



SATURDAY INTERNATIONAL TAX GYAN !!!

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SITG No. 211

Denso (Thailand) Co. Ltd.

v.

ACIT (International Taxation)

In case of absence of a specific article in DTAA, we need to check if it is falling under any other general article before going to article 22 i.e. other income.

22.06.2024



Facts of the Case

- ❖ Appellant is a company incorporated under the laws of Thailand and a tax resident of Thailand.
- ❖ Appellant acts as a regional service centre of the Denso Group for Asia and Oceania undertaking business administration, material engineering services, etc. for the Group and during the year under consideration, appellant earned INR 16,60,43,718, which, as per the claim of appellant is in the nature of FTS on account of services provided to its five Indian group companies.
- ❖ Appellant contended that the said receipts are taxable as **business income under Article 7 of DTAA** in absence of FTS clause in the India-Thailand DTAA. Further, in absence of permanent establishment ('PE') of appellant in India, business income is not liable to be taxed in India. However, the **AO** was of view that in the absence of FTS clause in the tax treaty, **income should fall under Article 22.**

Assessee's Contention

- ❖ Appellant submitted that in case the services are in the nature of business activities, **taxability of the same shall be tested first under Article-7 in absence of FTS Article rather directly approaching to Article-22.** The services under consideration are in the nature of business activities of the Appellant and in the **absence of PE in India, receipts should not be taxed in India.**
- ❖ Appellant submitted that even though certain exceptions are discussed in new article 22(2) of new DTAA, but those exceptions do not include FTS. However, non-inclusion of FTS in the exception given in Article 22 does not mean that the amount of FTS would be taxable as per the provisions of the Act.
- ❖ Further, appellant filed copies of **MOA** and other documents before AO to substantiate that the services provided by the Appellant have been rendered in normal course of its business. Therefore, **FTS should be covered by Article 7 of the DTAA.**

Revenue's Contention

- ❖ Revenue contended that in the absence of FTS clause in the tax treaty, income should fall under Article 22 (i.e. other income) of DTAA and accordingly should be taxed as FTS at 10% as per section 9(1)(vii) of the Income-tax Act, 1961.
- ❖ Ld. AO has observed that the services provided by the Appellant are not in the nature of its primary business activities based on web portal. Mere mentioning activities in memorandum of association, does not entail Appellant to claim said activity is part of its prime business.
- ❖ As per new DTAA, effective from 2016, Article 22 got amended, and taxing rights of source state further strengthen with a non-obstante clause. Certain exceptions are discussed in new article 22(2) of new DTAA, but those exceptions do not include FTS and therefore, taxing such receipts under domestic law by invoking article 22 of DTAA is correct.

Legal provisions

India-Thailand DTAA:

Article 7

1. “The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the profits of the enterprise may be taxed in the other State but only so much of them as is attributable to that permanent establishment.”

Article 22

“1. Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Agreement shall be taxable only in that State.

2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6, if the recipient of such income, being a resident of a Contracting State, carries on business in the other Contracting State 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 the income is 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.”

Ruling

- ❖ There is no dispute on the part of the Revenue that the disputed income of Rs. 16,60,43,718/- by its nature and characteristics is accepted to be FTS only.
- ❖ Hon'ble ITAT discussed that where there is no FTS clause available in the treaty with a country, then the income in question would be assessable as business income and it can be taxed in India only if there is a permanent establishment in India and the income is attributable to activities or functions performed by such PE.
- ❖ Hon'ble ITAT further held that MOA of an assessee which is actually relevant to give a finding about the nature and scope of the business activity which the enterprise can enter into and the **web portal in no way is an evidence of the business activities** of an assessee.
- ❖ Thus, **once the assessee raises a claim that the source of its revenue is out of "profits of an enterprise", under Article 7 of DTAA, then Article 22 would not be applicable.** If at all AO wants to invoke any other provision of the Act or the DTAA, then the said activity **should be examined to establish that same does not fall in any other Article and then only Article 22 may be invoked.**

Ruling

- ❖ Thus where a DTAA does not make a reference for taxability of FTS, as separate item, then Article 22, which vests residuary powers, cannot be invoked. The intention of having residuary powers of taxing an income vested in any of the contracting state is to deal with those incomes which due to lack of regularity, continuity and frequency do not form part of regular business activity of the entity
- ❖ The residuary provisions of Article 22 will not apply to items of income, which can be classified under other provisions of the tax treaty, but their taxability is subject to fulfillment of conditions mentioned therein. **Thus we conclude the fee paid towards technical services can be brought under the item of business income, if there is no material to show that the same is not related to the business of the assessee.**
- ❖ On a perusal of the documentary evidences filed and taking into consideration the nature of services provided by Assessee, we would concluded that the **services provided by the assessee to the Indian AEs are in the nature** of technical, managerial or consultancy, which, themselves together as **FTS, do not fall in any Article of the DTAA, can very well be part of business income.** Thus for the applicability of Article 7 assessee had brought on record the evidence which establish that FTS, actually is part of business activity and assessee does not have a PE in India. So benefit of Article 7 is to be extended.

Our Comments

❖ In a case where **FTS article is not available** in the DTAA, we need to **first check the other articles** where it could be covered **before moving to the article 22**, which is a residuary article in any DTAA. The above contention is supported by in the case law of “*Solvay Asia Pacific (P.) Ltd. v. DCIT: [2024] 159 taxmann.com 90 (Delhi - Trib.)*”.

❖ Whenever we are reading the DTAA, we always follow the principle of **specific over general**. Therefore while reading any DTAA, we first check that whether a transaction is falling under any specific article for the income or not. If it does not fall under any specific Article, then it would fall under residuary Article.

Accordingly, if a company is providing technical services, it could be the business of assessee. However, if such services are falling under FTS, it would be taxable under the Article of FTS, even though if it is the business of assessee. In case of absence of FTS article, then we need to check the taxability under Article 7 i.e. business income. If it is not the business of assessee, then only, such services would fall under Article 22 i.e. other income.

Section/Article	Article 7 & 22, Sec 9 of IT Act
DTAA/Country	India-Thailand
Court	Delhi Tribunal
Date of decision	31.05.2024

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



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