IN THE INCOME TAX APPELLATE TRIBUNAL
MUMBAI 'I' BENCH, MUMBAI

[Coram: Pramod Kumar (Vice President),
and Saktijit Dey (Judicial Member)]

ITA No. 7315/Mum/2018
Assessment year: 2015-16

SCA Hygiene Products AB **……..……Appellant**
(now known as Essity Hygiene and Health AB)
c/o Sudit K Parekh & Co, Urmi Axis 6th floor
Famous Studio Lane, Dr. E Moses Road
Mumbai 400 011, [PAN: AATCS0899K]

Vs.

Deputy Commissioner of Income Tax
International Taxation 4(2)(1), Mumbai **……Respondent**

Appearances by
Jitendra Jain *for the appellant*
S S Iyengar *for the respondent*

Date of concluding the hearing : January 6, 2021
Date of pronouncement : January 8, 2021

O R D E R

Per Pramod Kumar, VP:

1. This appeal, filed by the assessee, calls into question the correctness of the order dated 11th October 2018 passed by the Assessing Officer under section 143(3) r.w.s. 144C (13) of the Income Tax Act, 1961, for the assessment year 2015-16.

2. In the first ground of appeal, the assessee has raised the following grievance:

Ground No. I - Taxability of SAP License Charges as Royalty

1.1. On the facts and in the circumstances of the case and in law, the learned DCIT and Dispute Resolution Panel ('DRP') has erred in not considering the fact that Appellant has only recharged actual cost it incurred for acquiring SAP licenses from third party and since there is no profit element the same is not taxable in India.

1.2. Without prejudice to the ground no. 1.1 above, on the facts and in the circumstances of the case and in law, the learned DCIT and DRP has erred in holding that the amount received by the Appellant from SCA Hygiene Products India Private Limited ('SCA India') in respect of SAP license charges amounting to INR 1,30,04,613 is taxable as

Royalty under Article 12(2) of the India -Sweden Double Taxation Avoidance Agreement ('DTAA').

3. To adjudicate on this issue, only a few material facts need to be taken note of. The assessee before us is a company incorporated, and fiscally domiciled, in Sweden. It has a subsidiary in India by the name of SCA Hygiene Products India Pvt Ltd (**SCA-India**, in short). Under a service agreement dated 29th September 2014, a copy of which was placed before us at pages 7 to 16 of the paper-book, the assessee was under an obligation to render services, which included "providing hardware and software for various ERP systems, CRM Systems and other business system" (Annexure B: IT Services, at page 14 of the paper-book) to its India subsidiary "at cost". It was under this arrangement that the assessee provided SAP software and licence to the SCA-India, on a "cost to cost basis without any markup being charged on the same", and received an amount equivalent to Rs 1,30,04,613. During the course of scrutiny assessment proceedings, the Assessing Officer noticed these facts and required the assessee to show cause as to why the SAP software licence charges not be brought to tax under article 12(3)(a) of India Sweden Double Taxation Avoidance Agreement [(1998) 229 ITR (Statutes) 11; **Indo Swedish tax treaty**, in short]. It was, *inter alia*, explained by the assessee that this receipt of Rs 1,30,04,613 reflects a reimbursement *simpliciter*, that the SAP licences were acquired from a rank outsider, that as it is pure reimbursement without any markup, there is no income element embedded therein. The assessee also advanced certain arguments on other facets regarding the inapplicability of article 12(3)(a) to the facts of this case. However, since the issue in the appeal can be decided on the short ground of its being pure reimbursement in nature, we see no need to deal with those aspects of the matter. The Assessing Officer was not convinced by these submissions. The Assessing Officer noted that there was no evidence on record that the market value of services to various group entities is not equivalent to the payments received by the assessee from group entities. He was further of the view that "once a right has been provided for a cost, then the fact that there is no markup or any profit would not take the receipt out of income nature." He referred to certain decisions of the coordinate benches, as also the Authority for Advance Ruling, in support of the proposition that absence of markup, by itself, would not take the receipt outside the ambit of income. Aggrieved by the stand so taken by the Assessing Officer in the draft assessment order, the assessee raised a grievance before the Dispute Resolution Panel, but without any success. Rejecting this line of argument, the Dispute Resolution Panel observed as follows:

