Taxability should be determined by reading tax treaty and its protocol together – protocol is not independent of the tax treaty

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In brief

The Delhi bench of the Income-tax Appellate Tribunal (Tribunal), in a recent ruling,[1] *inter-alia*, held that the taxability has to be decided after taking into account the provisions of the Double Taxation Avoidance Agreement (tax treaty) along with its protocol. A protocol is to be considered as an addendum to the tax treaty and not to be viewed as an independent document. Any benefit conferred, expanded or reduced by the protocol is to be applicable even if there is no dispute in the terms of the tax treaty.

In detail

Facts

- The taxpayer was incorporated in Sweden and was engaged in the field of telecommunication and mobile telephony. The taxpayer had a branch office in India.
- The taxpayer, *inter-alia*, earned fee from Indian concerns being its associated enterprises for the supply of technical personnel engaged in installation and maintenance of mobile network system under contracts carried by such enterprises.
- The taxpayer computed a net tax loss, after aggregating revenues from all the streams (including the above fees) and deducting common expenses therefrom.
- During the assessment proceedings, the tax officer (TO) opined that the fee earned from Indian concerns was in the nature of fees for technical services (FTS), as per the India-Sweden tax treaty, and it should have been taxed on gross basis without allowing any deduction of expenses.
- The TO took note of an advance ruling obtained by the taxpayer in an earlier year, wherein it was held that fee received by the taxpayer was FTS in terms of the tax treaty and was taxable on gross basis.[2]
- The Commissioner of Income-tax (Appeals) upheld the TO's order. The aggrieved taxpayer filed an appeal before the Tribunal.

Issue before the Tribunal[3]

Whether the fee earned by the taxpayer was taxable as FTS, considering the beneficial provisions of the protocol to the India-Sweden tax treaty, entered into after the pronouncement of the earlier advance ruling in the taxpayer's own case?

[1] ITA No. 893/ Del/ 2006

[2] The Ruling read the provisions of section 44D of the Income-tax Act, 1961, which provides that a foreign company earning FTS income from India, pursuant to an agreement entered after 31 March, 1976, but before 01 April, 2003, is to be offered to tax without deducting any expenditure.

[3] Another issue with respect to allocation of expenses was restored to the file of the TO for fresh examination and has not been discussed in this alert.

Taxpayer's contentions

- The advance ruling delivered in the taxpayer's own case considered provisions of the India-Sweden tax treaty as notified in March 1989. The new tax treaty was notified in December 1997 and governed the year under consideration.
- The Protocol appended to the new tax treaty in June 1997 incorporated the Most Favoured Nation clause, whereby the "make available" clause, as provided in India-Finland tax treaty, had to be read into the India-Sweden tax treaty.
- Although the advance ruling in the taxpayer's case attained finality, the taxability would have to be reconsidered in light of the protocol to the new tax treaty. The advance ruling would be binding, save and except a subsequent change in the relevant provisions of the Income-tax Act, 1961 or the tax treaty.

Revenue's contention

The Protocol had no application in the present case, as it can only be resorted to if there is some dispute on the terms of the tax treaty.

Tribunal's ruling

- A protocol to the tax treaty is to be considered as its part and parcel. A protocol completes the tax treaty. Therefore, the provisions of the protocol conferring, expanding or reducing a particular benefit, which is absent in the tax treaty, are to be applied to that extent.
- The protocol should not be viewed as a document independent of the tax treaty and has to be considered as its addendum.
- Considering that the tax treaty under which the advance ruling in the taxpayer's case was rendered has been substituted, the arguments of the taxpayer in the light of the new tax treaty would have to be considered.
- As the TO passed the order simply on the basis of the advance ruling in the taxpayer's case for an earlier year, without considering the substituted tax treaty, the case was remanded back to the TO for deciding the issue afresh.

The takeaways

This decision reaffirms the position that a Protocol to the tax treaty has to be considered as its addendum, and if it extends or reduces a benefit absent in the tax treaty, the provisions of the Protocol will be applicable to that extent. The provisions of the Protocol to the tax treaty are to be followed in all situations, even if there is no dispute on the terms of the tax treaty.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact your local PwC advisor

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