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TAX FLASH NEWS

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If certain benefits/limitations are given in a Protocol then it shall apply to the respective tax treaty because the Protocol is part of the tax treaty

Background

Recently, the Delhi Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Ericsson Telephone Corporation India AB (India Branch)[1] [the taxpayer] while dealing with the applicability of Most Favoured Nation (MFN) clause under the Protocol to India-Sweden tax treaty[2] observed that a Protocol to the India-Sweden tax treaty is to be considered as part and parcel of the tax treaty. There is no question of resorting to a Protocol only if some clarity is needed in the tax treaty. If a particular benefit is being conferred, expanded or reduced by the Protocol, which is absent in the tax treaty, then the provisions of the Protocol shall apply only to that extent. A Protocol cannot be viewed as a document independent of the tax treaty and has to be considered as its addendum.

Since the new India-Sweden tax treaty and the Protocol have not been considered by the Assessing Officer (AO) who has gone by the ruling rendered by the Authority for Advance Rulings (AAR)[3], the matter has been remitted back to the AO for fresh adjudication.

Facts of the case

- The taxpayer, a Sweden based entity, is engaged in the field of telecommunication and mobile telephony. During the year, the taxpayer, *inter alia*, received fees for rendering certain services.

- The AO relied on the AAR ruling in the case of Ericsson Telephone Corporation and held that receipts were taxable as Fees for Technical Services (FTS) under the tax treaty. Further, the AO invoked the provisions of Section 44D of the Income-tax Act, 1961 (the Act) and held that no deduction should be allowed. The tax rate of 20 per cent under Section 115A of the Act was applied by the AO.

- The taxpayer relied on the Protocol to the tax treaty. As per the MFN clause in the Protocol, if India had entered into a tax treaty with a third country which is a member of OECD, where it had limited its taxation rights in terms of rate or scope, which are more beneficial than that provided in the India-Sweden tax treaty, then such lower rate or scope shall apply in preference to the rate or scope of FTS provided in the India-Sweden tax treaty.

- The taxpayer contended that India entered into a tax treaty with Finland, which is a member of the OECD. Article 12 of the India-Finland tax treaty deals with 'Royalties and FTS' which contains the 'make available' clause, which was absent in the India-Sweden tax treaty. When the AAR[4] rendered its Ruling in 1996, the new tax treaty between India and Sweden was not entered into. Subsequently, it was notified on 17 December 1997 and came into effect after the AAR ruling was rendered. However, in the instant case, the Assessment Year (AY) under consideration is 2000-01. The taxpayer contended that the Protocol under the tax treaty of 1998 had the effect of changing the complexion of the case.

- The tax department contended that the Protocol would have no application as it can resort only if there was some dispute on the terms of the tax treaty.

[1] Ericsson Telephone Corporation India AB v. DDIT (ITA No. 893/Del/2016) – Taxsutra.com
[2] With respect to Fees for Technical Services
[3] Ericsson Telephone Corporation v. CIT [1997] 224 ITR 203 (AAR)

[4] The AAR in the taxpayer's own case [Ericsson Telephone Corporation v. CIT [1997] 224 ITR 203 (AAR)] held that the receipts of the taxpayer were in the nature of FTS within the meaning of Article 13 of the tax treaty. It was held that in terms of Article 7(3) of the tax treaty, though the FTS should be treated as 'business profits' and expenditure incurred to earn the same were to be deducted, but, in view of Section 44D(6) of the Act, no deduction could be allowed where the agreement was entered into after 31 March 1976.

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Tribunal's decision

- A Protocol to the tax treaty for all practical purposes is to be considered as it is part and parcel. There is no question of resorting to it only if some clarity is needed in the tax treaty. In fact, a Protocol completes the tax treaty.

- If a particular benefit is being conferred, expanded or reduced by the Protocol, which is absent in the tax treaty, then the provisions of the Protocol shall apply only to that extent. A Protocol cannot be viewed as a document independent of the tax treaty and it has to be considered as its addendum.

- The lower tax authorities have decided the issue of taxability of the amount of fees received by the taxpayer from services earned from Indian concerns simply on the basis of the AAR ruling.

- The India-Sweden tax treaty under which such AAR ruling was rendered, has been substituted. In such circumstances, the prescription of Section 245S(2)[5] of the Act gets attracted, which requires consideration of the arguments of the taxpayer in the light of the substituted tax treaty along with its Protocol to the facts of the present case. Such new tax treaty and the Protocol have not been considered by the AO, who had simply gone by the AAR ruling.

- The Tribunal remitted the matter back to the AO and directed to decide the issue afresh by considering the effect of alterations, introduced in the new tax treaty along with the Protocol.

- If the new tax treaty and the Protocol really impact the ruling given by the AAR against the taxpayer on the issue, then, the ruling should be applied in the light of such amendments. The decision on issues decided by the AAR, which remain unaltered by the new tax treaty or the Protocol, will have to be applied as such.

