AAR denies benefit of MFN clause under India-France tax treaty with respect to 'make available' clause

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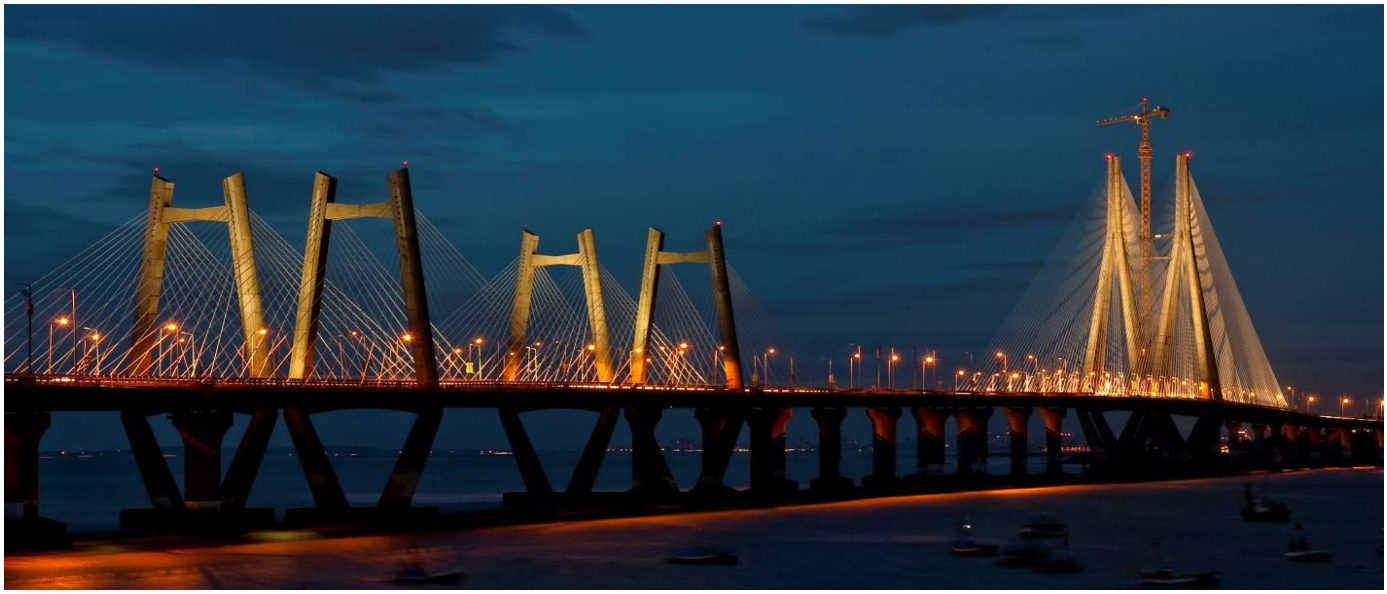

Background

Recently, the Authority of Advance Rulings (AAR) in the case of Steria (India) Ltd[1] (applicant) held that payment for management services will be taxable as Fees for Technical Services (FTS) under the India-France tax treaty (tax treaty) in spite of Most Favoured Nation (MFN) clause provided under the tax treaty The payments shall also be taxable under the Income-tax Act, 1961 (the Act). Consequently, the applicant is liable for withholding of tax under Section 195 of the Act.

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. As per the Protocol, the restrictions are on the rates and 'make available' clause cannot be read into it. The Notification ratifying the Protocol did not include anything about the 'make available' provision. Had the intention of the Protocol or Government been to include 'make available' clause in the tax treaty, it should have done so in the said Notification.

Facts of the case

- The applicant, a public limited company, is a tax resident in India and it is a leading provider of IT driven business services for its client's core business processes.
- Groupe Steria SCA (Steria France), a partnership firm, incorporated in France. It does not have any office or personnel based in India. It centralises technical skills to carry on management functions such as legal finance, human resources, communication risk control, information systems, controlling and consolidation, etc.
- The applicant entered into a Management Services Agreement (MSA) with Steria France whereby Steria France provides various management services to the applicant with a view to rationalise and standardise the business conducted by the applicant in India in accordance with the international best practices.

[1]Steria (India) Ltd. [2014] 45 taxmann.com 281 (AAR)

- As per the terms of agreement Steria France has to provide services in the nature of general management, corporate communications, finance, group marketing, internal audit, etc. through telephone, fax, e-mail etc. For rendering such services, no personnel of Steria France would visit India.
- The services provided by Steria France are not binding on the applicant and the applicant shall have the right to engage any other person to render any services that are similar to or duplicative of the services rendered by Steria France by virtue of the agreement.
- Only the applicant is intended to get benefit from these services and applicant's customers do not get any benefit of the services. The total amount charged by the Steria France from Steria India is based on cost plus mark up of 5 per cent and it is apportioned to various affiliates on revenue and number of head count basis.
- The applicant claimed that though there is no 'make available' clause in the India-France Treaty. The make available clause in the India-UK tax treaty, which was signed much after 1st September, 1989, is applicable in the India-France tax treaty by virtue of the protocol signed between India and France. The restricted scope of FTS in the India-UK tax treaty will, therefore, be applicable in the applicant's case. In absence of such 'make available' of the technical knowledge, experience, skill, know-how or processes, the services rendered by Steria France will not fall under the definition of technical services and hence will not be subjected to tax in India.
- The tax department claimed that there is no requirement of 'make available' under Article 13 of the tax treaty and therefore, the services rendered by Steria France falls under the broad definition of technical services under the tax treaty and the Act.

