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TAX FLASH NEWS

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

Recently, the Pune Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Sandvik AB[1] held that in view of the Most Favoured Nation (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[2] would apply to the India-Sweden tax treaty (tax treaty). Therefore, the consideration for training services provided by the taxpayer to its associate company cannot be taxed as 'Fees for Technical Services' (FTS). The Tribunal observed that once two sovereign states have added Protocol to the India-Sweden tax treaty which contains the MFN clause, the inference could be drawn is that the beneficial provisions contained in the India-Portuguese tax treaty is to be read in the tax treaty.

With respect to the taxability of training fees under 'business profits' Article of the tax treaty, the Tribunal held that the taxpayer did not have any Permanent Establishment (PE) in India, and thus it could not be taxed as business profits.

Facts of the case

The taxpayer is a Sweden based company received training fees from its Indian associate company. The taxpayer contended that by virtue MFN clause under the tax treaty, it was eligible for the restricted scope provided i.e. make available clause under the India-Portuguese tax treaty. Thus, the training fees were not chargeable to tax as FTS.

The Assessing Officer (AO) denied the benefit of MFN clause and rejected the contention of the taxpayer for entitlement to the limited scope of the term FTS as given in the India-Portuguese tax treaty. The AO relied on AAR ruling in the case of Perfetti Van Melle Holding B.V.[3] and observed that the services rendered by the taxpayer were in the nature of managerial, technical or consultancy services under Article 12(3)(b) of the tax treaty. Services were technical in nature, which made available the technical knowledge and hence it was taxable as FTS under Article 12 of the tax treaty. The Dispute Resolution Panel (DRP) upheld the order of the AO.

Tribunal's decision

Whether benefit of India-Portuguese tax treaty can be allowed in terms of MFN clause

The AAR in the case of Perfetti Van Melle Holding B.V. held that a tax treaty is a contract between two sovereign countries, and any diversion from it, will need the consent of both the contracting states. Further, a contract with a certain country cannot be used to interpret a separate independent contract with another country. It also held that the Protocol attached to a tax treaty no doubt should be looked into for finding the meaning of an expression used in the tax treaty, but to refer to a tax treaty to which two countries are not parties, would not be appropriate. Similar view was reiterated by the AAR in the case of Steria (India) Ltd.[4] Subsequently, the AAR ruling in the case of Steria (India) Ltd. was challenged before the Delhi High Court. The Delhi High Court overruled the AAR ruling and held that Protocol is a part of the tax treaty and there is no need for separate notification incorporating the beneficial provisions of the other tax treaty as forming part of the tax treaty to which the Protocol is attached.

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[1] Sandvik AB v. DCIT (ITA No.2524/PUN/2017) – Taxsutra.com

[2] 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

[3] Perfetti Van Melle Holding B.V., in Re [2012] 342 ITR 200 (AAR)

[4] Steria (India) Ltd. 2014 364 ITR 381 (AAR)

Further Perfetti Van Melle Holding B.V. ruling has also been overruled by the Delhi High Court[5]. Thus, there is a substance in the contention of the taxpayer that once two sovereigns have added Protocol to the India-Sweden tax treaty which contains the MFN clause, the inference could be drawn is that the beneficial provisions contained in the India-Portuguese tax treaty is to be read in the India-Sweden tax treaty.

Whether training fee a consideration for rendering managerial services

The meaning of the term FTS as given in Article 12(3)(b) of the tax treaty, includes, inter alia, consideration for managerial services, which is contrary to the taxpayer's stand. The Tribunal observed that the philosophy of equating the nature of training with the rendition of the same nature of service is unfounded. Ordinarily, training is conceived as passing on of some proficiency by the trainer to the trainee. It simply leads to honing-up the skills of the other in the subject, which patently cannot be termed as an equivalent of rendering service in that field.

For instance, acquainting someone in a formal manner with techniques to boost sales does not stand at par with rendering marketing services. Rendition of marketing services takes place when marketing activities are actually undertaken for and on behalf of an organisation by practically plunging into the field or doing some activity concerning the marketing. In fact, doing the activity is synonymous with rendering of service of that nature. Simply equipping or enabling the others for doing an activity is a step anterior to rendition of such services. The Tribunal held that rendering leadership training to employees of associate company cannot be said as rendering managerial services.

