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TAX FLASH NEWS

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Consultancy services are not taxable as FTS in view of MFN clause under the India-Sweden tax treaty

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of SCA Hygiene Products AB[1] held that in view of the Most Favoured Nation[2] (MFN) clause under the India-Sweden tax treaty, the restricted scope i.e. 'make available' clause provided under Article 12(4)(b)[3] of the India-Portuguese tax treaty would apply to the India-Sweden tax treaty (tax treaty). Therefore, the consultancy services provided by the taxpayer to an Indian entity are not taxable as Fees for Technical Services (FTS) in India.

Facts of the case

The taxpayer is a company incorporated, and fiscally domiciled, in Sweden. It has a subsidiary in India (SCA Hygiene India). The taxpayer rendered the following project consultancy services:

- Plan and steer execution of all the work to establish the factory;
- Responsible for all activities until machines are runing at a target level and taken over by local manufacturing management;
- Responsible to manage project spending within thebudget;
- Leading the project team consisting of both locl resources and resources supporting from other locations within SCA; etc.

The taxpayer claimed that in view of the MFN clause under the tax treaty, the restricted scope provided in India Portugal tax treaty is applicable to the tax treaty. As per the India-Portugal tax treaty FTS are not taxable unless technical services 'make available' technical knowledge, experience, skill, knowhow or process. The AO did not accept the taxpayer's contention for the invocation of MFN clause under the tax treaty and held that the services are taxable under the tax treaty. The DRP upheld the order of the AO.

Tribunal decision

Applicability of MFN clause and taxability of consultancy services as FTS

The implementation of the MFN clause is not always in a homogenous manner. There are different ways in which the MFN clause can be implemented. There are three different modes in which the MFN clause can be implemented i.e. first, as in India-Switzerland tax treaty, where all that the MFN clause ensures is that the negotiations take place, without any delay, to ensure that the same treatment is provided to the treaty partner. Secondly, under the India-Philippines tax treaty, where the information, about a more generous treatment for any another tax jurisdiction, by one of the treaty partners is to be provided to the other treaty partner, through diplomatic channels, so that existing provisions can be brought at par with more generous tax treatment in the source jurisdiction. Thirdly, the tax treaty does not prescribe anything further that is required to be done, for giving effect to the MFN status.

In the present case, as per the MFN clause under the tax treaty, the action of limiting the source taxation, for dividends, interest, royalties or FTS, to any other OECD member jurisdiction, by itself, is enough to trigger the MFN clause and the subsequent beneficial provisions 'shall also apply' under the tax treaty. No further actions on the part of India are envisaged in the tax treaty to trigger the application of the MFN clause under the tax treaty.

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[1] SCA Hygiene Products AB v. DCIT (ITA No. 7315/Mum/2018) – Taxsutra.com The Tribunal dealt with many issues in this decision. However, only issue relating to MFN has been captured in this flash news.

[2] Some of the Indian tax treaties include MFN clause to grant a benefit of a restricted scope and/or a reduced tax rate available in a subsequent beneficial tax treaty

[3] The India-Portuguese tax treaty has the 'make available' clause which restricts the taxation of FTS. It provides that FTS are taxable only when services 'make available' technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or technical design which enables the person acquiring the services to apply the technology contained therein

The Tribunal in the case of ITC Ltd[4] observed that the benefit of lower rate or restricted scope of FTS under the India-France tax treaty is not dependent on any further action by the respective governments.

However, when an identical issue, in the case of India-France tax treaty itself, came up before the AAR, in the case of Steria India Ltd[5], different approach was adopted by the AAR. The AAR held that the effect of the protocol clause is to be given by a formal notification, and unless that happens, the protocol is toothless. However, this position has been reversed by the Delhi High Court in the case of Steria India Ltd[6]. The views so expressed by the Delhi High Court, in the absence of anything contrary thereto by jurisdictional High Court, or, for that purpose, even any other High Court, bind the Tribunal. Further, the AAR ruling does not constitute binding judicial precedents for the Tribunal.

It is also not in dispute that Portugal is an OECD jurisdiction. The India-Portuguese tax treaty was entered into after the tax treaty, and it provides far more restricted scope of FTS. It adopts the 'make available' clause which restricts the taxation of FTS. Therefore, following the decision in the case of ITC Ltd, which has been specifically approved by the Delhi High Court in the case of Steria India Ltd, the Tribunal held that the provisions of Article 12(4)(b) of the India-Portuguese tax treaty, being more restricted in scope vis-à-vis Article 12(3)(b) of the tax treaty, apply to the tax treaty as well.

The consultancy services are in the nature of leading the setting up of factory, including planning and steering execution of work, being responsible for managing project within budget constraints, etc. Just because the taxpayer renders these services does not mean, and by no stretch can imply, that the recipient can next time do all this work without recourse to the taxpayer. In any case, just because the Indian entity is interacting with the project leader and getting inputs from him does not mean that the Indian entity is transferred the technology of being a project leader of this type and next time Indian entity can perform similar services without recourse to the same which is the core test for the fulfilment of 'make available' clause. In the present case, the make available clause is not satisfied, in the course of rendition of services by the taxpayer, and, as such, the consultancy fees cannot be brought to tax, in the hands of the taxpayer, under Article 12 of the tax treaty.

Our comments

The issue with respect to the interpretation of MFN clause vis-à-vis taxability of FTS has been a subject matter of debate before the Courts/Tribunal.

The Delhi High Court in the case of Steria (India) Ltd. held that the payment for managerial services cannot be taxed as FTS in view of the MFN clause under the India-France tax treaty. The High Court observed that the MFN clause given in the protocol to the tax treaty cannot be interpreted restrictively. The definition of FTS provided in Article 13(4) of India-UK tax treaty excludes managerial services. Therefore, applying the MFN clause under the India-France tax treaty read with the definition of FTS under the India-UK tax treaty, 'managerial services' will be outside the ambit of FTS.

The Tribunal in IATA BSP India[7] held that the restricted scope with respect to FTS under the India-USA and India-Portuguese tax treaties, was applicable to the India-France tax treaty, by virtue of MFN clause in the India-France tax treaty. Accordingly, the services did not make available technical knowledge, skills, etc., and the same were not taxable as FTS under the India-France tax treaty. Further, the Ahmedabad Tribunal in the case of Cadila Health Care Ltd[8] had provided the benefit of the 'make available' clause under the India-Canada and India-U.S.A. tax treaties to the taxpayer in view of MFN clause under the India-Belgium tax treaty.

The Kolkata Tribunal in the case of ITC Ltd observed that the benefit of lower rate or restricted scope of FTS under the India-France tax treaty is not dependent on any further action by the respective governments.

The Mumbai Tribunal in the instant case has held that in view of the MFN clause under the India-Sweden tax treaty, the restricted scope i.e. 'make available' clause provided under Article 12(4)(b) of the India-Portuguese tax treaty would apply to the India-Sweden tax treaty. Therefore, the consultancy services provided by the taxpayer to an Indian entity are not taxable as FTS in India.

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[4] DCIT v. ITC Ltd [2002] 82 ITD 239 (Kol)
[5] Steria India Ltd [2014] 72 taxmann.com 1 (AAR)
[6] Steria India Ltd v. CIT [2016] 72 taxmann.com 1 (Del)
[7] DDIT v. IATA BSP India (ITA No. 1149/Mum/2010) (Mum)
[8] ITO v. Cadila Health Care Ltd [2017] 78 taxmann.com 330 (Ahm)

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