

IN THE HIGH COURT OF JUDICATURE AT MADRAS
DATED : 24.10.2018
CORAM
THE HON'BLE MR.JUSTICE T.S.SIVAGNANAM

&

THE HON'BLE MRS.JUSTICE V.BHAVANI SUBBAROYAN

T.C.(A)No.878 of 2008

The Director of International Taxation
Madras ... Appellant / Appellant

Vs.

M/s.TVS Motors Co Ltd.,
(Rep assessee of AVL List GmbH
Austria), Jayalakshmi Estates
No.8, Haddows Road,
Chennai - 600 006. ... Respondent / Respondent

Tax Case Appeal has been filed under Section 260A of the Income Tax Act, 1961, against the order of the Income Tax Appellate Tribunal Tribunal 'C' Bench, Chennai, Dated 18.01.2008 in ITA.No.505/Mds/2007.

For Appellant : Mr.Karthick Ranganathan Sr. Standing Counsel Assisted by
Mr.S.Rajesh Jr. Standing Counsel

For Respondent : Mr.Vikram Vijayaraghavan for
M/s.Subbaraya Aiyar Padmanaban

JUDGMENT

T.S.SIVAGNANAM, J.

This Appeal filed by the Revenue under Section 260A of the Income Tax Act, 1961, (hereinafter referred to as the "Act"), is directed against the order passed by the Income Tax Appellate Tribunal Madras Bench 'C', (hereinafter referred to as the "Tribunal") in ITA.No.505/Mds/2007, dated 18.01.2008, for the assessment year 2002-03.

2. The respondent/assessee is a representative assessee of M/s.Avl List GmbH, Austria, filed return of income for the assessment year 2002-03 on 31.10.2002, admitting 'Nil Income' and claiming refund of Rs.64,41,795/-. The return was processed under Section 143 (1) on 23.03.2004, accepting the 'Nil Income' admitted. Subsequently, the assessment was reopened under Section 147 of the Act

and a notice, dated 22.03.2005 was sent. The assessee submitted their reply dated 13.04.2005, stating that the return of income filed on 31.10.2002 may be treated as return filed in response to notice under Section 148 of the Act. Subsequently, notice was issued under Section 143(2) on 22.09.2005, and the case was heard and the Assessing Officer by order dated 27.03.2006, under Section 143(3) read with Section 147 of the Act, rejected the contention raised by the assessee and treated a sum of Rs.2,14,72,290/- as royalty and brought the same to tax under the Double Taxation Avoidance Agreement (DTAA) between India and Austria; levied excess tax by grossing up the amount and initiating penalty proceedings under Section 271(1)(c) of the Act. Aggrieved by such order, the assessee preferred appeal before the Commissioner of Income Tax (Appeals)-XI [CIT (A)]. The CIT (A) by order dated 13.10.2006, accepted the case of the assessee and allowed the appeal. The Revenue carried the matter by way of appeal to the Tribunal and the Tribunal by the impugned order dated 18.01.2008, has dismissed the appeal filed by the Revenue. Questioning the correctness of the order passed by the Tribunal, the Revenue is before us by way of this appeal. The appeal was admitted on 24.07.2008, on the following substantial question of law:-

□Whether on the facts and in the circumstances of the case, the Income Tax Appellate Tribunal was right in treating the sum of Rs.2,14,72,290/- as royalty and bringing it to tax against the claim of the assessee that the payment represent fee for technical services is valid in law?□

3. Mr.Karthick Ranganathan, learned Senior Standing counsel appearing for the Revenue assisted by Mr.S.Rajesh, learned Junior Standing counsel, submitted that the Tribunal erred in concluding that a sum of Rs.2,14,72,290/-, represents fee for technical services without accepting the stand taken by the Revenue. It is submitted that in terms of paragraphs 1 to 7 of Article 12 of the DTAA between India and Austria vide notification, dated 21.09.2001, royalty and fees for technical services may also be taxed in the contracting State in which they arise and tax so charged shall not exceed 10% of the gross amount of royalties and fees for technical services. Further, it is submitted that the Tribunal ought to have seen that the earlier decision of the Tribunal relates to agreement entered into by the assessee earlier and the current issue is relating to a fresh agreement made on 13.11.2000. It is submitted that the Assessing Officer rightly held that the payment was in the nature of royalty and exigible to tax as per Article 6 of the DTAA with Austria. Further, it is submitted that the provisions of the DTAA are wider in amplitude than the provisions of the Act and the assessee, in the instant case, seeks to utilise the expertise of the Austrian company and therefore, the main object is to exploit such expertise and the assessee has no right to disclose or sell the project design to any third party and has only limited right to use the project design and the assessee must use the design only for the purpose mentioned in the agreement and they cannot transfer, sell or modify the design and they get only a limited right to use the design developed by the Austrian company. Therefore, it is submitted that the amount received by the Austrian Company from the assessee for the design is royalty only and is taxable as royalty as per Article 6 of the DTAA between India and Austria as per notification dated 05.04.1965, as corrected by notification, dated 27.08.1965. It is further submitted that Article 6 of the DTAA between India and Austria mentions that royalties derived by a resident of one of the territories from sources in other territory may be taxed only in that other territory and the royalty received by the Austrian company is therefore, taxed in accordance with Section 9(1)(vi) of the Act. Thus, it is contended that the agreement between the assessee and the Austrian company is only for exploitation of know how and therefore, the Assessing Officer was right in treating the payment as royalty. In support of his contention, the learned counsel placed reliance on the decision of the Madras Bench of the Tribunal in the case of TVS Suzuki Ltd., vs. Income Tax Officer (2000) 73 ITD 91 (Mad); decision of the High Court of Karnataka in Commissioner of Income Tax vs. CGI Information Systems & Management Consultants (P) Ltd., [2014] 48 taxmann.com 264 (Karnataka); and the decision of the High Court of Delhi in the case of Commissioner of Income Tax, Delhi-I, vs. Voest Alpine A.G., [2015] 55 taxmann.com 489 (Delhi). The learned counsel also referred to the various clauses in the technical assistance agreement entered into between the assessee and the Austrian company, dated 13.11.2000, to

