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Mumbai Tribunal holds that license fees and management charges do not fall within the purview of section 44C

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Synopsis

The Mumbai Tribunal in the case of Lloyd's Register Asia (India Branch office) has examined the term 'head office expenditure' illustrated in clause (iv) of Explanation to section 44C and held that license fees and management charges were not in the nature of 'head office expenditure' under section 44C of the Act.

Facts

- The taxpayer company, is an Indian branch of Lloyd's Register Asia UK ('Lloyd's Register Asia'). Lloyd's Register Asia is the subsidiary company of Lloyd's Register UK.
- Lloyd's Register UK, i.e. the holding company is engaged in the business of survey and inspection of the ships, industrial inspection activity and drawing appraisal.
- Prior to the year under consideration (AY 2005-06), Lloyd's Register UK was operating in India through its branch. However, from assessment year 2005-06, Lloyd's Register UK, floated a subsidiary company i.e. Lloyd's Register Asia and all Indian operations were carried out through the taxpayer, which was the Indian branch of Lloyd Register Asia.
- Lloyd's Register UK had entered into a license agreement with all subsidiaries including the taxpayer's head office i.e. Lloyd's Register Asia, for granting license to use the brand "Lloyd's Register" i.e. for use of trade mark and trade name owned by Lloyd's Register UK.
- Lloyd's Register UK also provided general, technical and marketing support services to all its products which was referred as "Intellectual Property Rights" in the agreement. License fees and royalty was payable by Lloyd's Register Asia to Lloyd's Register UK, as per the licensing agreement.
- Lloyd's Register UK sent invoices to Lloyd's Register Asia, which in turn, allocated the royalty /license fees attributable to the Indian branch. The taxpayer paid the license fees to Lloyd's Register Asia, which in turn, paid to Lloyd's Register UK.
- Lloyd's Register UK had also entered into a management service agreement with

- Lloyd's Register Asia for providing services such as corporate communications, corporate finance and group reporting services, Group quality assurance, Human resources, Information technology, Integrated business system, Internal audit services, legal services, operational management and reporting, risk management and secretarial services and taxation and treasury services. As per the management service agreement, management charges were payable by Lloyd's Register Asia to Lloyd's Register UK.
- Lloyd's Register UK had filed its return of income in India, declaring the above income received from the taxpayer.
- As per the taxpayer the payment of license fees / management charges was only routed through the taxpayer's head office i.e. Lloyd's Register Asia and the said transaction was not with the head office and hence the payment was not in the nature of head office expenses. The taxpayer submitted that section 44C is only applicable to general and administration expenditure as referred to in Explanation (iv) to section 44C and license fees / management charges were not covered in the aforesaid explanation.
- The Assessing officer (AO) held that the license fees and management charges were in the nature of 'head office expenses' under section 44C and restricted the deduction of such expenses to 5% of the adjusted total income.
- The Commissioner of Income tax (Appeals) (CIT(A)) held that license fees / royalty expenses were not in the nature of head office expenses. With respect to the management charges, the CIT(A), held that 50% of management fees were in the nature of 'head office expenses' as per section 44C and upheld the action of the AO to that extent.
- The taxpayer filed an appeal before the Tribunal against the decision of the CIT(A) of holding that 50% of the management fees should be allowed in accordance with section 44C. The Department filed an appeal before the Tribunal against the decision of the CIT(A) of holding that license fees and 50% of management charges were not in the nature of head office expenses as per section 44C.

Issue before the Mumbai Tribunal

- Whether payment of license fees and management charges were in the nature of 'Head office expenses' as defined in clause (iv) of Explanation to section 44C.
- Whether no disallowance of license fees / management charges should be made under section 44C in view of the Article 24 on non-discrimination provisions, in the India UK Double Tax Avoidance Agreement (DTAA).

Ruling of the Mumbai Tribunal

- The Tribunal examined the provisions of section 44C read with Explanation (iv) and held that the payment of 'license fees' for using brand/trademark and other business intangibles which were in the nature of intellectual property, does not fall within the scope of 'head office expenditure' as illustrated in clause (iv)(a) to (iv)(c) of Explanation to section 44C.
- As per Explanation (iv) to section 44C, head office expenditure means executive and general administration expenditure incurred by the assessee outside India, including expenditure incurred in respect of
 - Rent, rates, taxes, repairs or insurance of any premises outside India used for the purpose of the business or profession;
 - Salary, wages, annuity, pension, fees, bonus, commission, gratuity, perquisites, or profits in lieu of or in addition to salary, whether paid or allowed to any employee or other person employed in, or managing the affairs of, any office outside India.
 - travelling by any employee or other person employed in, or managing the affairs of, any office outside India, and
 - Such matters connected with executive and general administration as may be prescribed

- The Tribunal held that the payment for general, technical and marketing support services was not in the nature of rent, rates, taxes, repairs, insurance, salary, wages, bonus, commission, etc. or travelling expenses of any employee, illustrated in Explanation (iv) to section 44C.
- Clause (iv)(d) of Explanation to section 44C provides the residual category of expenses incurred for executive and general administration.
- The Tribunal observed that there is no circular / instruction from CBDT illustrating the expenses that fall under the clause (iv)(d) of the Explanation to section 44C.
- The Tribunal held that license fees was not in the nature of executive and general administration expenses and hence did not fall under the clause (iv)(d) of Explanation to section 44C.
- The Tribunal held that as per the agreement, the payment of management charges, was made for specialized services and hence the management charges were not in nature of head office expenditure as per clause (iv) of Explanation to section 44C.
- The Tribunal held that since the license fees and management charges were not in the nature of head office expenses, deduction should be allowed for these expenses without invoking provisions of section 44C.
- The Tribunal has not commented on the taxpayer's alternative argument relating to the applicability of Article 24 on non-discrimination in the India UK DTAA, since it has held that license fees / management charges did not fall within the purview of section 44C of the Act.

Comments

The Mumbai Tribunal in the case of ADIT v. Antwerp Diamond Bank NV Engineering Centre (2014)163 TTJ175 (Mumbai – Trib.) held that data processing cost, pertaining to allocation of expenses incurred by the Head office on a pro-rata basis for the banking application software acquired by the Head office, did not fall within the meaning of 'Head office expenses' as provided in Explanation (iv) read with section 44C of the Act, since expenses illustrated in this section have to be necessarily in the nature of executive and administrative expenses.

Source: Lloyd's Register Asia (India Branch office) v. ACIT (2015) 58 taxmann.com 58 (Mumbai – Trib.)

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