- It was clarified that the discussion of the new tax treaty or the Protocol should not be construed as a reflection of Tribunal's opinion on its applicability or otherwise to the facts of the instant case. The AO should decide its implications independently on merits.

[5] Section 245S(2) of the Act – The advance ruling pronounced by the Authority under Section 245R shall be binding only –
(a) on the applicant who had sought it;
(b) in respect of the transaction in relation to which the ruling had been sought; and
(c) on the Principal Commissioner or Commissioner and the income-tax authorities subordinate to him, in respect of the applicant and the said transaction

Our comments

The issue of whether a Protocol is part of the tax treaty has been a subject matter of debate before the Courts/Tribunal.

Klaus Vogel[6] explained the role of the Protocol and its role in interpreting the tax treaty. He has clarified that Protocols, and in some cases other completing documents are frequently attached to tax treaties. Such documents elaborate and complete the text of a tax treaty, sometimes even altering the text. Legally they are part of the tax treaty, and their binding force is equal to that of the principal treaty text. When applying a tax treaty, it is necessary to examine these additional documents. A Protocol is said to be a treaty by itself that amends or supports the existing treaty. The Kolkata Tribunal in the case of ITC Ltd.[7] observed that the Protocol is an indispensable part of the tax treaty with the same binding force as the main clauses therein.

The Delhi Tribunal in the case of Maruti Udyog Ltd.[8] observed that the provisions of the tax treaty are required to be read with the Protocol clauses and were subject to the provisions contained in such Protocol. The AAR in the case of Poonavala Aviation (P.) Ltd.[9] observed that a Protocol is said to be a treaty by itself that amends or supports the existing tax treaty. Similarly, it has been held in various cases[10] that the Protocol is an integral part of a tax treaty.

However, the AAR in the case of Steria (India) Ltd[11] observed that a Protocol cannot be treated as the same with the provisions contained in the treaty itself, though it may be an integral part of the tax treaty. The Protocol could be used for interpreting a provision of the tax treaty, however, it would not be correct/proper to import words, phrases or clause that were not available in tax treaties. Subsequently, the Delhi High Court in the case of Steria (India) Ltd[12] held that Protocols under the tax treaty form part of it and do not need to be notified separately unless the treaty/Protocol itself suggests otherwise.

[6] In his Third Edition on Double Taxation Convention
[7] DCIT v. ITC Ltd. [2002] 76 TTJ 323 (Kol)
[8] Maruti Udyog Ltd. v. ADIT [2010] 37 DTR 85 (Del)
[9] Poonavala Aviation (P.) Ltd.[2012] 343 ITR 202 (AAR)
[10] CIT v. ISRO Satellite Centre [2013] 263 CTR 549 (Del), Mersen India (P.) Ltd., In re [2012] 20 taxmann.com 475 (AAR)
[11] Steria (India) Ltd. [2014] 364 ITR 381 (AAR)
[12] Steria (India) Ltd. v. CIT [2016] 386 ITR 390 [Del]

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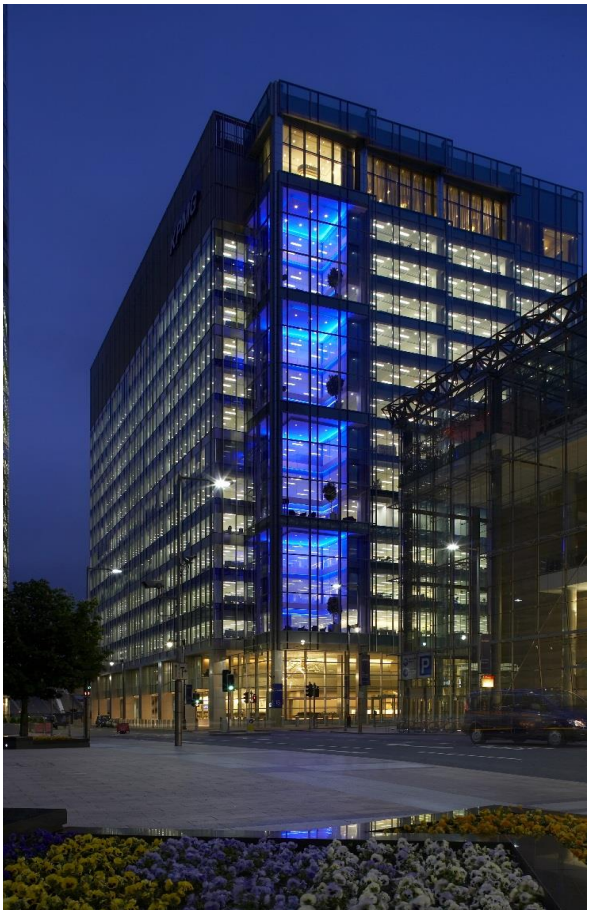
The Delhi Tribunal in the instant case observed that a Protocol is to be considered as part and parcel of the tax treaty. If a particular benefit is being conferred, expanded or reduced by the Protocol, which is absent in the tax treaty, then the provisions of the Protocol shall apply only to that extent.



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