substantiate his contention. The learned counsel has drawn attention of this Court to the technical assistance agreement entered into between the assessee and the Austrian company and in particular to the general terms and conditions. Referring to clause 7 of the said conditions, which deals with 'industrial property rights' it is submitted that clause 7.1 therein states that any existing ideas and know-how and patents owned by the AVL, not resulting from work carried out under the contract, but introduced into the project by AVL, shall remain AVL's exclusive property. Further, it is submitted that clause 7.2 states that any ideas, know-how and inventions made by AVL's employees as a result of work carried out under the contract shall be AVL's exclusive property. Further, in terms of clause 7.3 drawings and technical documents relating to the project shall remain exclusive property of the submitting party and shall be treated as confidential information by the receiving property and may be utilised only for the work performed pursuant to the contract. Further, clause 7.4 (a) states that a non-exclusive licence to use the ideas, know-how and patents is described in clauses 7.1 & 7.2 for all purposes included in the subject project, but for no other purposes. Thus, it is submitted that know-how and patents remain as exclusive property of the Austrian company and therefore, the Assessing Officer rightly treated the payment made by the assessee to the Austrian company as royalty and prayed that the order passed by the Tribunal be set aside and the order of the Assessing Officer be restored.

4. Mr. Vikram Vijayaraghavan, learned counsel appearing for the assessee referred to various clauses in the technical assistance agreement, dated 13.11.2000 and submitted that the agreement is for the purpose of modification of the engine developed by the assessee to make the same fuel efficient and in terms of the agreement, the assessee will supply all design documentation, engines, components and vehicles required for the project to the Austrian company free of charge and the work involved in the project is improvement of an already existing engine developed by the assessee. It is submitted that in respect of a similar agreement with the Austrian company in respect of carburetter, the payment made by the assessee was treated as 'fee for technical services' and the same will equally apply to the present agreement, which is for improvement of an engine. Further, it is submitted that after the improvements are done to the engine, the same is given back to the assessee and it is the exclusive property of the assessee. The learned counsel referred to the findings given by the CIT(A) as well as the Tribunal and contended that the entire issue revolves on questions of fact and there is no substantial question of law involved in this appeal.

5. With regard to the general terms and conditions of the agreement, it is submitted that they are general in nature, intended to safeguard the Austrian company from fraud and such generic clauses cannot change the technical assistance agreement, where the payment is as fee for technical services into that of royalty. Thus, the standard clauses in the general conditions is only to protect the Austrian company and it cannot change the nature of the agreement between the parties. Further, by referring to Section 9(1)(vii) Explanation 2, it is submitted that no periodic payment is made by the assessee to the Austrian company and the fee for technical services is a lumpsum payment and what is envisaged in royalty is transfer of right to use or a licensed use for which if payment is made, it shall be treated as 'royalty'. With regard to the decisions relied on by Mr. Karthick Renganathan, it is submitted that those decisions namely, in the case of Voest Alpine A.G., and CGI Information Systems (supra), will not apply to the facts of the present case. With the above submissions, the learned counsel appearing for the assessee sought to sustain the order passed by the Tribunal.