> **The DRP is not convinced by this argument. Typically, a reimbursement of expenditure would be an expenditure incurred by the non-resident which was responsibility of the appellant. An instance of such reimbursement can be expenditure incurred on employees of Indian company visiting the AE for bearing their hotel expenses. However, it is also equally accepted that a transaction of the Indian party with a third party cannot be given a cover of reimbursement by routing this transaction with the AE. In the present case, the AE has purchased licence on behalf of the assessee and then charged the assessee for these amounts. In such a scenario, the amount cannot be treated as reimbursement. This is a case of routing SCA India's expenses the AE and is not cost reimbursement but cost allocation (AMD Research and Development Centre India Pvt Ltd [(2015) 53 taxmann.com 300 (Hyd-Trib)].**

4. It was in this backdrop that the Assessing Officer taxed an income of Rs 1,30,04,613 under article 12(3)(a) of Indo Swedish tax treaty. The assessee is aggrieved and is in appeal before us.

5. We have heard the rival contentions, perused the material on record, and duly considered facts of the case in the light of the applicable legal position.

6. We find that it is a case in which the assessee has purchased the SAP software licence from a third party- namely "Be One Solutions, Switzerland," and even a copy of one of the purchase invoices is placed before us at page 17 of the paper-book. The finding of the DRP to the effect that it is a case of purchase of software through an AE of the assessee is thus factually incorrect. We have also taken note of the certificate dated 18th April 2018, signed by the Finance Director of the assessee company, which states that "this is to certify that we have provided SAP/SAP B1 licences to SCA Hygiene Products India Pvt Ltd (SCA-India) during year April 2014 to March 2015" and that "we further certify that the above-mentioned licences are provided to SCA-India on cost to cost basis without any mark up being charged." There is no, and perhaps rightly so, challenge to the factual element of its being a cost to cost reimbursement received by the assessee. What learned Departmental Representative contends is that if the Indian entity was to be directly supplied this licence by the actual product vendor supplying it to the assessee, the tax withholding by Indian entity would have come into play, and that tax withholding has been avoided by routing the purchase through the assessee. That issue, whether right or not, has no bearing on taxability of an income in the hands of the assessee. We reject this argument. As regards learned DRP's reliance on a decision of the coordinate bench in the case of **AMD Research and Development Centre India Pvt Ltd** *(supra)*, we can only say that it was a case in which the coordinate bench came to the conclusion that the payment for a software licence to the group company was not on "cost to cost basis", as evident from the coordinate bench observations to the effect that "**In the absence of these details as well as the basis of allocation of cost of software applications/licences, we find it difficult to accept the contention of the assessee that the amount in question paid by it to ATI Technologies, Canada towards its share of software applications/licences on cost to cost basis, without involvement of any element of profit, so as to say that the amount so remitted is not chargeable to tax in the hands of ATI Technologies, Canada in India, being merely in the nature of reimbursement of actual expenses incurred by the said company, without any profit element**". This decision, therefore, does not support the case of the Assessing Officer anyway inasmuch as this decision supports the proposition that when the payment for software licence fees to a group entity is a reimbursement pure and simple, it will not be taxable as income of that group entity. It is quite elementary that what can be taxed in the hands of an assessee is not a receipt, by itself, but only the income element, and, therefore, when a receipt by the assessee is bereft of income element, as a pure reimbursement inherently is, it cannot be brought to tax in the hands of that assessee. Hon'ble jurisdictional High Court, in the case of **CIT Vs Siemens AG [(2009) 310 ITR 320 (Bom)],** have accepted this proposition and observed as follows:

> **That leaves us with the last contention as to whether the amounts by way of reimbursement are liable to tax. To answer that issue, we may gainfully refer to**

the judgment of a Division Bench of the Delhi High Court in Industrial Engineering Projects (P.) Ltd.'s case (supra). The learned Division Bench of the Delhi High Court was pleased to hold that reimbursement of expenses can, under no circumstances, be regarded as a revenue receipt and in the present case the Tribunal had found that the assessee received no sums in excess of expenses incurred. A similar issue had also come up for consideration before the Division Bench of the Calcutta High Court in Dunlop Rubber Co. Ltd.'s case (supra). The learned Division Bench was answering the following question:

