MOORE Singhi

Tax Update

ITAT Bangalore Rules Guarantee Fee Received by Korean Parent Company Not Taxable in India

Introduction

The present case pertains to the taxability of the purported demerger of the treasury undertaking of Reckitt Benckiser Healthcare India Pvt. Ltd.[1] (hereinafter referred to as "the assessee"). The core issue before the Ahmedabad Income Tax Appellate Tribunal (ITAT) was whether the transaction in question qualified as a tax-neutral demerger under Section 2(19AA) of the Income-tax Act, 1961 or whether it constituted a transfer of capital assets, thereby attracting liability under Section 45 of the Act. Additionally, the tribunal examined whether the issuance of shares by the resulting company in favor of the shareholders of the demerged entity resulted in a deemed dividend distribution within the meaning of Section 2(22) of the Act.

This decision, in KIA Corporation v. Assistant Commissioner of Income-tax [2025] 176 taxmann.com 246, reaffirms the principle that DTAA provisions override domestic tax laws and that where income is not categorised under specific treaty articles (such asbusiness profits, interest, or royalties), the residual article applies - even where there may be a territorial nexus under Indian tax law.

Facts of the Case

KIA Corporation, a company incorporated and tax resident in South Korea, extended a corporate guarantee to its Indian subsidiary, KIA India Pvt. Ltd., enabling the latter to obtain a loan from a bank. For this service, KIA Corporation received guarantee fees of ₹9.74 crores from the Indian subsidiary during AY 2022–23.

The assessee claimed that the income was not taxable in India on the basis of Article 22 of the India-Korea Double Taxation Avoidance Agreement (DTAA), which governs "Other Income". As per Article 22, items of income of a resident of a Contracting State, wherever arising, that are not dealt with in the foregoing articles of the Convention, shall be taxable only in that State.

Department's Stand and DRP's Findings

The Assessing Officer rejected the treaty claim and held that the guarantee fee was taxable in India under:

- ☑ Section 5(2) – as income received in India; and
- ☑ Section 9(1)(i) – as income accruing or arising in India or deemed to accrue or arise in India.

The AO reasoned that since the loan was used in India and the subsidiary carried on operations in India, the economic nexus of the payment lies within Indian territory. The Dispute Resolution Panel (DRP) affirmed this position and upheld the inclusion of the guarantee fee in the taxable income of the assessee.

Tribunal's Ruling

The ITAT ruled in favour of the assessee on the following grounds:

- ☑ It was undisputed that the guarantee fee did not fall under Articles 6 (immovable property), 7 (business profits), or 11 (interest) of the India-Korea DTAA.
- ☑ The Department could not bring any material on record to prove that the guarantee fee represented business income or interest.
- ☑ Hence, Article 22 (Other Income) applied as a residual clause, and in terms of that Article, the income would be taxable only in Korea, the state of residence of the assessee.

The Tribunal relied on the decision in Daechang Seat Co. Ltd. v. DCIT [2023] 152 taxmann.com 163 (Chennai-Trib.), which had held that guarantee fees received by a Korean parent company from Indian subsidiaries were taxable only in Korea under Article 22 of the India-Korea DTAA.

It also distinguished the Delhi High Court ruling in Johnson Matthey Public Ltd. v. CIT [2024] 162 taxmann.com 865, where guarantee fees were held taxable in India under the India-UK DTAA. The Tribunal noted that the wording of the "Other Income" article in the India-UK DTAA was materially different, permitting source-based taxation under certain conditions - unlike Article 22 of the India-Korea DTAA, which provides for exclusive residence-based taxation unless a specific article applies.

Our Comments

This is a welcome decision that provides clarity and certainty for foreign parents receiving guarantee fees from Indian subsidiaries, especially under treaties with a residence-only taxation model for "Other Income". Taxpayers engaged in intra- group guarantees should review their treaty positions and income classification to determine if similar relief could apply.