SATURDAY INTERNATIONAL TAX GYAN !!!

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Dieffenbacher GmbH Maschinen Und Anlagenbau
vs
ACIT, International Taxation

CBDT Circular on MFN Clause shall be applicable prospectively

SITG No. 160

01.07.2023

[2023] 150 taxmann.com 533 (Mumbai - Trib.) [16-03-2023]

Facts of the Case

- ❖The assessee being a foreign company, a tax resident of Germany incurred an expenditure of Rs. 17,13,981 against the services received from its vendor CBV, (a sub-contractor from Belgium) which was disallowed u/s 40(a)(ia) by the Ld. AO on the pretext of non-deduction of TDS, since he assumes it to be a part of Fees for Technical Services (FTS) under Article 12 of India- Belgium DTAA.

- ❖The assessee company has a Permanent Establishment (PE) in India for the year under consideration i.e., A.Y. 2018-19.

- ❖A payment in nature of installation and supervision fee was made by the assessee to a sub-contractor in Belgium but TDS was not deducted. According to the assessee, the services are availed due to the expertise of CBV in the commissioning and installation of dryer fans.

- ❖It is pertinent to note that the services provided by CBV to the assessee were provided in India, however the assessee has not found to have made available any technical knowledge, experience, skill, or know-how.

- ❖The assessee submitted that in view of the Most Favored Nation (MFN) clause mentioned in DTAA between India and Belgium, no TDS is required to be deducted after taking into consideration DTAA between India- Portugal by claiming the benefit of the restricted definition of FTS.

Assessee's Contention

❖The Ld. Counsel contends that the services performed by CBV (the sub-contractor) did not impart or transfer any technical knowledge or skills or know-how to the service recipient, nor shall it be able to use in its own capacity in the future, hence such services performed shall not come under the ambit of FTS under Income Tax Act or DTAA.

❖The Ld. Counsel emphasizes the fact that CBV is a tax recipient of Belgium and therefore, is eligible for accessing the India- Belgium Tax Treaty.

❖Even if the Ld. A.O. considers such services as FTS, then also the Ld. Counsel contends that it can not be taxed as there exists the MFN Clause in the protocol of India- Belgium DTAA which suggests otherwise.

❖Accordingly, as per the protocol of the India- Belgium tax Treaty, India would limit its taxation on royalties or FTS if, under any scope, convention, or agreement between India and a third state being a member of the OECD, India limits its taxation on royalties or FTS to a lower or to a restricted scope than it is provided in the present agreement in the said item of income.

❖To claim the benefit of protocol, assessee chose India- Portugal DTAA wherein the "Make Available" clause was a part of the treaty unlike India- Belgium DTAA, and the Ld. Counsel humbly submits that knowledge is also not being made available in India, therefore, the **income is not taxable** in India.

Revenue’s Contention

- The Ld. A.O. believes that the assessee got specialized services in the form of commissioning and installation of plant in India and the technical know-how was made available to the Indian client.

- The A.O. is of the view that since the payment was in nature of FTS and since the services are provided in India, therefore the TDS is required to be deducted.

- The Ld. A.O. submits that the assessee has received managerial, technical, or consultancy services mainly from CBV, spanning the entire gamut of commissioning or installation of plant, etc., and enriching it with the knowledge of enduring nature.

- The Ld. A.O. is of the view that the impugned receipt of Rs. 17,13,981 certainly falls under the category which qualifies to be FTS under the act and also under Article 12(4) of India- Belgium read with India- Portugal DTAA.

- The Ld. D.R. supported the order passed by the lower authorities and referred to the circular issued by CBDT dated 3rd February 2022 and submitted that notification u/s 90 of the Income Tax Act is required for the implementation of the terms of DTAA.

Legal Provisions

❖As per **Article 12 (4) of India- Belgium DTAA**, the provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which, or the contract under which, the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

❖As per **Circular F. No. 503/1/2021 issued on 3rd February 2022**, CBDT panned out fresh requirements for India claiming the benefits of DTAA from the second state to DTAA with the first state. Such requirements are listed below:

- The second treaty (with the 3rd state) is entered into after the Entry into Force (depending upon the language of the MFN clause) of the treaty between India and the first state.
- The second treaty is entered into between India and a state which is a member of the OECD at the time of signing the treaty with it.
- India limits its taxing rights in the second treaty in relation to the rate or scope of taxation in respect of the relevant items of income.
- A separate notification has been issued by India, importing the benefits of the second treaty into the treaty with the first state, as required by the provisions of section 90(1) of the Income Tax Act, 1961.

Ruling

❖ Without reiterating the facts as elaborated by the Ld. Counsel and the various details submitted by the Ld. A.O., the Tribunal observed that there was no transfer of technical knowledge, know-how, experience skill, or process from the services provided by CBV.

❖ It is important to note that as per Article 12 of India- Belgium DTAA, the assessee is taxable @ 10% + Surcharge + EC if it is to be believed that such service is tantamount to service related to royalty and FTS.

