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TAX FLASH NEWS

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Payment of guarantee fee to a group entity is not taxable under the India-Netherlands tax treaty

The Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Lease Plan India Pvt. Ltd.[1] (the taxpayer) dealt with the taxability of payment of guarantee fees to the Netherlands based holding company under the India-Netherlands tax treaty (tax treaty). The Tribunal held that in absence of provision of capital and any debt claim between the parties, the guarantee fees paid by the taxpayer to the holding company cannot be held as interest under the tax treaty. Further the payment was not in the nature of Fees for Technical Services (FTS). Further such guarantee fees were not chargeable to tax as business income in absence of a Permanent Establishment (PE) of the Netherlands based holding company in India. The Tribunal also observed that the tax treaty does not include the 'other income' article.

Facts of the case

The taxpayer is engaged in the business of leasing of motor vehicles, financial services and fleet management. For the purpose of its business, the taxpayer obtained a corporate guarantee pursuant to an agreement with a Lease Plan Corporation NV (Netherlands based holding company). During the Assessment Year 2009-10, the taxpayer paid fees for guarantee to the holding company. The Assessing Officer (AO) observed that the tax was required to be deducted at source on the guarantee fees under Section 195 of the Income-tax Act, 1961 (the Act). The payment was in the nature of interest as well as FTS under Article 11 and 12 of the tax treaty. Further the sum paid would fall within the purview of Section 9(1)(vii) and therefore taxable in India as FTS. On account of non-deduction of tax at source, the AO disallowed the expenditure of guarantee fees under Section 40(a)(i). The Commissioner of Income-tax (Appeals) [CIT(A)] upheld the order of the AO.

Tribunal's decision

Taxability of guarantee fee as 'interest' under the tax treaty

Broadly, all income earned from the 'provision of capital' by way of 'debt claim' constitutes interest and provision of capital in the 'non debt form', generally, constitutes 'dividend'. Therefore, to consider the income as 'interest', there should be 'debt' and there should be a 'claim' on that debt and income should arise to qualify as 'interest'.

In the present case, AE has not provided any capital to the taxpayer on which income is earned. It is a corporate guarantee, being a surety to the lender bank of the taxpayer that, if in a case, in future, the taxpayer fails to pay the due amount owed to those lenders, the Netherlands Company will pay to those lenders. Thus, it was promised to reimburse the amount to those lenders on happening of an event i.e. failure of payments by the taxpayer.

Further, the word 'debt claim' predicate the existence of debtor-creditor relationship. That relationship can arise only when there is a provision of capital. Accordingly, it has been held that guarantee fee paid by the taxpayer to Netherlands company cannot be covered in the definition of interest as per Article 11 of the tax treaty.

The Tribunal referred the US Court decision in the case of Container Corporation2 where it was held that the guarantee is more analogous to services. In holding the guarantee fee as interest has too many shortcomings, as it does not approximate the interest on a loan. It is merely a promise to possibly perform a future act and

[1] Lease Plan India Pvt. Ltd v. DCIT (ITA No. 6461 & 6462/Del/2015) - Taxsutra.com

[2] The Container Corporation v. Commissioner of Internal Revenue of United States Tax Court [134 T.C. 122 (U.S.T.C. 2010), dated 17 February 2010].

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there was no obligation to pay immediately. Thus, the guarantee fee cannot be considered as an interest. However, it was held to be a service.

In view of this, the Tribunal held that in absence of provision of capital and any debt claim between the parties, the guarantee fees paid by the taxpayer to the holding company cannot be held to be 'interest' in terms of Article 11 of the tax treaty.

Taxability of guarantee fee as FTS under the tax treaty

Looking at the nature of services provided by the holding company as guarantee, it was a financial service and cannot called a 'consultancy service'. Even otherwise, it does not satisfy the 'make available' test under Article 12(5)(b) of the tax treaty. Therefore, the Tribunal held that provision of guarantee fees related services are not FTS under Article 12 of the tax treaty.

Business income

Guarantee fees was not chargeable to tax as business income in absence of a PE of the Netherlands entity in India.

