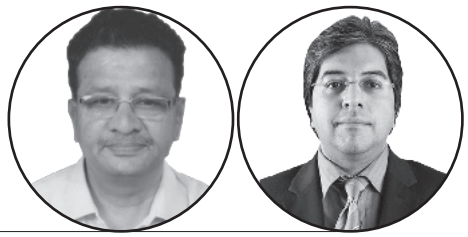

INTERNATIONAL TAXATION

Case Law Update

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A. SUPREME COURT

1 ***DIT vs. Samsung Heavy Industries Co. Ltd.***
[2020] 117 taxmann.com 870 (SC)

Where the assessee, a Korean company, was awarded a project by ONGC for the purpose of surveys, design, engineering, fabrication etc., its Project Office set up in India to act as a communication channel between the assessee and ONGC did not constitute a permanent establishment of the assessee within meaning of Article 5(1) of India-Korea DTAA, in view of the fact that the assessee was not carrying on its core business through its Project Office in India

Facts

i) The assessee, a tax resident of Korea, was awarded a 'turnkey' contract, for carrying out survey, design, engineering, procurement, fabrication, installation, modification, start-up and commissioning of facilities covered under the 'Vasai East Development Project' ("Project"), by Oil and Natural Gas Company ("ONGC").

ii) Subsequently, the assessee opened a Project Office (PO) in Mumbai for the purpose of acting as a communication channel between the assessee and ONGC in respect of the said Project. For the year under consideration (i.e. AY 2007-08), the PO prepared the Profit & Loss Account on the basis of the project completion method, whereby the PO recognised revenue in relation to pre-engineering survey, insurance and hook-up and commissioning activities. In relation to the said revenue, the PO claimed certain expenses namely (a) Pre-engineering survey; (b) Insurance (which was incurred for and behalf of ONGC); (c) hook-up and commissioning and (d) general administrative expenses such as rent, salaries etc. Thereby, the assessee filed the return of income declaring a loss of INR 23.50 lakhs. Activities in relation to engineering, procurement and fabrication were done outside India. (see Tribunal order reported in (2011) 133 ITD 413 (Delhi) at paragraph 17, 18, 34 to 37, 64 and 71)

iii) The AO during the course of assessment proceedings passed a draft assessment order by holding that the Project was a single indivisible "turnkey" project and thereby the profits arising from the commissioning of the Project would arise in India. The AO further, held that the work

relating to fabrication and procurement of material was very much a part of the turnkey contract and the said work was wholly executed by the PE in India. The AO distinguished the decision of SC in case of *Hyundai Heavy Industries Co. Ltd., [2007] 7 SCC 422*, by observing that, in the case of Hyundai Heavy Industries (supra), the project was in two separate parts, unlike the Project in the present case. Accordingly, the AO then attributed 25% of the revenue as the income of the assessee liable to be taxed in India.

iv) The DRP upheld the action of the AO and observed that opening of a project office clearly demonstrated that the assessee was doing something more than what would have been done through a liaison office and therefore considering the nature of activities undertaken in India it was clear that PE existed in the case of assessee. The DRP further upheld the finding of the AO that since the agreement was a 'turnkey' project, which could not be split, the entire profit earned from the said project would arise in India. The DRP also upheld the action of the AO in attributing 25% of the revenue as the income of the assessee (being the margin earned by comparables from similar projects, by relying on the data obtained from a database namely "Capital Line").

v) On further appeal, before the Tribunal, the assessee argued that pre-engineering survey etc. (i.e. hook-up and commissioning) were carried out through contractors, viz. Fugro Geonics (P.) Ltd., and Offshore Hook-up and Construction Services India (P.) Ltd. and the said activities were carried out for a period of 1-3 days to facilitate the design, engineering and fabrication activities which were being carried out outside India. The assessee further contended that the nature of expenses incurred by the PO were general administrative expenses like rent, telephone, printing, salary, etc., and the project office was established only to act as a communication channel between ONGC and the assessee for the purpose of, inter alia, passing on to ONGC the invoices raised by the head office, recovering the invoices, obtaining the milestone completion certificates from ONGC and transmitting the same to head office, arranging security clearance as and when required for personnel and equipment. The assessee further contended that no technical work was carried out by the project office in India and the activities in relation designing, engineering and fabrication of the platforms were carried outside India. (see Tribunal order reported in (2011) 133 ITD 413 (Delhi) from paragraph 34 to 37)

vi) The Tribunal, by relying on the application made by the assessee to the RBI for opening a project office and board resolution dated 3rd April 2006 of the assessee, upheld the action of the lower authorities and observed as follows:

a. The scope of activities to be conducted by the PO wasneither restricted by the RBI nor by virtue of the resolution. Accordingly, the decision of Hyundai Heavy Industries (supra) was not similar to the present case, since in Hyundai Heavy Industries (supra) permission was granted to the project office to work as a liaison office only and the project office was further not authorized to any conduct business activity.