❖ The Hon'ble Tribunal is satisfied that the circular dated 3rd February 2022 can not be invoked in the present appeal where it happened much prior to the CBDT circular issued, therefore, the assessee is entitled to claim the benefit of the restricted definition under India- Portugal Treaty. The facts of the case were similar to the case of *GRI Renewable Industries S.L. vs. ACIT (IT) [2022] 140 taxmann.com 448 (Pune- Trib.) (para 6)* where the coordinate bench of the Pune Tribunal held that such circular can not be applied to the case which happened much prior to the issue of such circular.

❖ Further, it has been held in various cases that there is no requirement for separate notification for importing the beneficial treatment from the agreement.

❖ However, since the assessee has been found not to have made available any technical knowledge, experience, or skill, therefore the **impugned services received by the assessee can not be offered to tax as FTS** under the said provision.

Our Comments

- ❖ The assessee received the services, from the vendor who is a tax resident of Belgium, in India, where the technical knowledge or skill was neither shared nor made available in India nor did the services performed by CBV impart or transfer any such knowledge, knowhow, or skill to the recipient of services i.e., the assessee in the present case.

- ❖ CBDT Circular can not operate retrospectively, unless otherwise stated, to the transactions taking place in any period prior to the issuance of the Circular. Hence, the submission by the Ld. A.O. that such transaction will be subjected to tax as the MFN Clause shall not be available with the assessee and the legal requirements of CBDT Circular has not been complied with as per section 90 of Income Tax Act, is humbly and respectfully not tenable in law, which was re-affirmed by the Hon’ble Tribunal in its judgment.

- ❖ However, if the transactions would have taken place after the issuance of the CBDT Circular, then in such case the assessee would have not been able to take the advantage of MFN Clause which exists in the treaty, and hence the benefit of “Make Available” which exist in India- Portugal treaty would have not been available with the assessee and resultantly the assessee shall have to pay tax at the applicable rate.

Our Comments

❖The conditions enumerated in the said circular to claim the benefit of the MFN Clause should be checked in the following way:

- **Date of Entry into Force/ signature**: - Such date of signature on the treaty is generally given at the start of the treaty between the respective countries.

- **Country is a member of OECD at the time of signing the treaty:** - Whether the country is a member of OECD at the time of signing the treaty, that has to be checked on the OECD site. One of the links to check the OECD Membership is provided hereunder- https://en.wikipedia.org/wiki/OECD#:~:text=%5Bedit%5D-,Current%20members,-%5Bedit%5D

- **Limiting the taxing rights in the second treaty: -** The assessee needs to check whether India limits its right to tax the respective items of income.

- **Separate notification to be issued: -** The notification related to its applicability shall be issued by India, however, it is still questionable whether India alone can limit the benefits which are otherwise available with the DTAA.

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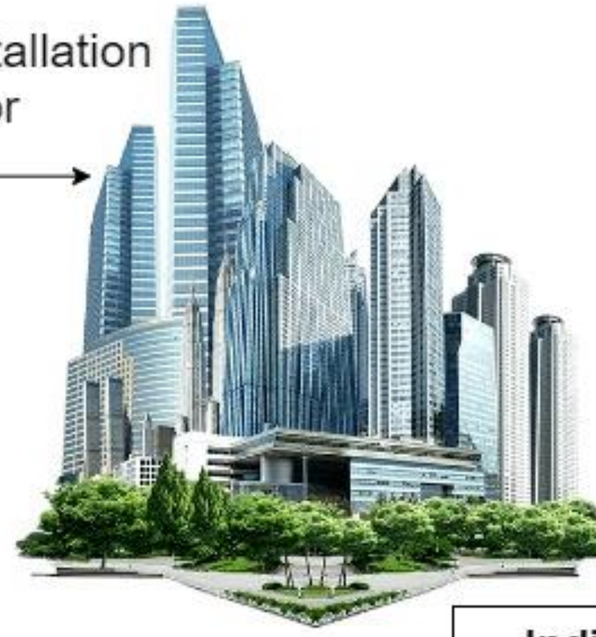
Assessee company entered into transaction for the installation and supervision of Fans through its sub contractor with the Indian Company



Assessee (Tax Resident Of Germany)

Indian Company

Asssessee Company made payment of RS 17,13,981 to CBV without deducting TDS considering Article 12 of India- Belgium DTAA

CBV

Sub Contractor of Assessee Company (Tax Resident Of Belgium Company)

Learned AO considered payment made to subcontractor as FTS and disallowed the expense for assessee stating that TDS was required to be deducted u/s 40(a)(ia) of Income Tax Act 1961

The Tribunal stated that there was no transfer of technical knowledge, know-how, or skill. Hence, it is not taxable as FTS. It further stated that regarding the CBDT Circular F. No. 503/1/2021 dated 3rd February 2022, the same shall be applicable prospectively and not retrospectively.

Section/Article	9 of the Income Tax Act, Article 12 of DTAA
DTAA/Country	India – Belgium DTAA , India - Portugal DTAA,
Court	Mumbai Tribunal
Date of decision	16.03.2023

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