AAR ruling

- There was no dispute that the services rendered by Steria France are technical services as defined in the Act and the tax treaty.
- In the case of Perfetti Van Melle Holding B.V.[2], the AAR held that the Memorandum of Understanding (MOU) under the India-USA tax treaty cannot be utilised in interpreting the tax treaty of India and Netherlands.
- The Protocol cannot be treated as the same with the provisions contained in the tax treaty itself, though it may be an integral part of the tax treaty. The Protocol provides India to limit its taxation at source for the detail items mentioned therein. The restrictions are on the rates and 'make available' clause cannot be read in the items.
- On the basis of the Protocol[3], as amended by Notification[4] it is observed that the said Notification does not include the 'make available' clause. Had the intention of the Government is to include 'make available' clause in the India-France tax treaty, it should have been done so in the said Notification.
- Perusal to the Notification issued in the case of India-Netherlands tax treaty[5] it is observed that the changes in the tax treaty on the basis of the Protocol were given effect by Notification only.
- Tax treaties are between two sovereign nations and every country has a particular relation with another countries and same treatment are not given to all the countries. For e.g. definitions of FTS are more restrictive with some countries than the others. Every tax treaty has particular purpose depending on the relationship between the two countries.
- Ordinary meaning of the tax treaties should be given while interpreting the provision of the tax treaties. Even to the extent of liberal interpretation of the tax treaty, the 'make available' clause cannot be imported as there is no change in tax complexion of the tax treaty provision.
- Protocol or MOU can be used for interpreting provision of the tax treaty, it will not be correct to import words, phrases or clause that is not available into the tax treaties between two Sovereign nations, on the basis of tax treaties with another countries.
- In the present case, India is under obligation as per the terms of the Protocol to limit its tax rate or rate of scope as was done in the Notification. However, such type of action will not be within the purview of the AAR.

[2]Perfetti Van Melle Holding B.V. [2012] 204 Taxman 166 (AAR)

[3]Notification No. GSR 681(E), dated 7 September 1994

[4]Notification No. 11438 [SO 650(E), (F.No.501/16/80-FTD)], dated 10 July 2000

[5]Whereby the Protocol was given effect to

- India-UK tax treaty signed in 1993 omitted managerial services and consequently, by virtue of Protocol in the tax treaty, the managerial services rendered by the applicant in the present case cannot be said to be omitted from the definition of FTS under the India-France tax treaty.
- Accordingly, the payment for services rendered by the applicant will fall within the definition of FTS both under the Act and the tax treaty and is liable to tax in India.

Our Comments

The AAR in the present case has also referred to its own decision in the case of Perfetti Van Melle Holding B.V. where the AAR has observed that a Memorandum of Understanding accompanying or supplementing the India-US tax treaty cannot be used as an aid to understand the terms of the India-Netherlands tax treaty. In the instant case however, it is the Protocol to the India-France tax treaty which has been used as an aid to interpret the tax treaty and this approach to interpret the tax treaty has also been concurred by the AAR in the case of Perfetti Van Melle Holding B.V. while interpreting the India-Netherlands tax treaty.

The AAR has further observed that a Protocol cannot be treated as the same with the provisions contained in the treaty itself, though it may be an integral part of the tax treaty. It would however be pertinent to note that the Karnataka High Court in the case of ISRO Satellite Centre[6] has 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.

The AAR in the case of Poonawalla Aviation Pvt Ltd[7] 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 French tax treaty. The AAR has also taken a similar approach in the case of Idea Cellular Ltd[8] 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.

It appears that the approach of the AAR in the Poonawalla's case and Idea Cellular's case gives full effect to the intention behind introduction of MFN clause under the respective tax treaty.

The entire purpose of a Most Favoured Nation (MFN) clause is to grant a benefit of a restricted scope and/or a rate to a treaty country by providing the MFN clause in the treaty or in the Protocol. Further the benefit of the MFN clause with respect to applicability of 'make available' clause in the subsequent treaty should be available under the India-France tax treaty.

Although the rulings of the AAR are binding only on the applicant, it could have a persuasive value on taxability of similar transactions for other taxpayers.

[6]CIT v. ISRO Satellite Centre [2013] 35 taxmann.com 352 (Kar)
[7]Poonawalla Aviation Private Limited [2012] 343 ITR 202 (AAR)
[8]Idea Cellular Limited [2012] 343 ITR 381 (AAR)

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