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Applicability of a tax treaty to a limited partnership in Germany is governed by the specific provisions of the relevant tax treaty and not by the OECD commentary

In brief

Recently, the Mumbai High Court (HC) in the case of Chiron Behring GmbH & Co[1] held that benefit under the Double Taxation Avoidance Agreement between India and Germany (tax treaty) cannot be denied to the limited partnership which pays trade tax covered under the tax treaty and is also issued tax residency certificate (TRC) by German tax authorities, evidencing that the assessee is a taxable unit under the laws of Germany. Applicability of a tax treaty is governed by the specific provisions of the relevant tax treaty and not the OECD Model Convention (OECD commentary).

Facts

- Chiron Behring Gmbh & Co. (Chiron Germany or the assessee) is a limited partnership in Germany.
- The tax return was submitted by the assessee in India for assessment year (AY) 2002-03 declaring income of INR 33.5 million.
- The assessee claimed benefit of lower taxation under Article 12(2) of the tax treaty. The said Article provides that royalty and fees for technical services (FTS) received in India by a resident outside India is not liable to tax in India in excess of 10% of the gross amount received.

[1] DIT (IT) *v.* Chiron Behring GmbH & Co. [TS-12-HC-2013 (BOM)]

- The assessing officer (AO) relied on the OECD publication "The application of OECD Model Tax Convention to Partnership" (OECD publication) and concluded that the assessee, being a limited partnership, is not liable to tax in Germany and accordingly he denied the benefit under Article 12(2) of the tax treaty.

- In an appeal before the Commissioner of Income-tax (Appeals) (CIT(A)), it was held that the assessee is paying trade tax (on business profits) in Germany and such tax is covered under Article 2 of the tax treaty. This fact was also certified in the TRC issued by German tax authorities. Accordingly, it was held that the assessee is eligible to take benefit under the tax treaty.

- The matter was referred to the Income-tax Appellate Tribunal (Tribunal) and the order of the CIT(A) was upheld[2].

Aggrieved by the order of the Tribunal, the revenue authorities appealed before the HC.

Issues before the HC

Whether on the facts and circumstances of the case and in law, the assessee, which is a limited partnership in Germany, can be considered as a tax resident of Germany so as to be entitled to tax treaty benefits.

Revenue's contentions

The assessee is a limited partnership and relying on the OECD publication[3] it can be concluded that limited partnership in Germany is not liable to tax and thus

[2] Important points to note as per the decision of the Mumbai Tribunal [2008] 314 ITR 59 (Mum) in the assessse's case:

- The main contention of revenue before the Tribunal were as follows:
  a) Trade tax is in the nature of tax on turnover and not tax on business income and thus assessee is not 'liable to tax' in Germany.
  b) The assessee is a limited partnership not liable to tax in Germany and hence tax treaty provisions are not applicable to it.
- In support of its argument, the assessee submitted the copy of trade tax return filed by it and also translated the German Trade Tax Act, which stated that the basis of trade tax is income from business.
- Revenue authorities did not corroborate their claim that trade tax is tax on turnover and not business income and further challenged the authenticity of translated German Trade tax Act without submitting any material on record.
- The departmental representative relied on the OECD publication stating that the tax on limited partnership was the liability of the partners and not of the firm and in such a case only the partners and not the firm could become the person on whom DTAA shall apply.
- Tribunal referred to the decision of P.V.A.L Kulandagan Chettiar [2004] 267 ITR 654 (SC) to conclude that specific provisions of the tax treaty are relevant and reference to OECD commentary is unnecessary.
- In the absence of any substantial evidence and legal proposition from the revenue authorities, in support of its contentions, the Tribunal upheld the decision of CIT (A).
- In coming to such a conclusion, the Tribunal did not independently analyse if the assessee can be considered as a 'resident' in terms of Article 4 of the tax treaty.

[3] Though the relevant text of the OECD publication has not been reproduced in the order of either the HC or the Tribunal, the same is extracted below for reference:

- As per paragraph 40 of the OECD publication, 'The Committee agreed that for the purposes of determining whether a partnership is liable to tax, the real question is whether the amount of tax payable on partnership income is determined in relation to the personal characteristics of partners (whether the partners are taxable or not, what other income they have, what are the personal allowances to which they are entitled and what is the tax rate applicable to them). If the answer to that question is yes, then the partnership should not itself be considered to be liable to tax. The fact that the income is computed at the level of the partnership before being allocated to the partners, that the tax is technically paid by the partnership or that it is assessed on the partnership as described in the preceding paragraph will not change that result.'
- As per paragraph 56 of the OECD publication (also inserted as paragraph 8.8 to Article 4 of 2010 update to OECD Model Convention), 'Where a State disregards a partnership for tax purposes and treats it as fiscally transparent, taxing the partners on their share of the partnership income, the partnership itself is not liable to tax and may not, therefore, be considered to be a resident of that State. In such a case, since the income of the partnership 'flows through' to the partners under the domestic law of that State, the partners are the persons who are liable to tax on that income

cannot be considered as a taxable unit in Germany. Therefore, the benefit of the tax treaty cannot be extended to the assessee.