b. Perusal of the board resolution dated 3rd April 2006 made it clear that the PO was opened for coordination and execution of the Project and hence it could not be said that the PO was

not a fixed place of business of the assessee in India to carry out wholly or partly the impugned contract in India under Article 5(1) of India-Korea DTAA, since all the activities to be carried out in respect of Project were routed through the PO only.

c. The assessee had obtained insurance with respect to the entire Project and the assessee was unable to demonstrate that the insurance had been restricted only with regards to activities outside India.

d. With respect to the argument of the assessee that the PO was only an auxiliary office; not engaged in any of the core activities of the assessee, as evidenced by the books of accounts which demonstrate that there was no expenditure in relation to the execution of the project, the Tribunal observed that maintenance of account was in the hands of the assessee and hence merely the mode of maintaining the accounts alone could not determine the character of PE.

e. The way the terms of the contract are described, that the PO of the assessee played a vital role in the execution of the Project, the onus was on the assessee to prove that the activities of the PE were preparatory and auxiliary in nature.

vii) The Tribunal, however, remanded the issue of attribution of profits to the PE, in absence of necessary material to ascertain the extent of activities carried out by the PO in India.

viii) On further appeal, the Uttarakhand High Court held that by submitting the return, the assessee had held out that it was carrying on business in India through a permanent establishment situated in India. In the circumstances, the contention of the assessee whether the project office opened at Mumbai could or could not said to be a PE was of no consequence. It further held that the facts of the case indicated two things namely i.) the assessee had a tax identity in India and a tax identity outside India and accordingly ii.) its tax liability in India was required to be apportioned. However, it further observed that neither the AO nor the Tribunal had made any effort to justify that the project office of the assessee was the PE of the assessee in India through which it carried on business during the relevant year and that 25% of its gross receipts was attributable to it. The High Court allowed the appeal of the assessee and set aside the judgement of the Tribunal so far as the same related to imposition of tax liability on the 25% of gross receipts of the assessee. (see High Court order reported in 42 Taxmann.com 140 (Uttarakhand)

ix) Accordingly, the Revenue filed an appeal before the Supreme Court and the Supreme Court held as under:

Decision

i) The SC after perusing Article 5 and Article 7 of the DTAA and referring to the decision of co-ordinate benches in case of ***Morgan Stanley & Co. Inc. [2007] 7 SCC 1, Hyundai Heavy Industries Co. Ltd. (supra), Ishikawajma-Harima Heavy Industries Ltd. [2007] 3 SCC 481 and E-Funds IT Solution Inc.[2018] 13 SCC 294***, observed that the profits of the non-resident are taxable only where the said non-resident carries on its core business through a permanent establishment in

India and that the maintenance of a fixed place of business for activities which is of a preparatory or auxiliary character in the trade or business of the non-resident could not be considered to be a permanent establishment.

ii) The SC after perusing the above-mentioned board resolution observed that the PO was established to coordinate and execute the "delivery documents in connection with the construction of offshore platform modification of existing facilities for ONGC" and hence the finding of the Tribunal that the PO was not a mere liaison office, but was involved in the core activity of execution of the project itself was held to be perverse.

iii) When it was pointed out that the accounts of the Project Office showed that no expenditure relating to the execution of the contract was incurred by the assessee, the Tribunal rejected the argument of the assessee, stating that as accounts were in the hands of the assessee, the mere mode of maintaining the accounts alone could not determine the character of permanent establishment. This finding of the Tribunal was held to be a perverse finding.

iv) The finding of the Tribunal that the onus is on the assessee and not on the Revenue to demonstrate that project office was not a permanent establishment of the assessee, was held to be contrary to the decision of Supreme Court E-Funds IT solutions Inc. (supra).

v) In view of the above, the SC held that since only two persons were working in the PO, neither of whom were qualified to perform any core activities, it could not be said to be a fixed place of business through which the core business of the assessee were wholly or partly carried on under Article 5(1) of the DTAA.

vi) Also, the SC held that the PO, based on the facts of the present case, would fall within Article 5(4)(e) of the DTAA, in as much as the PO was solely an auxiliary office, meant to act as a liaison office between the assessee and ONGC.

B. TRIBUNAL

2 ***DDIT v. Yum! Restaurants (Asia) (P.) Ltd.***
[2020] 117 taxmann.com 759 (Delhi-Trib.)

