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Guarantee charges neither taxable as interest nor as fees for technical services under India-Netherlands tax treaty

The Delhi Bench of the Indian Income-tax Appellate Tribunal (ITAT) rendered its decision that guarantee charges are neither taxable as interest nor as fees for technical services under the provisions of Article 11 or Article 12, respectively of the India-Netherlands tax treaty and thus, the payments thereof are not subject to withholding tax in India.

Facts of the case:

- Lease Plan India Private Limited (the taxpayer)[1] is engaged in the business of leasing of motor vehicles, financial services and fleet management.
- During the Financial Years (FY) 2008-09 and 2009-10, corresponding to Assessment Years (AY) 2009-10 and 2010-11, the taxpayer paid guarantee charges to its associated enterprise Lease Plan Corporation NV (LP Corp), based in Netherlands.
- The guarantee charges were paid pursuant to an agreement between the taxpayer and LP Corp, whereby LP Corp acted a guarantor for any bank loan availed by the taxpayer. The fees were fixed at 1/8 percentage per annum.
- The taxpayer considered that the payment of guarantee charges was not chargeable to tax in India and accordingly, did not withhold tax at source (TDS) while making its payment to LP Corp, because:
  - The payment was for reimbursement of actual charges; and
  - The payment did not involve any element of technical, consultancy or advisory services and thus, did not qualify as fees for technical services (FTS).
- During the course of audit proceedings, the Assessing Officer (AO) disallowed guarantee charges on the basis that TDS was not deducted by the taxpayer.
- On appeal, the Commissioner of Income Tax Appeals [CIT(A)] upheld the order of the AO and held that:
  - Guarantee charges / fees paid to LP Corp qualified as interest income from debt-claim of every kind, under Article 11 of the India-Netherlands tax treaty.
  - Alternatively, the guarantee charges / fees qualified as fees for technical services (FTS) on the following basis:

[1]Lease Plan India Pvt. Ltd. v. DCIT (ITA No. 6461 and 6462/Del/2015)

- Guarantee commission paid could fall within the ambit of FTS, as it represented payment for rendering a service that was ancillary or subsidiary to the application or enjoyment of right (i.e. the guarantee service enabled the taxpayer to enjoy unrestricted and easy access to credit in India).
- The guarantee services were utilised in the business carried on and for the purposes of income earned in India. The taxpayer's business model involved heavy capital investment in vehicles through bank loan and the role of guarantor was of utmost importance.

– Relying on various earlier rulings[2], the nature of services rendered by LP Corp was covered within the ambit of the term "consultancy services" and therefore TDS should have been deducted.

- Aggrieved by the CIT(A)'s order, the taxpayer filed an appeal before the Delhi Bench of Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted that the issue in the case under consideration was whether the guarantee fee paid by the taxpayer to LP Corp was chargeable to tax as FTS or as interest under Article 12 or under Article 11, respectively of the India-Netherlands tax treaty. If the guarantee fee was not chargeable to tax in India, then TDS was not required to be deducted by the taxpayer.
- The ITAT held the following, with respect to taxability of guarantee fee as interest under Article 11 of India-Netherlands tax treaty:
  – The following two criteria need to be satisfied to qualify as interest:
    - Provision of capital; and
    - It should be in the form of debt-claim.
  – The word debt-claim predicates the existence of debtor-creditor (i.e. lender-borrower), which could arise only when there was a provision of capital.
  – LP Corp had not provided any capital to the taxpayer on which income was earned.

  Accordingly, in the absence of provision of capital and debt-claim between the taxpayer and LP Corp, the ITAT held that the payment of guarantee fees did not qualify as interest under Article 11 of India-Netherlands tax treaty.

  The ITAT held the following, with respect to taxability of guarantee fee as FTS under Article 12 of India-Netherlands tax treaty:
  – Provision of guarantee was a service provided by LP Corp to the taxpayer.
  – The service provided by way of guarantee was a financial service and not a consultancy service. Further, the provision of guarantee service did not satisfy the 'make available' criteria.

[2]United Breweries Ltd. v. ACIT [1995] 211 ITR 256 (Kar HC), Sky Cell Communications Limited v. DCIT [2001] 251 ITR 53 (Madras HC), Advance Ruling P. No. 28 of 1999 [2000] 242 ITR 208 (AAR), CIT Vs. Bharti Cellular Ltd. [2009] 319 ITR 139 (Delhi HC), GVK Industries Limited [2015] 371 ITR 453 (SC)

In view of the above, the provision of guarantee service did not qualify as FTS under Article 12 of the India-Netherlands tax treaty.

- The guarantee fee was not chargeable under Article 7 of the India-Netherlands tax treaty in absence of a permanent establishment of LP Corp in India.
- In the absence of Other Income Article under the India-Netherlands tax treaty, the issue of taxability of guarantee fee as Other Income did not arise.

In view of the above, the ITAT held that the taxpayer was not required to deduct TDS from the payment of guarantee fee.

Comments:

- Provision of guarantee by non-resident group company on behalf of Indian group companies is a common transaction. The taxability of guarantee fee has been a litigative issue. This ruling lays down the principle that guarantee fee neither qualifies as interest nor as FTS under the India-Netherlands tax treaty.
- Taxpayers would need to evaluate the facts of their case while relying on this ruling.

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