Tax & Regulatory Services

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Payments made by an Indian resident, towards bauxite testing charges to a foreign company are held to be in the nature of 'fees for technical services'

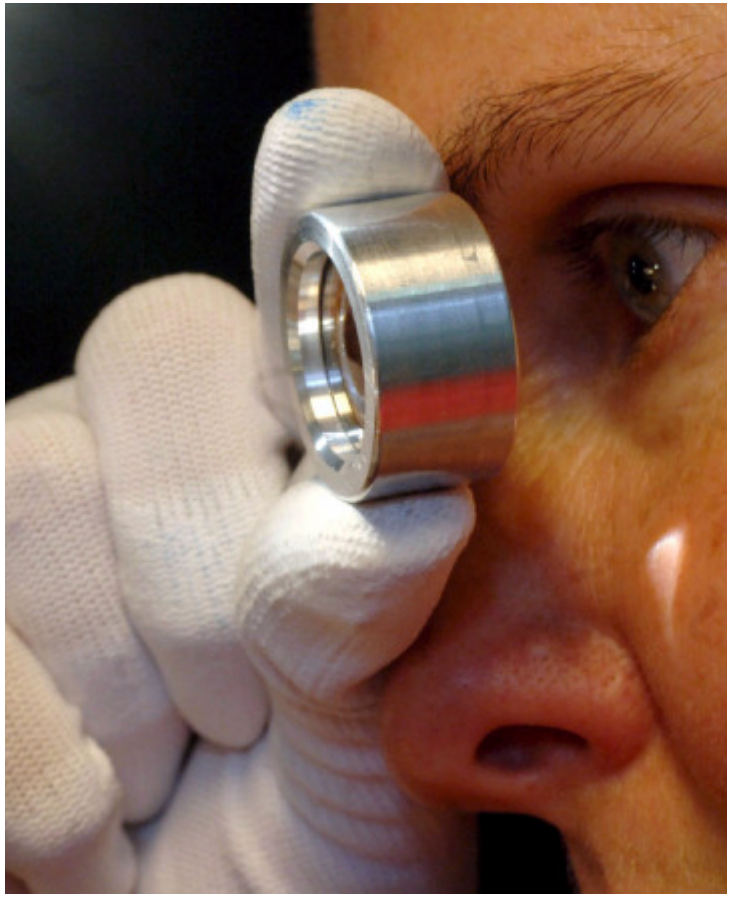
Background

The Mumbai Tribunal in a recent ruling[1] has held that payments made by Ashapura Minichem Ltd. ("the assessee"), an Indian resident, towards bauxite testing charges to China Aluminum International Engeineering Corp Ltd. ("the Chinese company") are in the nature of 'fees for technical services' ("FTS") under section 9(1)(vii) of the Income-tax Act, 1961 ("the Act") as well as under Article 12 of the Double Taxation Avoidance Agreement between India and China ("tax treaty"), in spite of the fact that the services have been rendered from outside India i.e. from China.

Facts

The assessee is an Indian company which was in the process of building an alumina refinery, using bauxite (an aluminum alloy). In this connection the assessee had entered into an agreement with the Chinese company for availing bauxite testing services from the Chinese company. These services were performed on the bauxite samples in the laboratories of the Chinese company in China. Also, the test reports for the samples were prepared in China.

At the time of making the payment to the Chinese company, the assessee made an application under section 195 of the Act for obtaining a 'nil' withholding order from the assessing officer ("AO"), contending that taxability could arise only if the Chinese company established a Permanent Establishment ("PE") in India in accordance with the provisions of the tax treaty. In the absence of any PE in India, the Chinese company did not have any tax liability in India and accordingly, no taxes are required to be withheld before making the payments to the Chinese company.



[1] Ashapura Minichem Ltd. *v.* ADIT [ITA No.2508/Mum/08] dated: 21 May, 2010; Source: www.itatonline.org

The AO held that the services rendered by the Chinese company were in the nature of FTS under section 9(1)(vii) of the Act as well as under Article 12 of the tax treaty. The AO, thus, concluded that under the terms of the tax treaty, the assessee should withhold tax at 10% of the gross amount of remittance to the Chinese company. Aggrieved by the Commissioner of Income-tax (Appeals)'s order, who upheld the AO's order, the assessee appealed before the Tribunal.

Assessee's contentions

The main contention was that no part of the services was rendered in India and hence, the Chinese company did not have any tax liability in India. It was contended that section 9(1)(vii) of the Act would be attracted only if the services were rendered as well as utilised in India. In this regard, the assessee referred to the Supreme Court's decision in the case of Ishikawajima Harima Heavy Industries Ltd.[2] and the Bombay High Court's decision in the case of Clifford Chance[3].