Where the seconded employee worked under the direct supervision and control of an Indian entity and the salaries of the seconded employee were reimbursed to the assessee (Singapore entity) on a cost to cost basis, the amount so reimbursed would not liable to be taxed in India as fee for technical services in the hands of the assessee under India-Singapore DTAA

Facts

i) The assessee, a tax resident of Singapore, was engaged in the business of franchising KFC, Pizza Hut and Taco Bell brands for a number of territories in the Asia Pacific region (including India).

ii) As per the Deputation Agreement between the assessee and Yum! Restaurants (India) Pvt. Ltd. (hereinafter referred to as 'Indian entity'), an employee of the assessee (hereinafter referred to as the seconded employee) was seconded to the said Indian entity.

iii) In terms of the Deputation Agreement, for administrative convenience, the assessee paid the salaries of the seconded employees and the said salaries were reimbursed

by the Indian entity on a cost-to-cost basis to the assessee. Further, as per the Deputation Agreement, the seconded employee was functioning under the direct control, supervision and direction of the Indian entity and the assessee did not retain any lien of employment nor the assessee was responsible for the risk/work of the seconded employee.

iv) Further, the Indian entity for the purpose of its business established a separate entity, namely Yum! Restaurants Marketing Pvt. Ltd. (YRMPL) to undertake AMP activities on behalf of the Indian entity and its franchisees. The assessee was not a party to the above arrangement, and the same was exclusively between the Indian entity and YRMPL.

v) The AO concluded the assessment proceedings, by observing that the seconded employee was the employee of the assessee and services were being provided by the said seconded employee on behalf of the assessee and hence the reimbursement of salaries by the Indian entity constituted fees for technical services under Article 12 of India-Singapore DTAA (DTAA).

vi) With respect to the AMP activities undertaken by YRMPL, the AO alleged that the AMP expenses resulted in brand building of the assessee and hence the AO attributed certain income taxable @ 40%, by holding that the Indian entity was the Dependent Agent PE (DAPE) of the assessee, inasmuch as that the marketing activities were carried on in India on behalf of the assessee and the said AMP activities benefitted the assessee.

vii) On appeal, the CIT(A) held that the seconded employee was working under the control of the Indian entity and since the seconded employee was not the employee of the assessee (in absence of any lien over the seconded employee by the assessee), no service PE of the assessee could be said to be constituted in India. Further, the CIT(A) deleted the attribution of income to the alleged DAPE of the assessee, by holding that the Indian entity and YRMPL did not constitute DAPE or PE of the assessee.

viii) Accordingly, the appeal was filed by the Revenue before the Tribunal.

Decision

i) With respect to the constitution of a service PE, the Tribunal relied on the order of the CIT(A) to hold that as per the Deputation Agreement, the seconded employee was working under the direct control and superintendence of the Indian entity and the assessee discharged the seconded employee from all obligations and rights whatsoever, including lien on employment and hence a service PE would not be constituted in India. Further, with respect to attribution of income to the alleged service PE of the assessee, the Tribunal observed that the expenses i.e. salary cost needs to be deducted from the business income generated by the alleged service PE in India, which in the present case would be NIL and hence there would be no income attributable to the said PE. Further, the Tribunal also observed that the existence of a service PE and provision of technical services could not co-exist together under Article 5(6) read with Article 12 of the DTAA.

ii) With respect to the characterization of reimbursement of salary cost as fees for technical services, the Tribunal held since the condition of 'make available' was not fulfilled under Article 12 of the DTAA, the said reimbursements could not be

characterized as fees for technical services. The Tribunal also held that since the reimbursements were made on a cost to cost basis, there was no element of income embedded therein and hence the said receipts were not taxable. Further, the Tribunal also observed that since the seconded employee had already paid taxes on the said reimbursement being salary, the same amount being further taxed as fees for technical services would amount to double taxation.

iii) The decision of Delhi HC in case of Centrica India Offshore Pvt. Ltd. [2014] 364 ITR 336 was distinguished by the Tribunal, by observing that the facts in the case of Centrica (supra) were at variance with the present case in as much as that in case of Centrica (supra), Centrica UK was providing services to Indian company through seconded employees to ensure quality control and management of their vendors of outsourced activities, with the intention to provide staff with appropriate expertise and knowledge about process and practices implemented.

iv) With respect to the alleged DAPE of the assessee, the Tribunal held that since none of the conditions as provided under Article 5(8) were proved to be satisfied by the AO, the assessee could not be said to have a DAPE in India. Further, the Tribunal also observed that in any case, since the marketing activities undertaken by the YRMPL were on behalf of the Indian entity and its franchisees and in the absence of any link whatsoever with the business of the assessee, there was no merit in attribution of any contribution (made by the independent third-party franchisees), to constitute PE of the assessee company in India.