6. Heard the learned counsels appearing for the parties and perused the materials placed on record.

7. The assessee entered into a technical assistance agreement with a non-resident company in Austria for design of new 75CC, 3-valve Cylinder head, the project which commenced in January 2001 and was completed in October 2001. The assessee during the assessment proceedings

contended that the fees paid by them to the Austrian company is only for technical services, as the entire work was done in Austria and no part of the work was done in India and the entire income was taxable only in Austria in terms of provision of the DTAA with Austria. The assessee placed reliance on the decision of the Madras Bench of the Tribunal in their own case [TVS Suzuki Ltd., vs. Income Tax Officer (2000) 73 ITD 91 (Mad)] wherein it was held that the services rendered by the Austrian company are in the nature of fees for technical services and not royalty and therefore, not subject to tax in terms of the DTAA with Austria. The stand taken by the assessee, did not find favour with the Assessing Officer, who was of the view that the amount received by the Austrian company from the assessee for design of 75CC 3-valve Cylinder head is royalty taxable in terms of Article 6 of DTAA with Austria. Thus, it was held that the royalty received by the Austrian company is taxable in accordance with Section 9(1)(6)(i) of the Act. Challenging the same, the assessee preferred appeal before the Commissioner of Income Tax (Appeals) [CIT(A)]. The CIT (A) by order dated 13.10.2006, allowed the assessee's appeal and held that the payment do not constitute royalty. The Revenue carried the matter to the Tribunal, which dismissed the appeal filed by the Revenue, by order dated 18.01.2008, which is impugned before us in this appeal.

8. The Assessing Officer, on going through the technical assistance agreement, dated 13.11.2000, held that the Austrian company is providing the design of newly developed engine for being used by the assessee and this is taxable as 'royalty'. Referring to Article 6(2) of DTAA between India and Austria, which defines royalty, it was held that the royalty means payment made for the right to use and in terms of clause (7) of the general conditions, the ideas and inventions carried out by the Austrian company where their exclusive property and though the assessee is providing technical inputs and material to the project, the new design developed by the Austrian company is the exclusive property of the Austrian company and therefore, the assessee has no right to disclose or sell the project design to any third party and they have only limited right to use the project design.

9. The CIT (A) also examined the Technical Assistance Agreement and took note of the decision in the assessee's own case in respect of technical services rendered to the assessee by the Austrian company for Carburettors and held that the said decision would be applicable to the case on hand. It is pointed out that there is no dispute that the assessee developed the basic engine and sent the same to the Austria, who in turn would have to carry out modifications and improvements to meet the desired parameters set out by the assessee. Therefore, it was held that it is not a readymade patented technology supplied by the Austrian company to the assessee and it is a specific service performed by the Austrian company in respect of engine manufactured by the assessee to meet the specified specifications. Finding that the technical assistance agreement was identical to that of the agreement which was considered by the Tribunal in the assessee's own case, allowed the appeal, holding that the payments do not constitute royalty.

10. Before the Tribunal, the Revenue appears to have reiterated the stand taken before the CIT(A), much of which fell from the findings given by the Assessing Officer. The Tribunal recorded that the finding of fact as recorded by the CIT(A), could not be controverted by the department with any counter material so as to take a different decision, than the one rendered by the Tribunal in TVS Suzuki Ltd., vs. Income Tax Officer (2000) 73 ITD 91 (Mad), and accordingly the appeal filed by the Revenue was dismissed.

11. The sheet anchor of the case of the revenue is pitched on clause No.7 of the General Terms and Conditions, which deals with [industrial property rights]. To be noted that the general terms and conditions is appended as annexure 4 to the agreement. Therefore, before we examine the clauses in the annexures, it is essential to examine the conditions contained in the technical assistance agreement.

12. The scope of the work was for design of a new 3-valve cylinder head with AVL CCBR combustion system. This would have considerable improvement of fuel efficiency, improved performance and Meeting India 2004 Emission Limits under IDC test conditions. The agreement states that the assessee has recently developed a new 75CC 4-stroke 2-valve air cooled engine with single speed transmission for moped application. As the local market, (India), is asking for better fuel economy, the Austrian company was asked to design a new 3-valve cylinder head with a lean burn combustion system with charge motion for rapid combustion. The whole work under the said agreement was to be carried out in Austria. The assessee was to supply the material with all design documentation, engines and components as required for the project. The total price for the project work deliverables and services was agreed at EURO 349.522. The General Terms and Conditions, which were appended as annexure 4 to the technical service agreement, applies to all deliverables of work, services and goods supplied by the Austrian company.

13. On a perusal of the same, it is seen that these conditions are standard conditions as drafted by the Austrian company to suit its requirement and essentially to protect its rights and property. To get a clear picture about the effect of the general terms and conditions, one has to peruse all the conditions contained therein and not restricted it to one of the conditions alone.

14. The revenue's plea is that clause 7 of the general terms and conditions would clearly show that the know-how and patents and the ideas introduced into the project shall remain the exclusive property of the Austrian company and therefore, what has been given to the assessee is only a right to use and therefore, the payment is royalty.