As regards Article 12(4) of the tax treaty, it was contended that this Article cannot be applied to the facts of the present case because the tax treaty has an additional requirement of the 'place of performance' being India, which must be satisfied before the payment can be taxed as FTS in India. Furthermore, as regards the deeming fiction under Article 12(6), which states that FTS shall be deemed to arise in India when the payer is a resident of India, the assessee contended that the place of performance test is to be satisfied before FTS can be taxed in India under Article 12(6) of the tax treaty. Accordingly, since the testing services were entirely rendered in China the testing services could not be brought to tax in India either under Article 12(4) or Article 12(6) of the tax treaty.

Revenue's contentions

The Revenue contended that the judgements of the Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd. (above) and the Bombay High Court in the case of Clifford Chance (above) are contrary to the legislative intent and have been set to rest by the retrospective amendment in the Explanation to section 9(1)(vii) by the Finance Act, 2010.

As regards the tax treaty, it was contended that the deeming provision of Article 12(6) was quite clear and categorical. When the payment is made to a Chinese company by the assessee, FTS is deemed to have arisen in India. It was further argued, with regard to the assessee's contention that the performance test must first be satisfied, that in this case the deeming clause would be rendered meaningless, as one cannot deem something which exists in reality anyway.

Accordingly, the Revenue contended that the payment for the testing fees is liable to tax in India both under the provisions of section 9(1)(vii) of the Act as well as under the provisions of Article 12 of the tax treaty.

Tribunal Ruling

The Tribunal considered the material on record and the issues raised and upheld the taxability of the sums payable for the testing services in China.

The Tribunal referred to the cases of Clifford Chance (above) and Ishikawajima Harima Heavy Industries Ltd. (above), for the twin condition test (of utilisation and rendering of services in India) and for the concept of a territorial nexus for the purpose of determining the tax liability in India. While doing so, the Tribunal observed that the legal proposition of the twin conditions no longer holds good in view of the retrospective[4] amendment to section 9 by the Finance Act, 2010. Thus, as the law stands now, utilisation of services in India is enough to warrant the taxability of these services in India. Accordingly, the amendment in the statute has virtually negated the judicial precedents supporting the proposition that the rendition of services in India is a pre-requisite for the taxability of these services in India.

[2] Ishikawajima-Harima Heavy Industries Ltd. *v.* DIT [2007] 288 ITR 408 (SC)
[3] Clifford Chance *v.* DCIT [2009] 318 ITR 237 (Bom)

[4] With effect from 1 June, 1976

Furthermore, as regards the concept of a territorial nexus, the Tribunal observed that this is relevant only for a territorial tax system in which taxability in a tax jurisdiction is confined to the income earned within its borders. Under such a system the income earned outside its borders is not taxed in that tax jurisdiction. Apart from the tax havens and prominent countries (i.e. France, Belgium, Hong Kong and Netherlands) that are considered as territorial tax systems, which also come with certain anti-abuse riders, other major tax systems follow the source rule and the residence rule. Also, where the source rule is an integral part of a taxation system, any double jeopardy to a taxpayer, due to an inherent clash of the source rule and resident rule is relieved only through the specified relief mechanism, as provided under the treaties and the domestic law. Accordingly, it is fallacious to proceed on the basis that a territorial nexus to tax jurisdiction is a pre-requisite to determine taxability in any tax system.

As regards Article 12(4) of the tax treaty the Tribunal has observed that the scope of the expression "provision of services" is wider than that of the expression "provision of rendering of services", and will cover the services even when these are not rendered in India, as long as they are utilised in India.

Further, the deeming fiction of Article 12(6) of the tax treaty provides that irrespective of the *situs* of the rendering of technical services, FTS will be deemed to have accrued in the tax jurisdiction in which the person making the payment is located (i.e. India). Relying of the case of Hindalco Industries Ltd.[5], the Tribunal observed that a literal interpretation of a tax treaty, which renders the treaty provisions unworkable and which is contrary to the clear and unambiguous scheme of the treaty, has to be avoided.

The Tribunal finally concluded that the payment to the Chinese company is taxable in India under section 9(1)(vii) of the Act and also under the provisions of Article 12 of the tax treaty. Accordingly, the withholding tax liability of the assessee under section 195 of the Act was upheld.

Conclusion

The issue of provision of services by foreign companies to Indian companies is a common issue, where the services are often rendered from outside India. Accordingly, this decision is of immense importance as it brings within the ambit of taxability even those cases where the services have been rendered outside India and only utilised in India, thereby negating the judicial precedents set by various courts.

[5] Hindalco Industries Ltd. *v.* ACIT [2005] 94 ITD 242 (Mum)

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