> **"Whether, on the facts and in the circumstances of the case, the amounts received by the assessee (English company) from M/s. Dunlop Rubber Co. (India) Ltd. (Indian company) as per agreement dated 29-1-1957 constituted income assessable to tax?"**

On considering the issue the learned Bench noted that the Tribunal was of the view that what was recouped by the English company was part of the expenses incurred by it. The learned Court upheld the said finding. The learned Bench was pleased to hold that sharing of expenses of the research utilised by the subsidiaries as well as the head office organisation would not be income which would be assessable to tax. A similar view was taken in Stewarts & Lloyds of India Ltd.'s case (supra).

We are in respectful agreement with the view expressed by the Delhi and Calcutta High Courts.

7. In view of the above discussions, as also bearing in mind entirety of the case, we hold that the receipt of software licence fees by the assessee, from its Indian subsidiary, is reimbursement of software licence fees paid by the assessee to a third party, and, therefore, it cannot constitute income taxable in the hands of the assessee. As this income is not taxable under the domestic law provisions in India, we see no need to deal with the other aspects of the matter with respect to non-taxation of this income under the provisions of the Indo-Swedish tax treaty. We leave it at that.

8. Ground no. 1 is thus allowed in the terms indicated above.

9. In ground no. 2 and 3, which we will take up together, the assessee has raised the following grievances:

Ground No. II- Taxability of consultancy services as FTS

2.1 On the facts and in the circumstances of the case and in law, the learned DCIT and DRP has erred in not considering the fact that Appellant has only recharged the actual cost it incurred for providing the project consultancy services and since there is no profit element the same is not taxable in India.

2.2 Without prejudice to ground number 2.1 above, on the facts and in the circumstances of the case and in law, the learned DCIT / DRP has erred in holding that the amount received by the Appellant Company for consulting services amounting to INR 1,97,94,209 from SCA India would be taxable as FTS under DTAA in spite of the fact that such services do not make available technical knowledge, experience, skill, know-how or processes or consists of the development and transfer of technical plan or technical design.

On the facts and in the circumstances of the case and in law, the learned DCIT/DRP has erred in holding that the protocol granting. Most favored Nation benefit available in India - Sweden DTAA can be granted only through Government notification disregarding the fact that no such notification is required as per DTAA.

Ground No. III- Taxability of IT Support services as Fees for Technical Services (FTS)/ Royalty

3.1 On the facts and in the circumstances of the case and in law, the learned DCIT/DRP has erred in not considering the fact that Appellant has only recharged the actual cost it incurred for providing the IT Support services and since there is no profit element the same is not taxable in India.

3.2 Without Prejudice to the ground no. 3.1, on the facts and in the circumstances of the case and in law, the learned DCIT/DRP has erred in holding that the amount received by the Appellant for IT Support services amounting to INR 57,47,684 from SCA India would be taxable as FTS and Royalty under India - Sweden Double Taxation Avoidance Agreement (DTAA) in spite of the fact that such services do not make available technical knowledge, experience, skill, know-how or processes or consists of the development and transfer of technical plan or technical design.

3.3 In addition to the above, DCIT/DRP has erred in considering a part of IT Support services are bundled with software supplied and hence the services are ancillary and subsidiary to enjoyment of such software and accordingly the same is taxable under Article 12(4)(a) of India-Portuguese Republic DTAA as technical services.

10. So far as these two grounds of appeal are concerned, briefly the material facts of the case are as follows. The assessee has under the same agreement, as is referred to in paragraph 3 above in connection with the first ground of appeal, rendered services for "leading the work during 2014 and 2015 of building up the new factory site at Ranjangaon, near Pune". This work was to be done, for consideration of "**approximate actual cost based charges: 16,000 EUR per month + expenses (mainly travelling costs) during 2014 until the end of the project**" by one Nazir Alibay. The total amount received by the assessee under this arrangement was Rs 1,97,94,209. The nature of services included the follows:

Factory project leader: Nazir Alibay

Description of services: Leading the work during 2014 and 2015 of building up the new factory site at Ranjangaon near Pune: Full time assignment.