15. We are unable to accede to the said contention on account of the fact that the General Terms and Conditions are generic in nature applicable to all agreements that the Austrian company may enter into with various third parties. In other words, it is to protect its rights, know-how, patents ideas and therefore, it will be an improper manner of interpretation of the technical assistance agreement by reading clause 7 of the general conditions to state that the agreement between the parties was a licence for which the payment made is to be treated as royalty. Hence, we are unable to accept the submission made by the Revenue for the reason that the engine has already been developed by the assessee and scope of the technical services agreement was only to design a new 3-valve cylinder head with a specified combustion system for considerable improvement of fuel efficiency, performance and meeting the Indian emission standards. All products, design of the engines and vehicles are supplied by the assessee. On completion all the drawings are also delivered by the Austrian company to the assessee. The entire project was carried out in Austria and no part of the project was performed in India. Thus, in our considered view the CIT(A) rightly held that the payment does not constitute royalty.

16. In the assessee's own case for the assessment years 1991-92, 1992-03 & 1994-05, a similar agreement came up for interpretation. In the said agreement, the Austrian company was to render technical assistance for consideration to be paid in four installments for improvement of fuel efficiency of carburettors manufactured by the assessee for two wheeler engines. The Tribunal after considering the admitted facts, pointed out that the Austrian Company was not a manufacturer of two wheelers and was only a consultant and according to the terms of the agreement between the two companies the entire technical know-how was absolutely to be passed on to the assessee and there was no grant of any right to use any property of the Austrian company and the payment could only be termed as 'fees for technical services' and could not be considered in the nature of royalty, since it was not payment for the right to use any property of the Austrian company. We find the terms and conditions of the agreement are similar to that of the agreement, which is subject matter of consideration in this appeal and the decision in the assessee's own case reported in (2000) 73 ITD 91 (Mad), would be applicable with full force to the case on hand.

17. In the case of CGI Information Systems (supra), the question which was considered by the High Court of Karnataka was whether the payments made by the assessee therein for using intranet facilities provided by the non-resident assessee is liable to tax in India. The learned counsel appearing for the Revenue referred to paragraph 7 of the said judgment, wherein relevant clauses of the agreement entered into between the parties in the said case, were referred to. It is contended that the conditions therein are also more or less identical to that of the clause 7 of the General Terms and Conditions in the agreement between the assessee and the Austrian company and relying on the observations made in the said judgment, it is submitted that the payment made by the assessee has to be treated as 'royalty'. In the said case, the assessee's contention was, it was only a cost sharing agreement and not royalty, which plea was rejected. However, on going through the facts of the said case, we find that the Canadian company permitted the assessee therein to use the tool, which they have developed, as an operational guidance for its day-to-day business and for using the same, the assessee allocated cost in respect of the facilities on agreed basis. Further, the assessee did not have any right to the intellectual property rights and the assessee was not permitted to allow to use the facility, which exclusively belongs to the Canadian company, as the Canadian company allowed the assessee to use the facilities for its day-to-day operational guidance only. Thus, interpreting the nature of the agreement, the Court found that the agreement was not a cost sharing agreement, but the payment was to be as 'royalty'. In case on hand, the engine design, patents etc., are wholly owned by the assessee company and the agreement was entered into for the purpose of providing technical assistance by improving the cylinder head of the engine developed by the assessee. Thus, the decision in the case of CGI Information Systems (supra), is clearly distinguishable on facts.

18. In the case of Voest Alpine A.G.,(supra), the High Court of Delhi was considering the question whether the sum received by the assessee in terms of Article 4.1 of the technical assistance agreement was in the nature of royalty. The agreement was for engineering development/visitation. Clause 4.2 of the agreement dealt with 'royalty' and it is stated that for using information and patents furnished or licensed by the assessee therein to the Punjab Power Generation Machine Ltd, they were required to pay a royalty at the rate of 5% of the net ex-factory sale price of the product, manufactured and sold by Punjab Power Generation after commencement of commercial production. Interpreting the agreement, the Court held that the agreement would fall in the category of contract involving supply of technical know-how etc., as well as technical services. We find the decision is wholly distinguishable on facts and can have no application to the assessee's case.

19. Thus, after carefully considering the terms and conditions of the technical assistance agreement, we are fully convinced that the findings recorded by the CIT(A), as confirmed by the Tribunal is just and proper and the payments made by the assessee do not constitute royalty.

20. For the above reasons, the appeal fails and it is dismissed and the substantial question of law framed for consideration is answered against the Revenue. No costs.

(T.S.S.J) (V.B.S.J)

24.10.2018

pbn

Internet : yes/no

Speaking Order/Non-Speaking Order

To

Income Tax Appellate Tribunal Tribunal 'C' Bench, Chennai,

T.S.SIVAGNANAM.J.,

and

V.BHAVANI SUBBAROYAN.J.,

pbn

Pre-delivery Judgment in

T.C.(A)No.878 of 2008

24.10.2018