

## **Global Business Tax Alert** Sharp Insights

**The Delhi Income Tax Appellate Tribunal (the Tribunal) in the case of Iveco S.p.A. (72 taxmann.com 195) has held that in absence of any material to prove that the services were rendered by the appellant through its Branch Office in India, Royalty income earned by the appellant from provision of such services could not be said to be effectively connected with the Permanent Establishment of the appellant in India. Hence, the Royalty income was held to be taxable as per Article 13 of the India-Italy tax treaty, and not as business income.**

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## Background

- The appellant, Iveco S.p.A., is a company established in Italy, and is engaged in the business of designing, developing, manufacturing and selling commercial vehicles and diesel engines.
- In India, the appellant entered into a Technical Collaboration and License agreement (TCL) with an Indian company, thereby providing right to assemble diesel engines and their parts in India. In terms of the TCL, the licensee may request the appellant to depute its technical personnel in India for rendering the required services.
- The appellant also has a Branch Office (BO) in India, which is engaged, *inter alia*, in sourcing engines and exporting the same outside India, providing after-sale support services for products sold and licenses granted to customers in India, and provision of technical support services to customers in India.
- During the relevant assessment year, the appellant received Royalty income on account of the TCL with the Indian company, and also accrued business income in respect of the activities carried out by the BO.
- The appellant filed its return of income and offered the Royalty income to tax on gross basis under Article 13 of the India-Italy tax treaty, while business income was offered to tax on net basis in terms of Article 7 of the tax treaty being effectively connected with the Permanent Establishment (PE) of the appellant in the form of BO.
- In the course of assessment proceedings, the Assessing Officer (AO) contended that Royalty income earned by the appellant under the TCL is also attributable to the activities carried out by the BO, and thus, taxable as business income.
- The Dispute Resolution Panel (DRP) also upheld the contentions of the AO, pursuant to which the AO passed the final order, holding that Royalty income was taxable as business income on net basis.
- Aggrieved by the order of the AO, the appellant preferred an appeal before the Tribunal.

### Questions before the Tribunal

*Inter alia*, the appellant raised the following grounds before the Tribunal:

- Whether the Royalty income earned by the appellant is effectively connected with the BO/ PE, and thus, taxable as business income?
- Whether presumption made by the AO, in absence of sufficient material, that employees of BO were engaged in rendering services to the Indian licensee under the TCL, is valid?

### **Arguments by the appellant**

- BO is engaged in specified activities, which are mentioned in permission given by the Reserve Bank of India (RBI), and is not engaged in providing any services with respect to the TCL.
- The TCL was executed prior to setting up of BO which itself demonstrates that the BO had no role to play in performance related to the agreement.
- Royalty received and offered to tax under Article 13 of the tax treaty in the preceding year, which was also the first year of assessment of the appellant, was accepted by the revenue to be not effectively connected with the BO.
- The appellant referred to the decision of the Delhi High Court in the case of Sumitomo Corporation (ITA No. 714/ 2014) to contend that only those profits which are economically attributable to PE are chargeable to tax as business income under Article 13(5).
- There is a distinction between the income which is the result of activities of the PE and which arises by reasons of direct dealing by the enterprise with HO without the aid or assistance of PE.
- The appellant, *inter alia*, further referred to the judgement of the Uttarakhand High Court in the case of Samsung Heavy Industries Co. Ltd. (42 taxmann.com 140), and contended that in absence of any material on record to show that the amount received for performing activities outside India was attributable to the business carried out by the appellant's PE in India could not be brought to tax in India.

### **Arguments by the revenue**

- The assessee did not provide information of duration of stay of employees of head office who visited in India. Therefore, it is inferred that royalty income is effectively connected to the appellant's PE.
- Technical support and training is part of the TCL. Presence of such persons in BO, out of which one is expatriate and some are having engineering background, makes it possible that such employees have provided the services described in TCL.
- RBI permission to BO allows it to provide after-sale services including warranty and spare parts to its customers in India in relation to product sold by appellant and its licensees to customers in India. The BO was also authorized to provide technical support services to customers of assessee in India.
- BO has 25 people whereas the appellant has shown only 9 employees. Therefore, in the interest of justice, the issue required to be decided on correct facts and therefore may be set aside to the file of AO.