As Factory project leader, following shall be the services rendered:

- **To plan and steer execution of all the work to establish the factory (including building, infrastructure and machinery). Responsible for all activities until machines are running at target level and taken over by local manufacturing management**

- **Responsible to manage project spending within budget.**
- **Leading the project team consisting of both local resources and resources supporting from other locations within SCA.**
- **Coordinating contractors for building and machinery and follow up their work to secure execution according to agreements.**
- **Regularly spending time on site to follow the progress of activities, but also at SCA India office in Mumbai as well as in Europe to secure communication and good flow of information between people within the company directly or indirectly involved in the project.**
- **Preparation of monthly project reports.**
- **Informing progress to project steering group as well as management of SCA India.**

11. Yet another receipt by the assessee, under the said agreement, was for Information Technology Services. These payments aggregated to Rs 57,47,684 during the relevant financial period. The nature of these services, as set out in Annexure B to the said agreement, is as follows:

1. Object and Term of the Services

SCA Sweden shall perform the following Services for SCA India;

- **Providing hard and software for various ERP systems, CRM systems and other business systems**
- **Providing hard and software for various internet services**
- **Providing data communication services**
- **Providing management of workplace environment**
- **Providing data processing of above systems**
- **Providing operations, support and consulting services for the above**
- **Providing support for implementation of ERP system [SAP 81) for project Vindaloo which includes support for**

  - **Pre implementation work i.e. applying per-sets for Template (all changes not impacting the productive Database), Cleansing current Database,**
    finalizing target processes and preparing Infrastructure

- **Assisting in Testing Phase i.e. testing upgrade, testing new integration scenarios, training users to new processes, testing business process on upgraded Database with users,**
- **Post implementation work which includes upgrading Database, applying new integration scenarios and applying other part of templates.**
- **Other tasks including creation and testing Fixed Assets module, additional reporting modules, retraining new users to ERP and on site support post GO live**

2. Details of the object of the Services

<u>Scope, type and purpose of the intended collections, processing, or use of data</u>
Data managed is related to the operations of the SCA business and to the management of its workforce, and will only be used to that purpose.

The processing and use of the date is restricted to the territory of a member state of the European Union or another state party to the Agreement of the European Economic Area. Relocation to other countries is subject to SCA India's prior approval.

<u>Type of Data</u>

The collection, processing and/or use of personal data refers to the following types/categories of data:-

- **Personal data**
- **Communication data (e.g. Telephone/e-mail)**
- **Contractual accounting and payment data**
- **Financial and non-financial planning and control data**
- **Information obtains from third parties, e.g, credit inquiry agencies or public directories**
- **Statistical data**

The group of data subjects affected by the use of their personal data hereunder comprises:

- **Employees**
- **Customers and Vendors**
- **Interested parties**
- **Consumers**
- **Other contract persons**

12. During the course of the scrutiny assessment proceedings, the Assessing Officer, noticed the above payments and required the assessee to show cause as to why these receipts not be taxed in the hands of the assessee under article 12 of the Indo Swedish tax treaty, as also under the Income Tax Act. One of the arguments that was adopted by the assessee was that under the restricted meanings of the 'fees for technical services' under article 12 of the

Indo Swedish tax treaty, as read with "most favoured nation (MFN) clause" in protocol thereto and read with India Portugal Double Taxation Avoidance Agreement [(2016) 244 ITR (Stat) 57; **Indo Portuguese tax treaty**, in short], unless a technical service "makes available" technical knowledge, experience, skill, knowhow or process, it cannot be brought to tax as fees for technical service. The Assessing Officer, however, did not accept this contention. When the matter travelled to the Dispute Resolution Panel, on objections being raised by the assessee, learned Dispute Resolution Panel did reject the invocation of MFN clause and observed that "**with regard to automatic application of the MFN clause available in the India Sweden Treaty, the DRP has its own reservations and feels that both the states are required to invoke the MFN clause through issuance of notifications**" and that "**in the absence of such notifications, benefits of other treaties cannot be extended automatically to a third state**". Without prejudice to this stand, on merits of applicability of "make available" clause, learned Dispute Resolution Panel observed as follows:

