Existence of "debt-claim" is crucial to determine whether a fee in relation to loan can be categorised as "interest"

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In brief

Recently, the Authority for Advance Rulings (AAR) ruled[1] that any processing fee paid post the debt-claim comes into existence, has a direct nexus with the debt-claim, and the fees so paid would fall within the meaning of "interest" as defined in the India-France Double Taxation Avoidance Agreement (tax treaty).

Further, the upfront appraisal fees paid for appraising the loan was not in the nature of debt-claim. The AAR observed that (a) front end fee (other than appraisal fee)[2]; (b) commitment fee[3]; (c) cancellation fee[4]; (d) monitoring fee[5]; and (e) amendment fee[6] *[collectively referred as "fees other than upfront appraisal fees"]* were paid post securing the loan and would have direct nexus with the debt-claim. Hence, it ruled that they would fall within the meaning of "interest" as defined in the tax treaty.

In detail

Facts

- The applicant was a limited liability company incorporated in France and was engaged in the business of private sector financing in different countries, including India.
- The applicant had entered into agreements with clients in India, for grant of loan facility.
- Pursuant to such loan facility, the applicant earned the following fees:
  - Upfront appraisal fee.
  - Fees other than upfront appraisal fees.
- The applicant sought an advance ruling on the taxability of the above fees in India.

Questions before the AAR

- Whether the following fees fall within the ambit of "interest" as defined in the tax treaty:
  - Upfront appraisal fee payable for appraisal of loan application
  - Fees other than upfront appraisal fees
- If such fees was not taxable as "interest," whether it would be regarded as fees for technical services (FTS) under Article 13 of the India-France tax treaty?

Taxpayer's contentions

- The income earned from the above referred fees was not income from debt-claim, and hence, could not fall within the meaning of "interest."

[1] A.A.R. No 1105 of 2011
[2] Payable at the time of signing the agreement
[3] Payable for securing the unutilised portion of the credit facility
[4] Payable as a percentage of unutilised credit facility for cancelling the credit facility
[5] Payable for undertaking periodic financial analysis; time-to-time review of credit arrangement, etc.
[6] Payable for amending the terms of the agreement

- The income earned from the above referred fees could not be categorised as FTS, as the services of the applicant did not "make available" technical knowledge, skill, know-how or processes to the person availing credit facility.
- The applicant drew reference to the Most Favoured Nation (MFN) clause under the India-France tax treaty and invoked the "make available" clause under India-Portugal tax treaty.

Revenue's contention

- The Revenue accepted the contention of the taxpayer that upfront appraisal fee paid for appraisal of credit facility would not fall within the meaning of "interest."
- However, it contended that fees other than upfront appraisal fees had direct nexus with the debt-claim, as the credit facility had come into existence when these fees were paid and were calculated taking into account the amount of credit facility approved. Thus, they directly relate to the debt claim.
- Relying on the judgment of Mumbai bench of the Income-tax Appellate Tribunal and the Bombay High Court (HC) in the case of Commonwealth Development Corporation,[7] the Revenue contended that commitment fee, cancellation fee, amendment fee and monitoring fee was camouflaged for interest and was paid after disbursement of loan.
- With respect to FTS, it was contended that the "make available" clause of the India-Portugal tax treaty could not be automatically imported into the tax treaty without notification, relying on the Supreme Court's decision in Azadi Bachao Andolan.[8]

AAR's ruling

- The definition of interest in the India-France tax treaty is more restrictive.
- To constitute "interest" as per the tax treaty, the income must be free from debt-claims.
- Relying on the judgment of the Bombay HC in case of Commonwealth Development Corporation,[9] it ruled that the upfront appraisal fee would not be in the nature of "interest," as there was no debt-claim in existence when this fee was payable.
- Fees other than upfront appraisal fee would be paid after signing the loan agreements.
- Loan agreements created a debt-claim that was legal, valid and enforceable.
- When fees other than upfront appraisal fees were directly related to debt-claim and were charged after disbursement of loan, the same would establish a direct nexus between the fees and the debt-claim, which was already in existence.
- It also ruled that it was immaterial whether the fees was calculated as a percentage of loan unutilised or other method. The fact that the fees paid were directly related to the credit facility advanced would make the fees other than upfront appraisal fees as "interest."

The takeaways

- This is a welcome ruling, as it provides guidance on when a fee would be considered as debt-claim.
- This ruling affirms that fees other than appraisal fee paid post the sanction of credit facility have a direct nexus with the credit facility, and hence, the fees should also be regarded as debt-claim.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

[7] Commonwealth Development Corporation *v.* DIT [ITA nos. 1987 & 1988/ Mum/2006] and DIT *v.* Commonwealth Development [Appeal No 1058 of 2011(Bombay)].

[8] Union of India *v.* Azadi Bachao Andolan [2003] 263 ITR 706 (SC)

[9] CIT *v.* Commonwealth Development [2012] 210 Taxman 310 (Bombay)

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