3 *Reliance Corporate IT Park Ltd. vs. DCIT*
[TS-845-ITAT-2019(Mum)]

License fees paid to a Singapore Co. for obtaining software license coupled with rights to access database would not fall within the scope of 'royalty' under Article 12 of the India-Singapore DTAA, since no rights in the copyright of the database and the software were granted to the payer i.e. assessee

Facts

i) The assessee, a domestic company, was engaged in the business of providing support services. During the year under consideration, the assessee made payment to a Singapore Co. as license fees for obtaining licenses for software viz. 'exSILentia version 3 ultimate bundle'. At the time of remittance of the said payment it withheld taxes @ 10%. Subsequently, the assessee filed an appeal u/s 248 of the IT Act, before the CIT(A) claiming that no tax was required to be withheld at the time of remitting the payments for license fees to the Singapore Co.

ii) The CIT(A) rejected the claim of the assessee by observing as under:

   a. The consideration paid by the assessee was towards the software server license fees for 25 concurrent ultimate licenses for software 'exSILenlia Version 3 Ultimate bundle' sold by the Singapore Co.

   b. As per the Software License Agreement, the software was owned by the Singapore Co. and was protected by copyright laws and international copyright treaties, as well as other intellectual property

laws and treaties and further, the software was licensed and not sold.

c. The said software was an integrated safety lifecycle engineering tool, predominantly used for equipment design and safety integrity level (SIL) verification. The 'Ultimate' version of the said software comprised of a right to use safety related databases of the seller being in the nature of Exida Safety Equipment Reliability Handbook Viewer and a Proprietary Equipment Reliability Database, which were specific to the online/ intranet version with Citrix platform.

d. Accordingly, the license fee paid by the assessee was not only related to the cost of software but also was also for the use or right to use such proprietary information and hence was not akin to off-the-self or shrink wrapped software but was software along with the database access which enabled the assessee to conduct Safety Integrity Level Verification (SILver) by using these databases and handbooks.

e. Thereby, the same was not a sale of a copyrighted article but payment for the use of databases and suitable scientific manipulating (design/ analysis) tools provided along with the software and thereby the same represented payments for "use or right to use any copyright of a design or model information concerning industrial, commercial or scientific experience under Article 12(3) of the India-Singapore DTAA. (hereinafter referred to as DTAA).

iii) Accordingly, appeal was filed by the assessee before the Tribunal.

Decision

i) The Tribunal held that access to database being coupled with software license would not fall within the scope of 'royalty' under Article 12 of the DTAA. The Tribunal relied on the decision of Ahmedabad Tribunal in case of ***ITO vs. Cadila Healthcare Ltd. (2017) 77 taxmann.com 309 (Ahmedabad-Trib.),*** wherein it was held that when the assessee made payments to obtain the rights to access the copyrighted material (i.e. access to the literary database under limited non-exclusive and non-transferable licence) and not the copyright of the said literary database, the said payments could not be treated as royalty.

ii) Accordingly, the Tribunal held that when the database access by itself did not amount to 'royalty', such database access being coupled with a software would not bring, the said software, within the scope of 'royalty'.

iii) The Tribunal further relied on the decision of co-ordinate bench in case of ***ADIT vs. TII Team Telecom International Ltd. [12 ITR (Trib) 688 (Mum)***], wherein it was held as follows:-

a. Under Article 12(3) of the India-Israel DTAA, the clause in which payment for software could possibly fall was 'consideration for use of, or right to use of, a process'.

b. The issue as to whether payment for supply of software can be viewed as a payment for copyright or not was no longer a res integra and the Special Bench in case of ***Motorola Inc. vs. Dy. CIT [2005] 95 ITD 269 (Delhi)*** had decided this issue in favour of the assessee.

c. The provisions of Article 12(3) of India-Israel DTAA specifically provide that what was liable to be treated as royalty was payment for 'use of, or the right to use, any copyright of literary, artistic or scientific work', and the connotations 'use of copyright' of a work were distinct from the use of a copyrighted article. The meaning of 'use of copyright of a work' could not be treated as extending to 'use of a copyrighted work' as well, as it would amount to doing clear violence to the words employed by the India-Israel DTAA. As held by the Special Bench, in Motorola Inc. case (supra), the four rights which, if acquired by the transferee, constitute him the owner of a copyright, and these rights were: i) right to make copies of the computer programme for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease, or lending; ii) right to prepare derivative computer programmes based upon the copyrighted computer programme; iii) right to make a public performance of the computer programme and iv) right to publicly display the computer programme. Since any of these rights were not transferred by the assessee, the payment for software could not be treated as payment for use of copyright in the software.

d. Further, under the standard terms and conditions for sale of software, the buyer of software was not even allowed to tinker with the process on the basis of which such software runs or to even work around the technical limitations of the software and hence it could not be held that the payment for software was de facto a payment for 'process'. Further, in terms of article 12(3) of the Indo-Israel DTAA the term 'process' had to be in the nature of know-how and not a product.

iv) In view of the above, the Tribunal held that the payments to the Singapore Co. were not liable to tax in India.

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