> **4.17 The relevant clause of the Article 12(4) relied on by the assessee is reproduced below:**
>
> > ***- make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of technical plan or technical design.***
>
> **4.18. There are two clear components in this clause – One which requires making available of technical knowledge, experience, skill, know how or process and the second which consists of the development and transfer of technical plan or technical design. The DRP finds that the case of the assessee is to be examined with reference to both these requirements.**
>
> **4.19 It needs clarification that when third party consultants are operating on behalf of the assessee and the amount received by it include payments for these excerpts, the character of their service needs to be elaborated for purpose of deciding the character of fee received by the assessee. It is also noted that the assessee is operating in project monitoring and project scheduling and budgeting which require development of elaborate plans which are subsequently transferred to the Indian party for execution.**
>
> **4.20. It is not the case of the assessee that these services are provided in isolation of the employees of SCA India who are involved in project execution, whether it is pre-development stage or subsequent stage. We are not convinced that the project execution service could be executed by the assessee without active involvement of project related employees of SCA India. It is not merely engineering or architectural designs which are contemplated under Article 12(4)(b) of the Treaty but also development and transfer of any technical plan or technical design, Technical does not mean technological. It only means specialized- the area may be finance, legal, commerce, arts, science or project implementation as in the case. This will include scheduling charts, time lines, bar charts which are contemplated in the case of the assessee under Project Administration. This also includes project and financing controls including necessary charts and controls for implementation of project. The assessee is not**

executing the project but is rendering consultancy service to the AE. When project implementation tools are provide to the employees of the AE, they are enable to employ these tools in implementing their own project.

5.14. The nature of service rendered by the assessee as detailed by it has been reproduced above. Admittedly, these vacancies are effectively connected with the SAP system implemented by the Group as a whole and have been made towards effective utilisation and efficient working of the SAP system. The assessee admits that these services are required on an annual basis and are meant for maintenance and upkeep of the system. The procurement of licences for SAP system has been held to be in the nature of royalty.

5.15. The assessee is not correct in claiming that the services so rendered are covered by Article 12(4)(b) of the India Portugal Treaty, even if the claim of automatic application of MFN clause is allowed to the assessee. The services is found to be intrinsically linked with enjoyment of the SAP system and hence, would fall within the ambit of Article 12(4)(a) of the Article where there is no requirement of making available of any knowledge, skill or experience.

5.16. In light of the above discussion, the DRP is of the view that these services constitute. FTS under the Act as well as under India Sweden DTAA and are required to be taxed in India under Article 12 of the India Sweden DTAA.

13. Accordingly, the Assessing Officer proceeded to make the additions of Rs 1,97,94,209 as consultancy services taxable under article 12 and Rs 57,47,684 as information technology support services taxable under article 12. The assessee is aggrieved and is in appeal before us.

14. We have heard the rival contentions, perused the material on record, and duly considered facts of the case in the light of the applicable legal position.

15. Let us first take a look at the provisions with respect to taxability of fees for technical services under the Indo Swedish tax treaty, the related protocol clause of the Indo Swedish tax treaty, and the provision for fees for technical services under the Indo Portuguese tax treaty. These provisions are set out below:

ARTICLE 12 OF INDO-SWEDISH TAX TREATY

ROYALTIES AND FEES FOR TECHNICAL SERVICES

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. Notwithstanding the provisions of paragraph (1), such royalties and fees for technical services may also be taxed in the Contracting State in which they arise,

and according to the laws of that State, but if the recipient is the beneficial owner of the royalties or fees for technical services, the tax so charged shall not exceed 10 per cent of the gross amount of the royalties or fees for technical services.

3. (a) The term 'royalties' as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

(b) The term 'fees for technical services' means payment of any kind in consideration for the rendering of any managerial, technical or consultancy services including the provisions of services by technical or other personnel but does not include payments for services mentioned in Articles 14 and 15 of this Convention.

