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SITG No. 209

Johnson Matthey Public Ltd. Co.

v.

Commissioner of Income-tax

Guarantee fee charged by foreign entity for guarantee provided to banks to extend credit facilities to its Indian subsidiaries, would not fall within expression of 'interest' in article 12 of India UK DTAA

08.06.2024



Facts of the Case

- ❖ Appellant is a tax resident of the United Kingdom and is engaged in the manufacture of specialty chemicals. It has established various subsidiaries across the globe including in India.
- ❖ During Financial Year 2010-11, the appellant **extended guarantees** to various overseas branches of foreign banks on a global basis in relation to credit facilities extended by those financial institutions to its Indian subsidiaries, namely, Johnson Matthey India Private Limited and Johnson Matthey Chemicals India Private Limited.
- ❖ Appellant received guarantee charges aggregating INR 1,49,15,090/- from those subsidiaries. In connection therewith, the appellant and its various Indian subsidiaries executed the Intra Group Parental Guarantee and Indemnity Services Agreement on 29 March 2010. The assessee in its Return of Income, as originally submitted, had characterized the amount of guarantee fee as interest and taxable under Article 12 of the DTAA.

Assessee's Contention

- ❖ Assessee contended that **guarantee fees** should be liable to **tax as interest income** under **Article 12** of the DTAA without prejudice to its other submissions that the income was not taxable at all.
- ❖ Assessee contended that the Tribunal has erred in holding that the **income accrued or arose in India** ignoring the fact that the **fee was earned as consideration for bearing the risk** of default on the part of the Indian subsidiary which was the principal debtor.
- ❖ Further, it was contended that since the **risk would ultimately be borne** by the appellant **outside India** and where it could face the specter of coercive proceedings being initiated against its overseas financial assets, the income received would fall **outside the scope of Section 5(2)** of the Act.

Revenue's Contention

- ❖ Revenue contended that every periodical payment or remuneration for service in the context of a loan cannot be treated as "interest". As long as the **assessee** is a **stranger to the privity of contract of loan** between the Indian entity and the banker, they cannot categorize the corporate/ bank guarantee recharge amount as interest for the purpose of taxation
- ❖ Revenue further contended that the Tribunal has correctly come to conclude that **income had accrued in India** since, and in terms of Section 5(2) of the Act.
- ❖ Since the loan transaction had undoubtedly taken place in India, it should not be open for the appellant to contend that no income had accrued to them in India. Since accrual of income is not concerned with actual receipt, it would be incorrect for the appellants to assert that income had not arisen or accrued in India.

Legal provisions

As per section 2(28A) of Income Tax Act, 1961:

"interest" means interest payable in any manner in respect of any moneys borrowed or debt incurred (including a deposit, claim or other similar right or obligation) and includes any service fee or other charge in respect of the moneys borrowed or debt incurred or in respect of any credit facility which has not been utilised ;

As per section 5(2) of Income Tax Act, 1961:

"Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

- (a) is received or is deemed to be received in India in such year by or on behalf of such person ; or*
- (b) accrues or arises or is deemed to accrue or arise to him in India during such year."*

Explanation 1(a) section 9(1) of Income Tax Act, 1961:

Explanation 1.—For the purposes of this clause— (a) in the case of a business, other than the business having business connection in India on account of significant economic presence, of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

Legal provisions

Article 12 of India UK DTAA:

“1. Interest arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.”

“2. However, such interest may also be taxed in the Contracting State in which it arises and accordingly to the law of that State, provided that where the resident of the other Contracting State is the beneficial owner of the interest the tax so charged shall not exceed 15 per cent of the gross amount of the interest.”

*“5. The term "interest" as used in this Article means **income from debt-claims of every kind**, whether or not secured by mortgage and whether or not carrying a right to participate in the debtor's profits, and in particular, income from Government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures but, subject to the provisions of paragraph 9 of this Article, shall not include any item which is treated as a distribution under the provisions of Article 11 (Dividends) of this Convention.”*

Ruling

- ❖ Hon'ble Delhi High court in this case stated that the expression '**interest**' is defined by Article 12(5) to mean income from "**debt-claims of every kind**" irrespective of whether they be secured by a mortgage or carry a right to participate in the debtor's profit. It becomes pertinent to note that the **guarantee charges were not received by the appellant in respect of any debt owed to it by its Indian subsidiary**. As per its own stated case, the **guarantee charges were received in connection with the credit facilities** which were extended by the **overseas branches of foreign banks** to its Indian subsidiaries.
- ❖ Hon'ble High court held that the Tribunal has correctly found that the appellant was **neither a party to the loan agreements** that may have been executed **nor** was there any **privity of contract** that could be said to exist. It was observed that the guarantee charges that the appellant received was a **remuneration for the assurance** that it had offered to lending entities and who may have extended credit facilities to its Indian subsidiaries. **The debt that it owed was to those financial institutions.**

Ruling

- ❖ It becomes pertinent to note that the assertion of guarantee charges being interest would also not sustain even when tested on the anvil of Section 2(28A) of the Act. The expression interest is defined to mean amounts **payable in respect of any monies borrowed or debts incurred**. Undisputedly the appellant had not borrowed any monies.
- ❖ The income that it received from its Indian subsidiaries was solely in consideration of any liability that could possibly befall the appellant in case its Indian subsidiaries were to default in their repayment obligations. It thus becomes apparent that the guarantee fee would neither fall within the ambit of Article 12 of the DTAA nor Section 2(28A) of the Act.
- ❖ The issue of whether guarantee charges would constitute **business income** and fall within the ken of Article 7 of the DTAA is **kept open** to be addressed in an appropriate case.

Our Comments

- ❖ Article 12 of India UK DTAA state that interest income means income in respect of "**debt-claims of every kind**". However, in this case, assessee did not provide any loan to its Indian subsidiary, whereas assessee provided guarantee in respect of loan given by **overseas branches of foreign banks**. Hence, guarantee fees charged by assessee is not covered Article 12 of India UK DTAA. The similar meaning can be drawn from the Income Tax Act.
- ❖ For E.g. – If Mr. A provides project report services in respect of loan taken by Mr. B from a bank and bank charges interest at the rate of 9% and processing fee @1.5%. In this case, Interest @9% and processing fee @1.5%, both will be treated as interest income because it is in respect of loan given by bank to Mr. B. However, project report services can not be treated as interest income because person A has not given any kind of loan to Mr. A.
- ❖ Further, GST also treats guarantee fees as a separate service which is not covered under definition of Interest. Further, guarantee fees cannot be considered as FTS. To read more – [**CLICK HERE**](#)

Section/Article	Sec 5(2), Sec 9(1) and 2(28A) of IT Act
DTAA/Country	India UK
Court	Delhi High Court
Date of decision	28.05.2024

Note: Case law name in **Red**- in favor of the revenue, **Green**-In favor of the Assessee, **Orange** = Partial



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