Assessee's contentions

- As evident from the TRC issued by German tax authorities, the assessee is a taxable entity under Germany laws.
- In terms of Article 2(3), the tax treaty is applicable even in respect of trade tax in Germany.

HC observations

- Trade tax paid in Germany is specifically included in the definition of 'taxes covered' as per Article 2(3) of the tax treaty.
- The term 'person' includes any entity which is treated as a taxable unit under the taxation laws of the contracting states.
- As per Article 4 of the tax treaty, 'resident' is defined as any person who under the laws of Germany is liable to tax therein by reason of his domicile, residence, place of management or any criterion of a similar nature.
- The assessee is filing trade tax return in Germany which is a tax covered in Article 2(3) of the tax treaty.
- TRC issued by the German tax authorities evidences the fact that the assessee is a taxable unit under the German laws.
- The tax treaty is applicable to the assessee and benefit under Article 12(2)[4] of the tax treaty therefore cannot be denied.
- The OECD commentary does not govern the applicability of a tax treaty. The specific provisions of the relevant tax treaty determine if the same is applicable.
- There is no merit in revenue's contention that the assessee is not a taxable entity in Germany relying only on the OECD commentary.

Conclusion

On the basis of specific terms of the tax treaty, it has been held that the limited partnership that pays trade tax in Germany and is issued TRC by the German tax authorities in this regard, is a 'resident' for the purposes of Article 4 of the tax treaty. Thus, the tax treaty is applicable and the assessee is entitled to claim benefits under the same.

In proceedings before the Mumbai Tribunal, it was agitated by the revenue authorities that the assessee, being a limited partnership, is a transparent entity as per German laws. The HC did not independently analyse the taxability of limited partnership (being a transparent entity) under German tax laws and also whether it is liable to tax in Germany on its worldwide income to be treated as a 'resident' as per Article 4 of the tax treaty. Income-tax status of the partners was also not analysed. Reliance was placed only on the TRC issued by the German tax

and are thus the appropriate persons to claim the benefits of the conventions concluded by the States of which they are residents. This latter result will be achieved even if, under the domestic law of the State of source, the income is attributed to a partnership which is treated as a separate taxable entity. For States which could not agree with this interpretation of the Article, it would be possible to provide for this result in a special provision which would avoid the resulting potential double taxation where the income of the partnership is differently allocated by the two States.'

[4] As per Article 12(2) of the tax treaty, royalty and FTS received in India by a person resident outside India is not liable to tax in India in excess of 10% of gross amount received.

authorities that *prima facie* indicated that the assessee was paying trade tax in Germany[5].

In the present context, it is pertinent to refer the decision of the Mumbai Tribunal in the case of Linklaters LLP[6] wherein the Tribunal on the basis of analysis of the OECD publication and judgments of Indian and foreign Courts has propounded the principle that the mode of taxation of income of a partnership firm (i.e. whether in the hands of the partnership firm or its partners) is not relevant for the source country for determining the applicability of a tax treaty to it, so long as the entire income of the partnership firm is taxed in the resident state.

While revenue authorities have placed reliance on the OECD publication, in support of its contention that the tax treaty is not applicable to the assessee, it has not taken note of the fact that India has expressed its reservation[7] to paragraph 8.8 of the OECD commentary on Article 4. Thus, the position stated in the OECD publication and corresponding paragraph in OECD commentary is not accepted by India. Consequently, the treatment accorded in the OECD publication and commentary is also not accepted by India[8]

The HC in the present case has given a consistent view as adopted by the Mumbai Tribunal in the case of Linklaters LLP (above).

5 'The general partnership (OHG) and limited partnership (KG) (*see* section 0.2.4.) are transparent entities for tax purposes. The income of the partnership is taxed in the hands of the partners. The income is subject to individual income tax if the partner is an individual and to corporate income tax if the partner is a company. The partnership itself is liable for business tax' - Source : IBFD Tax News Service.

6 Linklaters LLP *v.* ITO (IT) [2010] 132 TTJ 20 (Mum)

7 *Gabon*, *India*, *Ivory Coast*, *Morocco* and *Tunisia* do not agree with the interpretation put forward in paragraphs 5 and 6 of the Commentary on Article 1 (and in the case of India, the corresponding interpretation in paragraph 8.8 of the Commentary on Article 4) according to which if a partnership is denied the benefits of a tax convention, its members are entitled to the benefits of the tax conventions entered into by their State of residence. They believe that this result is only possible, to a certain extent, if provisions to that effect are included in the convention entered into with the State where the partnership is situated.

8 In paragraph 78 of decision of Mumbai Tribunal in the case of Linklaters LLP, the Tribunal observed: '*In this situation, i.e. when the government of India has rejected the stand taken in the OECD partnership report and the changes made in the OECD Model Convention Commentary as a result of the same, it cannot be open to hold that in the light of the OECD report, the partnership must be declined treaty entitlement benefits.*'

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