4. The provisions of paragraphs (1) and (2) shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

5. Royalties or fees for technical services shall be deemed to arise in a Contracting State when the payer is a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for technical services was incurred, and such royalties or fees for technical services are borne by such permanent establishment or fixed base, then such royalties or fees for technical services shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

6. Where by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties or fees for technical services, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

PROTOCOL TO INDO SWEDISH TAX TREATY

At the signing of the Convention between the Government of the Republic of India and the Government of the Kingdom of Sweden for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and on capital, the undersigned have agreed that the following shall form an integral part of the Convention:

……

With reference to Articles 10, 11 and 12 :

In respect of Articles 10 (Dividends), 11 (Interest) and 12 (Royalties and fees for technical services) if under any Convention. Agreement or Protocol between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention.

…….

IN WITNESS whereof the undersigned being duly authorised thereto have signed this Protocol.

DONE in duplicate at New Delhi, this 24th day of June, 1997, in the Swedish, Hindi and English languages, all three texts being equally authentic. In case of divergence between the texts the English text shall be the operative one.

ARTICLE 12 OF INDO PORTUGESE TAX TREATY

ROYALTIES AND FEES FOR INCLUDED SERVICES

1. Royalties and fees for included services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for included services may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the beneficial owner of the royalties and fees for included services is a resident of the other Contracting State, the tax so charged shall not exceed 10 per cent of the gross amount. The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this limitation.

3. The term "royalties" as used in this article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work including cinematograph films and films or

tapes or any other means of reproduction for use in connection with radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial, or scientific experience.

4. For the purposes of this article, "fees for included services" means payments of any kind, other than those mentioned in articles 14 and 15 of this Convention, to any person in consideration of the rendering of any technical or consultancy services (including through the provisions of services of technical or other personnel) if such services:

(a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or

(b) make available technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or technical design which enables the person acquiring the services to apply the technology contained therein.

5. Notwithstanding paragraph 4, "fees for included services" does not include payments:

(a) For services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property;
(b) For services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international craft;
(c) For teaching in or by educational institutions;
(d) For services for the personal use of the individual or individuals making the payment;
(e) To an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in article 14;
(f) For services rendered in connection with an installation or structure used for the exploration or exploitation of natural resources referred to in paragraph 2, f), of article 5;
(g) For services referred to in paragraph 3 of article 5.

6. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties and fees for included services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties and fees for included services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties and fees for included services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of article 7 or article 14, as the case may be, shall apply.

7. Royalties and fees for included services shall be deemed to arise in a Contracting State where the payer is that State itself, a political or administrative subdivision thereof, a local authority or a resident of that State. Where, however, the person paying the royalties and fees for included services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or fixed base in connection with which the obligation to pay the royalties and fees for included services was incurred, and such royalties and fees for included services are borne by that permanent establishment or fixed base, then such royalties and fees for included services shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

8. Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the royalties and fees for included services, having regard to the use, right or information for which they are paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Convention.

[Emphasis, by underlining, supplied by us]

16. The question that we first need to deal with is as to what is the impact of the MFN clause in the Indo Swedish tax treaty, read with the Indo Portuguese tax treaty which was subsequently entered into between India and Portugal, an OCED member country.

17. Let us first understand as to what a most favoured nation clause, in the tax treaties, is. All it implies is that in case the tax jurisdictions entering into the tax treaty, or any of the treaty partner, extends a more generous tax treatment to any other tax jurisdiction, or any other tax jurisdiction of a particular nature- e.g. OECD member jurisdiction, the same tax treatment will be due to the treaty partner in question. For example, if X jurisdiction provides for source taxation @ 15% for interest to Y jurisdiction, it also assures, by incorporating a MFN clause, that in case X jurisdiction enters into an agreement providing for a lower rate of source taxation, or more restricted scope for taxation of interest, with any other jurisdiction- or any other OECD member tax jurisdiction, the same will be extended to Y jurisdiction as well. In a sense, terming this clause as a 'most favoured nation clause' is a misnomer because what this clause ensures is an equal treatment vis-à-vis other jurisdictions, or other jurisdictions of a specific category, rather than a favoured treatment for the treaty partner jurisdiction.

