# ITAT rules fees for technical services provided by a Chinese entity outside India to an Indian resident is taxable in India

## Executive Summary

This alert summarizes the recent ruling of Mumbai Income Tax appellate Tribunal (ITAT) [ITA No. 2508/Mum/08] in the case of **Ashapura Minichem Limited** (Taxpayer) on an issue whether fees for technical services (FTS) provided by a Chinese resident from China, to an Indian resident, is liable to tax withholding under section 195 of the Income Tax Act (ITA). Before the ITAT, the Taxpayer contented that:

- As the services were not rendered in India, there was no territorial nexus for income to be taxed in India as per internationally accepted principle.
- Alternatively, the income is not taxable in India pursuant to Double Tax Avoidance Agreement (DTAA) with China.

The ITAT held that:

- Post the amendment to the ITA by the Finance Act 2010 rendering of services in India (territorial nexus) is not a pre requisite for taxability of FTS in India.
- As per the DTAA too, income is taxable in India.
- The Taxpayer is liable to withhold tax from the remittance.

## Background

As per the ITA, FTS paid by a resident of India is considered as an income which has accrued or arised in India, liable to Indian tax. However the non resident, at his option, is entitled to urge that the tax liability be determined pursuant to the DTAA, when it is beneficial to him. In the instant case, the Taxpayer, an Indian resident company, engaged China Aluminium International Engineering Corp. Ltd. (CAIECL), a resident of China, to provide technical consultancy services, in the form of test reports on chemical composition, physical phase constitution, arability test etc. in respect of bauxite, the material used by the Taxpayer in its manufacturing process. The services were wholly provided from China. Before effecting remittance of the FTS, the Taxpayer applied to the Tax Authority, to certify and declare that the remittance does not attract tax withholding pursuant to the DTAA with China. The Tax authority held that, both, in terms of the ITA and the DTAA, the remittance is liable to tax withholding @ 10% of the gross amount. The Taxpayer preferred an appeal before the first appellate authority, who too upheld the view of the Tax Authority. The Taxpayer then preferred an appeal before the ITAT.

## Taxpayer's contentions

- In terms of the ITA, as judicially held[1], tax liability would arise only if the twin conditions of utilization and rendition of services in India are satisfied. Since the services are wholly rendered

[1] Ishikawajima Harima Heavy Industries Ltd (288 ITR 408) and Clifford Chance (318 ITR 297)

outside India, the income is not taxable under the ITA.

- CAICEL which is resident of China was entitled to the beneficial provisions of the DTAA for determination of its tax liability.
- The FTS were in the nature of business profits within the scope of Article 7 of the DTAA, which could be taxed in India only if CAICEL has a permanent establishment (PE) in India. In the absence of PE, which is an undisputed fact, it is not liable to tax in India and hence there is no tax withholding obligation.
- If it is held that the payment is a FTS within the scope of Article 12 of the DTAA, as the services are not rendered in India, the income does not arise in India as referred to in the Article 12(1) and therefore sub clause (6) of the said Article, which deems the arising of the income in the jurisdiction of which the payer is the resident, is not attracted.

**Contentions of the Tax authority**

- In view of the retrospective amendment to the ITA, the judicial precedents (Supra) relied upon by the Taxpayer, do not hold the field. Post the amendment, the FTS is taxable in India, although the services may not have been rendered in India.
- In terms of the Article 12(6) of the DTAA, the income is deemed to arise in India when the payer is resident of India. This clause must be read harmoniously with the other clauses of the said Article; else, the said clause will be redundant.
- In terms of the ITA and DTAA as well, the income is taxable in India and therefore, the remittance by the Taxpayer is liable to tax withholding.

**ITAT ruling**

- The judicial rulings, relied upon by the Taxpayer, were on the conceptual and the legal premises that for the FTS to be taxable, the income should have territorial nexus with India i.e. income is taxable when both the rendition and utilization of services is in India. However, the retrospective amendment to the ITA has overturned these rulings. Hence, the FTS income is taxable in India, regardless of whether or not; the services are rendered in India.
- A plain reading of various sub clauses of Article 12 of the DTAA shows that:
  - The FTS income shall be deemed to accrue or arise in the source country, when the payer is resident of that country.
  - It is the "provision of services" and not necessarily the "performance of services" in the source country which attracts the taxability.
- There is no merit in the proposition that the deeming clause (6) is attracted only when the income has arised in the source country. It is obvious that what is actual, does not require validation of a deeming fiction. If the proposition of the Taxpayer is accepted, the said clause of the Article will become redundant. The tax treaties are the agreements that have to be interpreted in a manner that the intention thereof, is clearly brought out.[2] A literal interpretation to a tax treaty, which renders treaty provisions unworkable and which is contrary to the clear and unambiguous scheme of the treaty, has to be avoided.
- The expression "provision for services" used in the DTAA with China, is much wider in scope than the expression "provision for rendering of services" used in other tax treaties. Hence, for the FTS income to be taxable in India, the

[2] Hindalco Industries ( 94 ITD 242)

rendition of services in India is not necessary, it is sufficient that the services are utilized in India.

- In terms of the ITA and DTAA too, the FTS is taxable in India, the remittance whereof requires tax withholding.

## Our comments

The Supreme Court, under the pre-amended ITA provisions, ruled that the FTS income would be taxable in India based on territorial nexus, for which, the twin condition of rendition and utilization of services in India, need be fulfilled. The Finance Act 2010 amended the ITA with retrospective effect that the FTS income maybe taxed in India, regardless of, whether the services are rendered within India or otherwise. Hence, the ITAT rejected the Taxpayer's proposition that unless the services are rendered within India, there is no sufficient territorial nexus for the income to be taxed in India.

The DTAA with China uses the expression "**provision of services**" which is wider than the expression "**rendering of services**", as used in various other treaties and therefore, in terms of DTAA too, rendition of services in India is not a prerequisite for taxability of FTS income in India.

The jurisdictions with which India's DTAA uses the expression "provision of services" would expose the non-resident to the taxation of FTS income in India in respect of the services that may have been rendered from outside India.

It appears that, the ITAT being a creation of the statute (the ITA), it could not have, and has not, tested the legal validity of the amendment to the ITA that dispensed with, the condition of rendition of services in India (the territorial nexus) which was considered a pre requisite by the Judiciary for India's right to tax income of a non-resident. The validity of the amendment might be tested by the higher judicial forum.



## Disclaimer



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For any clarification or elucidation in respect of this alert, you may kindly connect to our **International Tax Team headed by CA Paresh Vakharia.**

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