Taxability of guarantee fees under other income article of the tax treaty

The taxpayer relied on a decision in case of Johnson Matthey Public Ltd.[3] where it was held that guarantee fees paid by the taxpayer was not interest, nor FTS and also not business income. However, it was chargeable to tax under 'other income' Article of the tax treaty. In the absence of any specific provision dealing with corporate/bank guarantee recharge, the same has to be taxed in India as per the provisions of the Act.

However, the above decision was under the India-UK tax treaty where 'other income' article exist. The Tribunal in the instant case was dealing with India-Netherlands tax treaty and it does not have article for 'other income'.

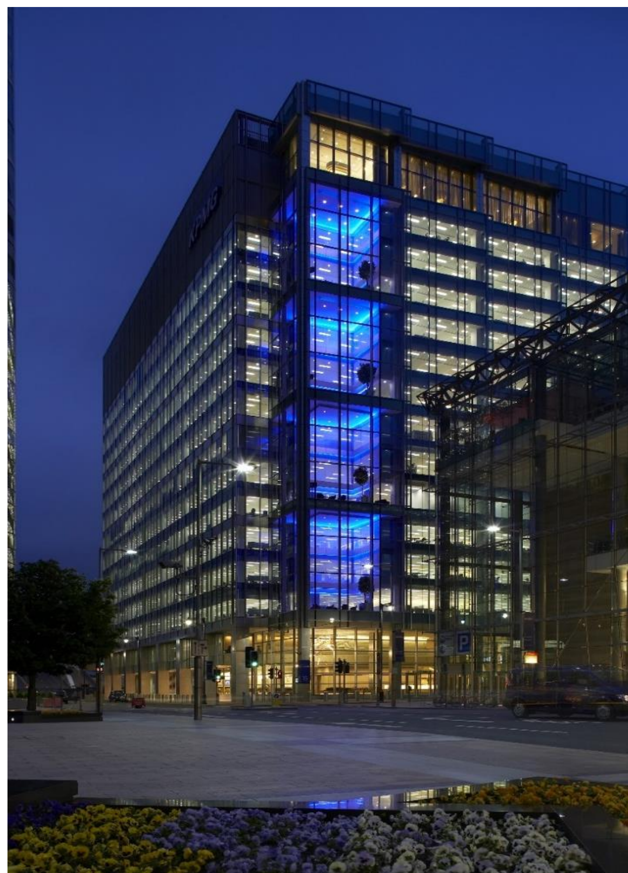
Our comments

The issue with respect to the taxability of corporate/bank guarantee fees received by a foreign holding company from an Indian group company has been a matter of debate before the Courts/Tribunal.

The Delhi Tribunal in the case of JC Decaux S.A.[4] held that corporate guarantee fees received by a foreign company from its Indian-AE was not taxable as FTS under the Act or tax treaty. Further, the Mumbai Tribunal in the case of Capgemini S.A.[5] held that guarantee commission received by a foreign company did not accrue in India nor it can be deemed to be accrued in India, therefore, not taxable in India under the Act. Further, as per Article 23(3) of India-France tax treaty, income can be taxed in India, only if it arises in India. The Mumbai Tribunal held that the income arises in the overseas country since the guarantee was given by the foreign taxpayer in the foreign country and, therefore, Article 23(3) of the India-France tax treaty does not apply as income does not arise in India.

However, the Delhi Tribunal in the case of Johnson Matthey Public Ltd. Company held that the bank guarantee commission was accrued to and received by the taxpayer in India. The corporate/bank guarantee fees received from an Indian subsidiary are taxable under the 'other income' article.

In the present case, the Tribunal while distinguishing the decision in the case of Johnson Matthey Public Ltd. observed that the India-Netherlands tax treaty does not have article for 'other income'.



[3] Johnson Matthey Public Ltd. Company v. DCIT [2017] 88 taxmann.com 127 (Del)
[4] JC Decaux S.A. v. ACIT [2020] 116 taxmann.com 408 (Del)
[5] Capgemini SA v. DCIT [2016] 160 ITD 13 (Mum)

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