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Benefit of restricted scope of FTS provided under India-Portuguese tax treaty cannot apply automatically to India-Switzerland tax treaty

Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Torrent Pharmaceuticals Ltd[1] (the taxpayer) observed that the restricted scope of Fees for Technical Services (FTS) by virtue of Protocol[2] to the India-Switzerland treaty (tax treaty), in a subsequent tax treaty between India and other OECD country cannot be read into the tax treaty. Therefore, the 'make available' clause, though not present in the tax treaty, but contained in India-Portuguese tax treaty cannot be invoked. The Tribunal observed that the Protocol only allows for re-negotiation of the clauses in the tax treaty if more liberal subsequent tax treaty has been signed with the OECD country. Till the tax treaty is actually re-negotiated and approved, 'make available' limitation provided in the India-Portuguese tax treaty cannot apply to Swiss remittances. Accordingly, it has been held that payments to a Switzerland based company for technical/consultancy service constitutes FTS under the tax treaty.

With respect to payments made to entities based out from USA and Canada, the Tribunal observed that payees did not 'made available' their expertise and technical knowhow thereby enabling it to use the same independently without their assistance. These payees have merely rendered consultancy services without imparting any knowledge. Therefore, it cannot be treated as FTS under the respective tax treaties[3].

Facts of the case

- The taxpayer is engaged in the business of manufacturing and marketing of pharmaceutical products. During the year under consideration, the taxpayer remitted payments to overseas payees located in Switzerland, Canada and U.S.A. without deducting any tax at source.
- The Assessing Officer (AO) passed withholding of tax order under Section 201 and interest under Section 201(1A) of the Income-tax Act, 1961 (the Act) holding that the remittances were in the nature of royalty/technical services covered by deeming fiction under Section 9(1)(vi) and 9(1)(vii) of the Act. The AO relied on respective tax treaties contending that payees had not 'made available' any technical knowhow as well.
- The Commissioner of Income-tax (Appeals) [CIT(A)] held that payment made to Canadian and U.S.A. residents were not taxable in India. However, payment made to Swiss remittances is liable to tax in India.

[1] ITO v. Torrent Pharmaceuticals Ltd (ITA No. 624/Ahd/2012C) – Taxsutra.com

[2] As per the Protocol to the tax treaty - If after the date of signature this amending Protocol, India under any Convention, Agreement or Protocol with a third state which is a member of the OECD, restricts the scope in respect of royalties or FTS than the scope for these items of income provided for in Article 12 of this Agreement, then Switzerland and India shall enter into negotiations without undue delay in order to provide the same treatment to Switzerland as that provided to the third State

[3] India-USA and India-Canada tax treaties contain 'make available' clause

Taxpayer's contentions

- The taxpayer contended that as per the Protocol to the tax treaty it is entitled to the benefit of 'make available' clause provided under the India-Portuguese tax treaty. Although 'make available' condition in respect of technical services is not explicitly contained in the tax treaty, the same is deemed to have been applicable by virtue of Protocol. The taxpayer relied on the decision of Sandvik AB[4].

Tribunal's ruling

Payment to Swiss entity

- There is no dispute about the fact that in case there exists a tax treaty in respect of any country, provisions of the Act shall apply to the extent they are more beneficial to such taxpayer and not otherwise. The Tribunal observed that there is no 'make available' clause present in the article of FTS under the tax treaty or Protocol. The said Protocol only postulates that India and Swiss shall enter into negotiation to this effect if former state enters into a tax treaty with a member of OECD state either reducing rate of tax or restricting the scope of specified categories of income.

- The decision relied upon by the taxpayer in the case of Sandvik AB is distinguishable to the facts of the present case since the said tax treaty contains a Protocol to the effect that in case India and an OECD member State enter into an agreement limiting taxation in case of various categories of income or restricted the rate and scope on the said items of income, similar rate or scope as provided for in that tax treaty shall apply under India-Sweden tax treaty. Accordingly, the taxpayer's argument is rejected.

Payment to Canadian and USA entity

- India-Canada, India-U.S.A. have entered into tax treaties which contains 'make available' clause with respect to the impugned services. The tax department failed to provide any evidence that taxpayer's payees in question based in Canada or U.S.A. have 'made available' their expertise and technical knowhow thereby enabling it to use the same independently without their assistance. These payees have merely rendered consultancy services without imparting any knowledge.

- Accordingly, the Tribunal upheld the CIT(A)'s order relying on various judicial precedents.

[4] Sandvik AB v. DDIT [2015] 167 TTJ 217 (Pune)

Our comments

Taxability of FTS vis-à-vis make available clause under the tax treaties has been a matter of debate before courts. Normally, the services are treated as 'made available' only if the technical knowledge or skills of the provider were imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without recourse to the provider. In various decisions[5] the courts have held that though services rendered were technical in nature, it would not be taxable under the tax treaties because the services did not make available the technical knowledge, skill, experience, etc.

India has entered into tax treaties with various countries i.e. Netherlands, Sweden, France, Spain, Hungary, etc. which contain MFN clause and do not require India to re-negotiate the tax treaty. However, the MFN clause in the Protocol to the India-Switzerland tax treaty provides that Switzerland and India shall enter into negotiations, subsequent to a more beneficial tax treaty entered into with other OECD country, in order to provide the benefit of reduced rate or restricted scope given in the subsequent tax treaty. In light of that the Tribunal in the present case observed that unless India actually re-negotiate and approve the tax treaty, 'make available' clause provided under the India-Portuguese tax treaty cannot apply to India- Switzerland tax treaty.

The Protocol to the India-Switzerland tax treaty has been amended[6] with effect from 1 April 2012 to provide that re-negotiation of the tax treaty is no longer required for availing the lower tax rate by virtue of the MFN clause. However, re-negotiation is still required to avail the benefit of a restricted scope of FTS under the tax treaty.

[5] ACIT v. WNS Global Service Private Ltd. [2011] 45 SOT 119 (Mum), Joint Accreditation System of Australia and New Zealand [2010] 326 ITR 487 (AAR), Federation of Indian Chamber of Commerce and Industry [2010] 323 ITR 399 (AAR)
[6] Notification No. 62/2011, dated 27 December 2011

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