

# ***Protocol is an integral part of the tax treaty – need not be separately notified; Restrictive definition of India-UK tax treaty can be read into India-France tax treaty***

August 3, 2016

## ***In brief***

The Delhi High Court (HC) reversed the ruling by the Authority for Advance Rulings (AAR) and held that the Protocol was an integral part of the tax treaty. Accordingly, by virtue of clause 7 of the Protocol to India-France Double Taxation Avoidance Agreement (tax treaty), the restrictive definition of ‘fees for technical services’ (FTS) appearing in the India-UK tax treaty must be read as forming part of the India-France tax treaty. Thus, managerial services provided by the French entity would not fall within the ambit of FTS under the India-France tax treaty.

## ***In detail***

### ***Facts***

- The Petitioner<sup>1</sup> was a public company registered in India, providing IT-driven services for its clients’ core businesses.
- A Management Service Agreement (MSA) was entered into on 1 January, 2009 between the Petitioner and a French Group entity, under which the French entity was to provide various management services to the Petitioner with a view to rationalise and standardise the Petitioner’s business in India. Services under the broad category of General Management Services included Corporate

Communication Services, Group Marketing Services, Development Services, Information System and Services, Legal Services, Human Relation Services etc. These services were rendered by the French entity through telephone, fax, e-mail, etc., and no personnel of the French entity visited India for providing such services.

- The French entity, a limited liability partnership firm incorporated in France, centralised skills for carrying on management functions such as legal finance, human resources, communication risk control, information systems, management information services, etc. It

did not have a Permanent Establishment (PE) in India under the provisions of the India-France tax treaty.

The Petitioner had sought a ruling from the AAR on whether the payments made by it for management services provided by the French entity were taxable in India under the provisions of the India-France tax treaty and whether the Petitioner was required to withhold taxes on such payments under section 195 of the Income-tax Act, 1961.

### ***AAR Ruling***

- Before the AAR, the Petitioner contended that with regard to Clause 7 of the Protocol to the India-

<sup>1</sup> (W.P. (C) 4793/2014 & CM APPL. 9551/2014)

France tax treaty, the restrictive definition of FTS appearing in the India-UK tax treaty must be read as forming part of the India-France tax treaty as well.

- The AAR ruled that the Protocol could not be treated as forming part of the tax treaty itself. It further ruled that restrictions imposed by the Protocol were only to limit taxation at source for the specific items mentioned therein. The restriction was only on the rates, and in the absence of a specific notification to incorporate the restrictive provisions of India-UK tax treaty, the 'make available' clause appearing in the India-UK tax treaty could not be read into expression FTS under the India-France tax treaty.
- Based on this reasoning, the AAR ruled that payments made by the Petitioner for managerial services were taxable as FTS under the India-France tax treaty, and that the Petitioner was required to withhold taxes on such payments.
- Aggrieved by this ruling, the Petitioner challenged it in the High Court (HC) by way of a Writ Petition.

### **High Court ruling**

#### ***Protocol- integral part of the tax treaties***

- The HC did not endorse the restrictive interpretation placed on Clause 7 of the Protocol to the India-France tax treaty, and held that the words, "a rate lower or a scope more restricted" in the Protocol envisaged that there could be a benefit of either kind, i.e., a lower rate or a more restricted

scope. One did not exclude the other.

- The purpose of Clause 7 of the Protocol, the HC held, was to afford to a party to the India-France tax treaty, the most beneficial of the provisions that might be available in any convention between India and another OECD country.
- The wording of Clause 7 of the Protocol made it self-operational. The Preamble in the Protocol stated, "*the undersigned have agreed on the following provisions which shall form an integral part of the Convention*". This extract made the position clear that the Protocol signed between India and France simultaneously formed an integral part of the tax treaty.
- Once the tax treaty had itself been notified and contained the Protocol, including Clause 7 thereof, there was no need for the Protocol to be separately notified. The Petitioner relied on the decision of the Kolkata Income-tax Appellate Tribunal (Tribunal)<sup>2</sup>, wherein the Protocol executed between India and France was interpreted.
- The HC disagreed with the AAR's conclusion that a separate notification incorporating the beneficial provisions of the India-UK tax treaty as forming part of the India-France tax treaty was required.
- It therefore held that the benefit of the lower rate or restricted scope of FTS under the India-France tax treaty was not dependent on any further action by the respective governments. The more restricted scope of FTS as

provided for in a tax treaty entered into by India with another OECD member country shall also apply under the India-France tax treaty with effect from the date on which the India-France tax treaty or such other tax treaty enters into force.

#### ***Taxability of managerial charges paid to French entity***

- The definition of FTS in Article 13(4) of the India-UK tax treaty clearly excluded managerial services. It was clear that once the expression, "managerial services" was outside the ambit of FTS, the Petitioner's question about having to withhold tax from payment for the same would not arise. It was therefore not necessary to examine the second limb of the definition, i.e., whether the services were 'made available' to the Petitioner.
- On the Revenue's contention raised regarding the French entity having a PE in India and its income being taxable under Article 7 of the India-France tax treaty, the HC held that the question whether the French entity had a PE in India would arise only if the Revenue contended that the French entity earned any business income in India. Since it was projected that the fee paid by Petitioner to the French entity partook the character of FTS, the question whether the French entity had a PE in India under Article 7 of the India-France tax treaty did not arise.
- The HC concluded that the payment made by the Petitioner to the French entity for managerial services could not be taxed as FTS, and hence, these payments were not liable to withholding tax under section 195 of the Act.