If training fee is not FTS, whether it can be taxed as business profit

Training fees received by the taxpayer is neither in the nature of consideration for managerial service nor consultancy or technical services. Though, the amount does not fall within the purview of FTS under Article 12 of the tax treaty read with its Protocol which contains MFN, it cannot be said that its taxability is ousted.

There are other Articles in the tax treaty incorporating the basis for inclusion of a particular income in the total income. Article 7 states that the profits of an enterprise of a contracting state shall be taxable only in that State unless the enterprise carries on business in the other contracting state through a permanent establishment (PE) situated therein. If the enterprise carries on business as aforesaid the profits of the enterprise may be taxed in the other state but only so much of them as are attributable to that PE. Article 7(6) makes it graphically clear that where profits include items of income which are dealt with separately in other Articles of the tax treaty, then the provisions of those Articles shall not be affected by the provisions of this Article. In other words, if a particular income is covered within the Article 12 and not Article 7. Only if the income does not get covered under Article 12, that it will revert for consideration under Article 7 of 'Business profits' subject to the enterprise carrying on business in the other State through a PE as defined in Article 5.

In such a scenario, the profits of the enterprise of Sweden may be taxed in India but only so much as are attributable to its PE in India. It has been observed that the taxpayer characterised the receipt of training fee as a consideration for 'managerial' services within the overall ambit of Article 12 and the tax department has also accepted the same as falling under that Article but as 'consultancy or technical' service. The Tribunal held that the training fee received by the taxpayer does not fall within the purview of Article 12 of the India-Portuguese tax treaty inasmuch as it is neither fees for managerial services on one hand nor consultancy or technical services on the other. Thus, the taxability of the same is required to be tested within the meaning of Article 7 read with Article 5 of the tax treaty.

The AO in its draft order has categorically observed that the provisions of Article 7 of taxing the business receipts in India do not apply as the taxpayer does not have a PE in India and consequently the profits from receipts from associate company cannot be taxed as `Business Income' is acceptable. Since the AO has himself accepted that the taxpayer did not have any PE in India, the amount of training fee will also escape tax net as it cannot be taxed as 'business profit' under Article 7 in the absence of there being any PE in India in terms of Article 5 of the tax treaty.

Our comments

The issue with respect to the availment 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. had 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 tax treaty read with the definition of FTS under the India-UK tax treaty, 'managerial services' will be outside the ambit of FTS.

However, AAR in some of the cases[6] had held that managerial services rendered by a foreign company to the applicant were taxable under Article 13(4) of the India-France tax treaty in spite of MFN clause provided under the French tax treaty.

[5] Perfertti Van Melle Holding. B.V. v. AAR [2014] 52 taxmann.com 161 (Del)

[6] Mersen India Private Limited [2013] 353 ITR 628 (AAR), Steria (India) Ltd. [2014] 45 taxmann.com 281 (AAR)

Recently, the Mumbai Tribunal in the case SCA Hygiene Products[7] held that in view of the MFN clause under the India-Sweden tax treaty, the restricted scope provided under Article 12(4)(b) of the India-Portuguese tax treaty would apply to the tax treaty. Therefore, the payment for services provided by the taxpayer to Indian entity do not tantamount to FTS and it was not taxable in India. The Tribunal in IATA BSP India[8] also 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, services were not making available technical knowledge, skills, etc., the same are not taxable as FTS under the India-France tax treaty. Further, the Ahmedabad Tribunal in the case of Cadila Health Care Ltd[9] has provided the benefit of 'make available' clause under the India-Canada and India-USA tax treaty to the taxpayer in view of MFN clause under India-Belgium tax treaty.

The Pune Tribunal in the present case has relied on the Delhi High Court decision in the case of Steria (India) Ltd. and held that in view of the MFN clause under 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 consideration for training services provided by the taxpayer to its associate company cannot be taxed as FTS.

[7] SCA Hygiene Products v. DCIT (ITA No. 7315/Mum/2018)
[8] DDIT v. IATA BSP India (ITA No. 1149/Mum/2010)
[9] ITO v. Cadila Health Care Ltd [2017] 78 taxmann.com 330 (Ahd)

KPMG in India addresses:

Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House, Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Embassy Golf Links Business Park,
Pebble Beach, 'B' Block,
1st & 2nd Floor,
Off Intermediate Ring Road, Bengaluru – 560071
Tel: +91 80 6833 5000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2, Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000

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KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011
Phone: +91 22 3989 6000, Fax: +91 22 3983 6000