### **The Tribunal held as under:**

- Letter filed by the appellant before AO and DRP explains the whole issue, and contents of such letter remain uncontroverted. Therefore, it is incorrect to state that appellant has not provided the details of persons who provided services in connection with TCL.
- It is not brought on record by revenue that whether during the year any services were in fact provided by the appellant to the licensee or not. Revenue has not made any inquiry with the licensee about the nature of services provided by the appellant during the year and who are the persons who provided these services.
- In absence of inquiry and material on record, and in view of affirmative statement by the appellant at all stages that employees of BO are not capable and are not engaged in performance of TCL, it is not possible to say that activities of TCL are effectively connected with the BO.
- There is mere allegation by the revenue that services have been performed by persons employed by BO in relation to the TCL even when appellant has categorically given information.
- Merely having some staff with its BO, that are technically qualified, it cannot be inferred that they have provided services for performance of the impugned contract. No presumption can be drawn by revenue regarding involvement of the PE in earning royalty income.
- To effectively connect royalty with a PE, one has to evaluate the 'asset test' and to effectively connect Fees for technical services (FTS) with PE, one has to evaluate 'activity test' or 'function test'. Assuming that sum is FTS, even then the 'activity test' or 'function test' is not satisfied.
- To 'effectively connect' this royalty income with the PE revenue should establish the following:
  - PE should be engaged in performance of technical services or should be involved in actual rendering of such services;
  - It should arise as a result of the activities of the PE; and
  - PE should, at least, facilitate, assist or aid in performance of such services irrespective of the other activities PE performs
- Revenue could not bring any material on record, which proves above facts in substance. Therefore, in absence of any such material it cannot be said that income of royalty is the income arising out of results of the activities of PE.

## Conclusion

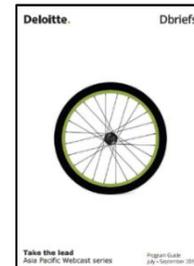
The Tribunal, in the present case, dismissed the contention of the revenue to presume facts and overlooking the appellant's submissions. The Tribunal, thus, held that in the absence of inquiry and substantive material produced by the revenue with regard to the nature of services performed, it is not possible to presume/ contend that income from such services is effectively connected to the appellant's PE.

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## Contacts

### Ahmedabad

19<sup>th</sup> Floor, Shapath - V  
SG Highway,  
Ahmedabad – 380 015.  
Tel: + 91 (079) 6682 7300  
Fax: + 91 (079) 6682 7400

### Bangalore

Deloitte Centre, Anchorage II,  
100/2, Richmond Road,  
Bangalore 560 025.  
Tel: +91 (080) 6627 6000  
Fax: +91 (080) 6627 6010

### Chennai

No.52, Venkatanarayana Road,  
7th Floor, ASV N Ramana Tower,  
T-Nagar,  
Chennai 600 017.  
Tel: +91 (044) 6688 5000  
Fax: +91 (044) 6688 5050

### Coimbatore

Shanmugha Manram  
41, Race Course,  
Coimbatore  
Tamil Nadu - 641018  
Tel: + 91 (0422) 439 2801  
Fax: +91 (0422) 222 3615

### Delhi/Gurgaon

Building 10,  
Tower B, 7th Floor,  
DLF Cyber City,  
Gurgaon 122 002  
Tel : +91 (0124) 679 2000  
Fax : + 91 (0124) 679 2012

### Hyderabad

1-8-384 and 385, 3rd Floor,  
Gowra Grand S.P.Road,  
Begumpet,  
Secunderabad – 500 003.  
Tel: +91 (040) 6603 2600  
Fax: +91 (040) 6603 2714

### Kolkata

Bengal Intelligent Park Building  
Alpha, 1st floor, Block EP and  
GP Sector V, Salt Lake  
Electronics Complex,  
Kolkata - 700 091.  
Tel : + 91 (033) 6612 1000  
Fax : + 91 (033) 6612 1001

### Mumbai

Indiabulls Finance Centre,  
Tower 3, 28th Floor,  
Elphinstone Mill Compound,  
Senapati Bapat Marg, Elphinstone  
(W),  
Mumbai – 400013  
Tel: + 91 (022) 6185 4000  
Fax: + 91 (022) 6185 4101

### Pune

106, B-Wing, 7<sup>th</sup> Floor,  
ICC Trade Tower,  
Senapati Bapat Road,  
Pune – 411 016.  
Tel: + 91 (020) 6624 4600  
Fax: +91 (020) 6624 4605



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