance for arrangements, control over the income, etc.

¹ CIT v. Fujitsu America Inc. (ITA No. 530 of 2022) (Del) – Taxsutra.com

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