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Payment for managerial services cannot be taxed as Fees for Technical Services on application of MFN clause under the India-France tax treaty

Background

Recently, the Delhi High Court in the case of Steria (India) Ltd.[1] (the taxpayer) held that payment for managerial services cannot be taxed as Fees for Technical Services (FTS) in view of the Most Favoured Nation (MFN)[2] clause under the India-France tax treaty (tax treaty). Accordingly, the said payments are not subject to withholding of tax under Section 195 of the Income-tax Act, 1961 (the Act).

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-U.K. tax treaty excludes managerial services. Therefore, applying the MFN clause under the tax treaty read with the definition of FTS under the India-U.K. tax treaty, 'managerial services' will be outside the ambit of FTS. The High Court held that the Authority for Advance Ruling (AAR) is unsustainable in law.

Facts of the case

- The taxpayer is a public limited company registered in India providing IT driven services for its clients' core businesses. The taxpayer is assessed to tax as a resident in India.
- Steria France is a non-resident company incorporated in France as a limited liability partnership. Steria France centralises technical skills for carrying on management functions such as legal finance, human resources, communication risk control, information systems, controlling and consolidation, delivery and industrialisation, technology and management information services. Steria France does not have any office presence or personnel in India and neither a Permanent Establishment (PE) in India.
- The taxpayer entered into a management service agreement with Steria France. Under the said agreement, Steria France was to provide various management services to the taxpayer with a view to rationalise and standardise the business conducted by the taxpayer in India. Services under the broad category of general management services included corporate communication services, group marketing services, development services, information system and services, legal services, human relation services, etc. These services are provided by Steria France through telephone, fax, e-mail, etc. and no personnel of Steria France visited India for providing such services.
- The taxpayer filed an application before the AAR seeking a ruling on whether the payment made for the management services provided by Steria France is taxable in India in the hands of Steria France under the tax treaty. Further, if the payment is not subject to tax in the hands of Steria France in India, whether Steria India will be liable to withhold tax under Section 195 of the Act.

[1] Steria (India) Ltd v. CIT (W.P. (C) 4793/2014 & CM Appeal 9551/2014) (Delhi High Court) – Taxsutra.com

[2] MFN clause under the tax treaty - In respect of dividends, interest and royalties, fees for technical services and payments for the use of equipment, if under any convention, agreement or Protocol signed after 1-9-1989 between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, fees for technical services or payments for the use of equipment to a rate lower or a scope more restricted than the rate of scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items income shall also apply under this Convention, with effect from the date on which the present Convention or the relevant Indian Convention, Agreement or Protocol enters into force, whichever enters into force later

- Before the AAR, the taxpayer contended that as per the Protocol to the tax treaty, the less restrictive definition of the expression FTS appearing in India-U.K. tax treaty, must be read as forming part of the tax treaty as well.

- The AAR ruled that the Protocol could not be treated as forming part of the tax treaty itself. The restrictions imposed by the Protocol were only to limit the taxation at source for the specific items mentioned therein. The restriction was only on the rates. Further, the 'make available' clause provided in the India-U.K. tax treaty could not be read into the expression FTS occurring in the tax treaty unless there was a notification under Section 90 of the Act issued by the Central Government to incorporate the less restrictive provisions of the India-U.K. tax treaty into the tax treaty.

- Aggrieved by the AAR ruling, the taxpayer filed a writ petition before the Delhi High Court.

High Court ruling

Protocol to the India-France tax treaty

- On a perusal of Clause 7[3] of the Protocol of the tax treaty, the High Court finds no warrant for the restrictive interpretation of the Protocol. The words 'a rate lower or a scope more restricted' occurring in the Protocol envisages that there could be a benefit on either score i.e. a lower rate or more restricted scope. One does not exclude the other.

- The benefit of Protocol could accrue in terms of lower rate or a more restrictive scope under more than one tax treaty which may be signed after 1 September 1989 between India and a third State which is an OECD member.

- The purpose of the Protocol is to afford a party to the tax treaty the most beneficial provisions that may be available in another tax treaty between India and another OECD country. The AAR has failed to notice the wording of the Protocol makes it self-operational.

- It is not in dispute that the tax treaty was itself notified by the Central Government by issuing a notification under Section 90 of the Act. It is also not in dispute that the separate Protocol signed between India and France simultaneously forms an integral part of the tax treaty itself.