<sup>2</sup> 82 ITD 239

### ***The takeaways***

This is a welcome decision from the HC, as it emphasises that the Protocol is an integral part of the tax treaty itself, and that no separate notification is required to give effect to the beneficial provisions of the Protocol, unless specifically agreed upon under the Protocol.

The Protocol to certain other tax treaties such as the India-Philippines and India-Switzerland have a Most Favoured Nation (MFN) clause. However, they specifically require a notification to be issued to make the Protocol operative. No such requirement exists under the India-France tax treaty.

It may therefore be prudent to examine the relevant tax treaty before applying the MFN clause.

### ***Let's talk***

For a deeper discussion of how this issue might affect your business, please contact:

#### ***Tax & Regulatory Services – Direct Tax***

Gautam Mehra, *Mumbai*

+91-22 6689 1154

[gautam.mehra@in.pwc.com](mailto:gautam.mehra@in.pwc.com)

Rahul Garg, *Gurgaon*

+91-124 330 6515

[rahul.garg@in.pwc.com](mailto:rahul.garg@in.pwc.com)

## Our Offices

### Ahmedabad

1701, 17th Floor, Shapath V,  
Opp. Karnavati Club,  
S G Highway,  
Ahmedabad – 380051  
Gujarat  
+91-79 3091 7000

### Hyderabad

Plot no. 77/A, 8-2-624/A/1, 4th  
Floor, Road No. 10, Banjara Hills,  
Hyderabad – 500034,  
Telangana  
+91-40 44246000

### Gurgaon

Building No. 10, Tower - C  
17th & 18th Floor,  
DLF Cyber City,  
Gurgaon – 122002  
Haryana  
+91-124 330 6000

### Bengaluru

6th Floor  
Millenia Tower 'D'  
1 & 2, Murphy Road, Ulsoor,  
Bengaluru – 560 008  
Karnataka  
+91-80 4079 7000

### Kolkata

56 & 57, Block DN.  
Ground Floor, A- Wing  
Sector - V, Salt Lake  
Kolkata – 700 091,  
West Bengal  
+91-033 2357 9101/  
4400 1111

### Pune

7th Floor, Tower A - Wing 1,  
Business Bay, Airport Road,  
Yerwada, Pune – 411 006  
Maharashtra  
+91-20 4100 4444

### Chennai

8th Floor  
Prestige Palladium Bayan  
129-140 Greams Road  
Chennai – 600 006  
Tamil Nadu  
+91 44 4228 5000

### Mumbai

PwC House  
Plot No. 18A,  
Guru Nanak Road (Station Road),  
Bandra (West), Mumbai – 400 050  
Maharashtra  
+91-22 6689 1000

### For more information

Contact us at  
[pwctr.knowledgemanagement@in.pwc.com](mailto:pwctr.knowledgemanagement@in.pwc.com)

## About PwC

At PwC, our purpose is to build trust in society and solve important problems. We're a network of firms in 157 countries with more than 208,000 people who are committed to delivering quality in assurance, advisory and tax services. Find out more and tell us what matters to you by visiting us at [www.pwc.com](http://www.pwc.com).

In India, PwC has offices in these cities: Ahmedabad, Bengaluru, Chennai, Delhi NCR (Gurgaon), Hyderabad, Kolkata, Mumbai and Pune. For more information about PwC India's service offerings, visit [www.pwc.com/in](http://www.pwc.com/in)

PwC refers to the PwC International network and/or one or more of its member firms, each of which is a separate, independent and distinct legal entity in separate lines of service. Please see [www.pwc.com/structure](http://www.pwc.com/structure) for further details.

©2016 PwC. All rights reserved

## Follow us on:



For private circulation only

This publication has been prepared for general guidance on matters of interest only, and does not constitute professional advice. You should not act upon the information contained in this publication without obtaining specific professional advice. No representation or warranty (express or implied) is given as to the accuracy or completeness of the information contained in this publication, and, to the extent permitted by law, PwCPL, its members, employees and agents accept no liability, and disclaim all responsibility, for the consequences of you or anyone else acting, or refraining to act, in reliance on the information contained in this publication or for any decision based on it. Without prior permission of PwCPL, this publication may not be quoted in whole or in part or otherwise referred to in any documents.

© 2016 PricewaterhouseCoopers Private Limited. All rights reserved. In this document, "PwC" refers to PricewaterhouseCoopers Private Limited (a limited liability company in India having Corporate Identity Number or CIN : U74140WB1983PTC036093), which is a member firm of PricewaterhouseCoopers International Limited (PwCIL), each member firm of which is a separate legal entity.