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TAX FLASH NEWS

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Based on the Protocol to the India-Switzerland tax treaty, FTS can be taxed on gross basis even though the Swiss company had a Service PE in India

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of AGT International GmbH[1] (the taxpayer) dealt with the issue of taxability of Fees for Technical Services (FTS) at a beneficial rate under Article 12(2) v/s. taxability under Service Permanent Establishment (PE) article on net basis under the India-Switzerland tax treaty (tax treaty). The Tribunal held that FTS is to be taxed on gross basis under the Protocol to the India-Switzerland tax treaty even though the taxpayer company had a Service PE in India.

Facts of the case

The taxpayer, a resident of Switzerland, received payment on account of FTS from an Indian company and offered the same to tax at 10 per cent on gross basis under Article 12(2) of the tax treaty. However, the Indian company deducted tax at 42.024 per cent on the entire amount.

The Assessing Officer (AO) observed that the services rendered by the taxpayer did not satisfy the criteria under Article 12(4)[2] as the role of the taxpayer was only of buying and selling services. The AO held that the taxpayer on account of rendition of services had a PE in India i.e. a Service PE under Article 5(2)(I) of the tax treaty. The AO attributed the FTS under Article 5(2)(I) of the tax treaty. The AO held that the expenditure was allowable on estimated basis at 40 per cent of total revenue and remaining amount was taxable at normal income-tax rates applicable to foreign companies.

Taxpayer's contention

The taxpayer while relying on the Protocol to the tax treaty contended that it had a choice to be taxed on gross basis at the rates provided under Article 12(2) or on net basis under Article 7 of the tax treaty.

Tribunal's decision

On a combined reading of the provision of Article 5(2)(l) read with the related Protocol clause[3] it was observed that the Service PE being triggered on account of rendition of services by a Swiss entity in India, or vice versa, can never put the taxpayer at a disadvantageous position in so far as the tax liability in source jurisdiction is concerned.

Unless the taxpayer has a lower tax liability on the taxability of PE on net basis under Article 7 vis-à-vis taxability of FTS on gross basis under Article 12(2) of the tax treaty, the PE was in fact tax neutral.

Therefore, the issue cannot turn in favour of the tax department on account of Service PE triggered by the rendition of services. The Protocol provides the phrase 'at the request of the enterprise' thus when the taxpayer pleads for the taxability under Article 12(2), it's implicit that the taxpayer wants to be taxed at that rate. Accordingly, the receipts were taxed as FTS at 10 per cent on gross basis under Article 12(2) of the tax treaty.

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[1] AGT International GmbH v. DCIT (ITA No. 7465/Mum/18) – Taxsutra

[2] Article 12(4) deals with the definition of FTS. It provides that the term FTS means the payments of any kind to any person in consideration for rendering of any managerial, technical or consultancy services, including the provision of such services by technical or other personnel

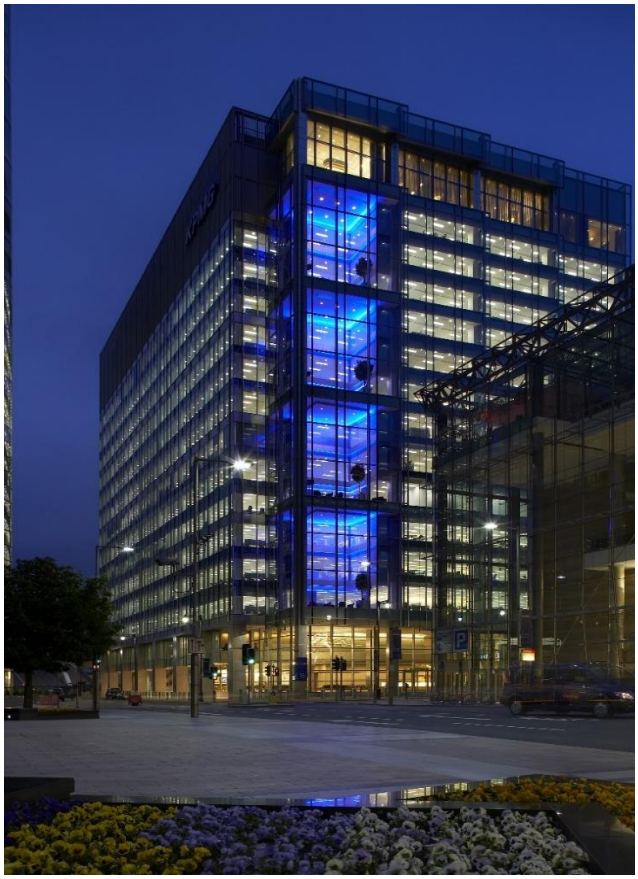
[3] With reference to Article 5 - The remuneration for furnishing of services covered by sub-paragraph (l) of paragraph 5(2) shall be taxed according to Article 7 or, on request of the enterprise, according to the rates provided for in paragraph 2 of Article 12.

Our comments

In the instant case, the taxpayer relied on the Protocol to the tax treaty and contended that since it had a service PE under Article 5(2)(l) of the tax treaty, the taxpayer had a choice to be taxed on gross basis at the rates provided under Article 12(2) or on net basis under Article 7 of the tax treaty with respect to FTS. The Tribunal relied on the phrase 'at the request of the enterprise' provided in the Protocol of the tax treaty and granted the beneficial treatment to the taxpayer to offer its FTS income on gross basis at the rates provided under Article 12(2) of the tax treaty.

Klaus Vogel in his commentary clarified that Protocols, and in some cases other 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.[4] 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 Ericsson Telephone Corporation India AB (India Branch)[5] observed that a Protocol to the India-Sweden tax treaty is to be considered as a part and parcel of the tax treaty.



[4] DCIT v. ITC Ltd. [2002] 76 TTJ 323 (Kol)
[5] Ericsson Telephone Corporation India AB v. DDIT (ITA No. 893/Del/2016)

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