18. It is crucial to bear in mind that the implementation of a most favoured nation clause is not always in a homogenous manner. There are different ways in which such an MFN clause can be implemented. There can be situations like in India Switzerland Double

Taxation Avoidance Agreement [(1995) 214 ITR Stat 223 @ 246; Indo Swiss tax treaty, in short] which only requires fresh negotiations to provide for giving effect to most favoured nation status in effect, as evident from the observations in the protocol to the effect that "If after the date of signing this Amending Protocol, India under any Convention, Agreement or Protocol with a third State which is a member of the OECD, restricts the scope in respect of royalties or fees for technical services than the scope for these items of income provided for in Article 12 of this Agreement, then Switzerland and India shall enter into negotiations without undue delay in order to provide the same treatment to Switzerland as that provided to the third State" *(Emphasis, by underlining, supplied by us).* Similarly, in the case protocol to the India Philippines Double Taxation Avoidance Agreement [(1996) 219 ITR Statutes 60 @ 83 ; Indo Philippines tax treaty, in short], all that provided is in the MFN clause is that the treaty partners inform the other party so that the matter is appropriately revied as is evident from the protocol observation to the effect that "With reference to Articles 8 and 9 if at any time after the date of signature of the Convention the Philippines agrees to a lower or nil rate of tax with a third State the Government of the Republic of the Philippines shall without undue delay inform the Government of India through diplomatic channels and the two Governments will undertake to review these Articles with a view to providing such lower or nil rate to profits of the same kind derived under similar circumstances by enterprises of both Contracting States *(Emphasis, by underlining, supplied by us)".* In the case of Indo Swedish tax treaty, however, the wordings are different inasmuch as it provides that "**if under any Convention. Agreement or Protocol between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interest, royalties, or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention** *(Emphasis, by underlining, supplied by us)".* There are thus three different modes, in the illustrations that we discussed, in which the MFN clause can be implemented- first, as in Indo Swiss tax treaty, where all that the MFN clause ensures is that the negotiations take place, without any delay, to ensure that the same treatment is provided to the treaty partner; second, as in India Philippines tax treaty, where the information, about a more generous treatment for any another tax jurisdiction, by one of the treaty partners is to be provided to the other treaty partner, through diplomatic channels, so that existing provisions can be brought in par with more generous tax treatment in the source jurisdiction; and, third- in which the treaty does not prescribe anything further that is required to be done, for giving effect to the MFN status, as the same rate or the same scope, as is extended to any other OECD country subsequently, "shall also apply" under this treaty. There can also be situations in which an MFN clause may require the treaty partner jurisdictions to issue notifications to the effect that the benefit extended to another jurisdiction is extended to the treaty partner jurisdiction as well. There can be several modes for implementation of the MFN clause, but its not really necessary to explore that aspect any further. Suffice to note that there are different methods in which MFN clause can be implemented, and there cannot, therefore, be a 'one size fits all' approach. As far as the situation that we are dealing with, i,e. MFN clause in Indo Swedish tax treaty, is concerned, it is a situation in which the action of limiting the source taxation, for dividends, interest, royalties or fees for technical services, to any other OECD member jurisdiction, by itself, is enough to trigger that the same provisions "shall also apply" under Indo Swedish tax treaty. No further actions on the part of India are envisaged in the Indo Swedish tax treaty to trigger the application of the same provisions in Indo Swedish tax treaty as well.

