DCITv.Sun Pharmaceutical Laboratories Ltd.

[2018] 96 taxmann.com 105 (Ahd)

MFN Clause and scope of seeking declaration from CIT(A) under amended provisions of section 248 explained.

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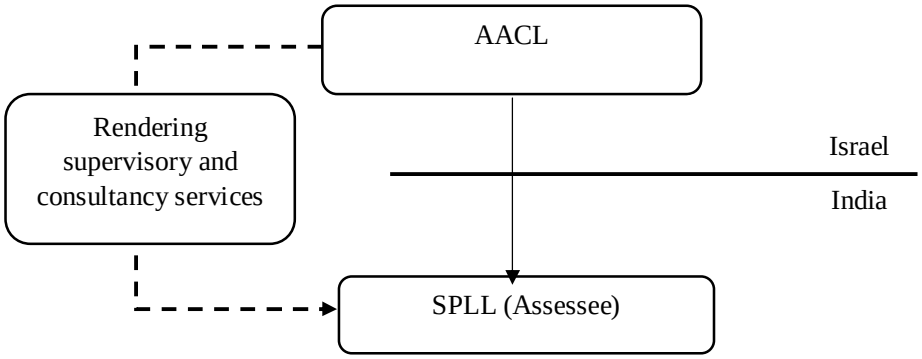
1. Facts:



a. The assessee, SPLL, is a large pharmaceutical Indian company. During the AY[1]s 2014-15 and 2015-16, the assesseeavailed supervisory and consultancy services from an Israeli company (AACL), which also involved the technical knowledge and skills of AACL.

b. The definition of 'fees for technical services' under the Indo-Israel treaty does not contain 'make-available clause'. However, the Protocol to the treatycontains the Most Favoured Nation (MFN) clause which provides that in the event India enters into any tax treaty, after January 1, 1995, in which India restricts its source taxation of, *inter alia*, fees for technical services "to a rate lower or a scope more restricted than the rate or scope provided for" in the Indo-Israel tax treaty, the same rate or scope as provided for in the said treaty shall also apply under Indo-Israel tax treaty with effect from the date on which the Indo-Israel or such other tax treaty comes into force, whichever is later.The Indo-Israel tax treaty, as also the Protocol, were signed on January 29, 1996, and subsequent thereto, the Indo-Portugal treaty has come into

[1] Assessment Year

force with effect from June 16, 2000, under which the Fees for Technical Services (FTS) clause included the 'make available' clause.

c. Accordingly, seeking relief under the MFN Clause, read with the definition of FTS under the Indo-Portugal treaty, the assessee procured a Chartered Accountant's certificate u/s 195 of ITA[2], confirming that the payment was not subject to TDS[3]. Yet, out of abundant caution, the assessee deducted TDS before making payment to AACL. Under the terms of the arrangement between the assessee and AACL, the assessee was liable to bear tax liability, if any, arising in India in respect of said services.

d. Subsequently, the assessee filed an appeal before the CIT(A) u/s 248 seeking a declaration that no tax was deductible on technical fees paid to AACL, in view of the Protocol to the Indo-Israel tax treaty read with the Indo-Portugaltax treaty.

e. The CIT(A) passed an order in favour of the assessee against which the department filed an appeal to the Hon'ble Tribunal.

2. Issues under consideration before the Tribunal

a. Whether an assessee can go in appeal u/s. 248 when statutorily he has no obligation to withhold tax at source and yet he proceeded to withhold the taxes?

b. Whether the assessee was entitled to the benefit of the Protocol to Indo-Israel tax treaty, which laid down the MFN clause?

c. Whether services provided by AACL to the assessee were in the nature of "Fees for Technical/Included Services" and consequently taxable in India?