- Once the tax treaty has itself been notified and contains the Protocol, there was no need for the Protocol itself to be separately notified or for the beneficial provisions in some other tax treaty between India and another OECD country to be separately notified to form part of the tax treaty. The taxpayer has correctly relied on the Klaus Vogel commentary on 'Double Taxation Conventions'.

Availability of benefit of the India-U.K. tax treaty by virtue of MFN clause

- The definition of FTS occurring in Article 13(4) of the India-U.K. tax treaty excludes managerial services. In the present case, Steria France has provided managerial services to the taxpayer in terms of the management services agreement. Once the expression 'managerial services' is outside the ambit of FTS, then the question of withholding of tax on payment for the managerial services, would not arise. Therefore, it was not necessary for the Court to further examine the second part[4] of the definition.

- The Tribunal in the case of ITC Ltd.[5] had held that the benefit of a lower rate or restricted scope of FTS under the India-France tax treaty was not dependent on any further action by the respective governments. It was held that the more restricted scope of FTS as provided for in a tax treaty entered into by India with another OECD member country should also apply under the India-France tax treaty with effect from the date on which the India-France tax treaty or such other tax treaty enters into force.

- The payment made by the taxpayer for the managerial services provided by Steria France cannot be taxed as FTS under the tax treaty. Accordingly, the said payments are not subject to withholding of tax under Section 195 of the Act.

- The High Court held that the AAR ruling is unsustainable in law.

[3] MFN clause

[4] Whether any of the services envisaged under Article 13(4) of the India-UK tax treaty are 'made available' to the taxpayer by the tax treaty with France

[5] DCIT v. ITC Ltd. [2002] 82 ITD 239 (Kol)

Our comments

The issue before the AAR in the taxpayer's case was whether on an application of the MFN clause contained in the Protocol to the India-France tax treaty, the narrower scope of the definition of FTS as available in the India-U.K. tax treaty can be applied. The AAR held that payment for management services would be taxable as FTS in spite of MFN clause provided under the tax treaty. The AAR observed that a Protocol cannot be treated as the same with the provisions of the tax treaty itself, though it may be an integral part of the tax treaty.

Similarly, the AAR in the case of Mersen India Private Limited[6] held that managerial services are taxable as FTS in spite of MFN clause provided under the tax treaty. The AAR held that 'make available' concept is applicable only to technical and consultancy services and not to the 'managerial services' since the comparative tax treaty does not include managerial services.

The Delhi High Court while holding that the AAR ruling is unsustainable in law observed that the restrictive interpretation cannot be made in the Protocol. The High Court also clarifies that MFN can lead to availment of benefits under more than one tax treaty. Further, the Protocol is an integral part of the tax treaty, and MFN Clause is self-operational.

The Karnataka High Court in the case of ISRO Satellite Centre[7] held that by virtue of the Protocol of the India-France tax treaty, the beneficial clause in the India-USA tax treaty entered by India applies in respect to the India-France tax treaty. Similarly, the Pune Tribunal in the case of Sandvik AB[8] applied MFN clause under the India-Sweden tax treaty and held that on the basis of the Protocol to the India-Sweden tax treaty, the taxpayer can claim the benefit of the conditions imposed for bringing to tax the FTS in the India-Portuguese tax treaty.

The AAR in the case of Poonawalla Aviation Pvt Ltd[9] dealt with the MFN clause under the India-France tax treaty and applied the beneficial and restrictive interest clause from Canada, Hungary and Ireland tax treaty with India. The MFN clause has not been applied merely to restrict the scope of the definition, but it has been extended to apply for the purpose of exemption clause under the India-France tax treaty. The AAR has also taken a similar approach in the case of Idea Cellular Ltd[10] where the beneficial exemption clause under India-Ireland tax treaty has been applied by placing reliance on MFN clause under the India-Sweden tax treaty.

This is an important ruling on the interpretation of MFN clause exists under some of the Indian tax treaties. It appears that the approach of the Delhi High Court in the present case gives full effect to the intention behind the introduction of MFN clause under the tax treaty.

[6] Mersen India Private Limited [2013] 353 ITR 628 (AAR)
[7] CIT v. ISRO Satellite Centre [2013] 35 taxmann.com 352 (Kar)
[8] Sandvik AB v. DDIT [2015] 70 SOT 551 (Pune)
[9] Poonawalla Aviation Private Limited [2012] 343 ITR 202 (AAR)

[10] Idea Cellular Limited [2012] 343 ITR 381 (AAR)

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