3. Revenue's contentions

The Revenue filed an appeal before the ITAT with the following arguments:

[2] Income tax Act, 1961
[3] Tax Deducted at Source

a. CIT(A) had wrongly admitted the appeal u/s. 248 and given a direction in favour of the assesseewithout providing an opportunity of being heard to the Revenue.

b. MFN clause in the Indo-Israeli tax treaty is only an enabling provision and cannot, in the light of another DTAA entered into subsequently by an OECD Member jurisdiction i.e. Portugal in this case, automatically alter the FTS clause in the said treaty.

c. Services rendered by AACL tothe assesseedid, in fact, make available technical knowledge, experience, skill and know how.

4. Assessee's contentions

a. The FTS[4] clause of the Indo-Israel treaty is to be read along with the Protocol to said treaty which lays down the MFN clause. Accordingly, the assessee is entitled to benefit of the "make available" provisions, under Indo-Portugal tax treaty executed after the date of Protocol to the Indo-Israel treaty.
b. Given the nature of services rendered, nothing is 'made available' to the assessee and the assesseeis not enabled to perform these services without recourse to AACL.

5. Held:

The ITAT dismissed the appeal of the department and held in favour of the assesseemaking following observations:

a. After amendment in section 248 of the ITA vide the Finance Act, 2007 with effect from June 1, 2007, an assessee can file an appeal to the CIT(A) seeking declaration that no tax is deductible under section 195, if the following two conditions are satisfied:
   (i) The personmaking the payments should, under an agreement or other arrangement, be liable to bear the TDS on any income paid to the non-resident. In other words, unless a person bears the tax liability of the recipient,

[4]Fees for Technical Services

by agreement or otherwise, he does not have a right to appeal under section 248.

(ii) The person should havededucted and paid the TDS to the credit of the Central Government.

The ITAT accordingly held that as long as a person making payment has the obligation to bear the tax liability and such a person pays tax to the credit of the Central Government, such a person has the statutory right to approach the CIT(A) for a declaration that "no tax was deductible on such income". The earlier controversy under the pre-amended provisions of section 248, that appeal under section 248 cannot lie unless there is an order of the Assessing Officer holding the assessee liable for deduction of tax at source under section 195, as held in Mahindra & Mahindra Ltd. v. Addl DIT [2007] 106 ITD 521 (Mum.)], doesnot hold good anymore. Section 248 provides a statutory remedy to assesseesto pre-empt the possible tax demands under section 201 r.w.s. 195.

b. As regards MFN clause, the ITAT explained that there could be two types of MFN clauses. One which requires further action to be taken by respective government-parties to the treaty, before the favourable provision of another treaty can be applied (such as India-Switzerland and India-Philippines treaties), and other, where the favourable clause of another treaty is automatically triggered and applied without any further action on part of the respective governments (such as India – France treaty). In the former case, the effect of the MFN clauseis toonly start negotiations and review by the parties so as to bring the parity in the provisions, whereas in the latter case, the parity in the provisions is brought immediately and automatically. It held that the Indo-Israel treaty fell under the latter category and accordingly, the favourable FTS definition in Indo-Portugal treaty, containing make-available clause, automatically became applicable to the Indo-Israel treaty due to the MFN clause.

c. Lastly, on the facts of the case, the ITAT held that the services provided by AACL did not “make available” any technical knowledge, experience, skill, know-how or processes to the assesseeand accordingly, the same was not FIS in view of the Protocol to the Indo-Israel treaty read with the Indo-Portugal treaty. Relying on the decisions in DIT v. Guy Carpenter & Co. Ltd. [2012] (346 ITR 504)(Del) and CIT v.

De Beers India Minerals (P.) Ltd. [2012] (346 ITR 467), it held that supervisory and consultancy services are inherently of such nature that theses cannot be said to be covered by the 'make available clause' in the tax treaties for the simple reason that while these services, on facts of a particular case, may require technical inputs, mere rendition of these services does not, by itself, result in transfer of such technical knowledge, skills or experience.

6. Comments:

This is a welcome decision clarifying the scope of section 248 of ITA, and thus, providing another course of remedy for tax payers to settle any doubts and disputes relating to their tax withholding liability under section 195 of ITA.