19. Elaborating upon the scope of this peculiar manner in which MFN clause operates in India France Double Taxation Avoidance Agreement [(1994) 209 ITR Statues 130 @ 159; **Indo French tax treaty**, in short) the relevant portion of protocol clause in which is identically worded in effect as in the case of Indo Swedish tax treaty, a coordinate bench of this Tribunal, speaking through one of us *(i.e. the Vice President*), in the judgment reported as **DCIT Vs ITC Ltd [(2002) 82 ITD 239 (Kol)]** made following observations around two decades back, in late 2001, and these observations, as we will see a little later, hold good even today:

> **……in our considered view, the benefit of lower rate of or restricted scope of 'fees for technical services' under the Indo-French DTAA is not dependent on any further action by the respective Governments, unlike the situation envisaged in, for example, para 4 of protocol to Indo-Philippines DTAA or para 3 of protocol to Indo-Swiss….**

20. It is interesting to note that the coordinate bench did take note of the notification issued by the Government of India, giving effect to, what it perceived as, the impact of the protocol clause as a result of a subsequent tax treaty being entered into by India. The controversy about the Government notification was on account of the fact that it did implement the protocol clause, but it extended lesser effect to it than as visualized by a plain reading of the protocol clause- i.e., about the rate of taxation in the subsequent treaty provision only and not about the restricted scope of the related treaty provision. However, the coordinate bench was of the view that nothing turned on this notification and ignored the same. The plea that issuance of notification was at best done as a measure of abundant caution by the CBDT, and it did not have any legal effect on the implementation of the protocol clause, was, in effect, accepted. However, when an identical issue, in the case of Indo French tax treaty itself, came up before the Authority for Advance Ruling, in the case of **Steria India Ltd In Re [(2014) 72 taxmann.com 1 (AAR)],** the approach adopted, on this issue, by the Authority for Advance Ruling was entirely different, as it held notification to be a crucial and legal source of the rights by the implementation of protocol, Hon'ble Authority for Advance Ruling observed as follows:

> **……..What is stated by the Protocol is for India to limit its taxation at source for the detail items mentioned therein. The restrictions are on the rates and 'make available' clause cannot be read in the items. On the basis of the Protocol, notification No.9602 [F.No.501/16/80-FTD], dated 6.9.1994 as amended by Notification No. SO 650(E), dated 10.7.2000. was issued by Govt. of India. The said Notification does not include anything about the 'make available' provision. Had the intention of the Protocol or the Government is to include 'make available' clause in the Tax Treaty between India and France, it should have been done so in the said Notification. We have taken note of the Notification issued in the case of India Netherland Tax Treaty whereby the Protocol was given effect to. The changes in the Treaty on the basis of the Protocol were given effect by Notification only. We do not see any reason as to why different treatment will be given in the present case.**

21. In other words, it was thus held, as has been held by the learned DRP in the impugned order, that the effect of the protocol clause is to be given by a formal notification, and unless that happens, the protocol is toothless. That legal position has, however, been reversed in the case of **Steria India Ltd Vs CIT [(2016) 72 taxmann.com 1 (Del**)] and Their Lordships have, referred to, with approval, the decision of a coordinate bench in the case of **ITC Ltd** *(supra)* and concluded as follows:

> **……The Court is …….. unable to agree with the conclusion of the AAR that the Clause 7 of the Protocol, which forms part of the DTAA between India and France, does not automatically become applicable and that there has to be a separate notification incorporating the beneficial provisions of the DTAA between India and UK as forming part of the India- France DTAA**
>
> **……..**
>
> **…….. a reference to the decision of the ITAT in Dy. CIT v. ITC Ltd. [2002] 82 ITD 239 (Kol.), where the Protocol separately executed between the India and France which formed part of the DTAA between the two countries was interpreted. It was held by the ITAT, and in the view of this Court correctly, that the benefit of the lower rate or restricted scope of fee for technical services under the Indo-French DTAA was not dependent on any further action by the respective governments. It was held that the more restricted scope of fee for technical services as provided for in a DTAA entered into by India with another OECD member country shall also apply under the Indo-French DTAA with effect from the date on which the Indo-French DTAA or such other DTAA enters into force.**

22. The views so expressed by Hon'ble Delhi High Court, in the absence of anything contrary thereto by Hon'ble jurisdictional High Court, or, for that purpose, even any other Hon'ble High Court, bind us. The AAR decisions, as is the well-settled legal position, do not constitute binding judicial precedents for us. It is also not in dispute that Portugal is an OECD jurisdiction, that the Indo Portuguese tax treaty was entered into after the Indo Swedish tax treaty was entered into, and that the Indo Portuguese tax treaty provides far more restricted scope of 'fees for technical services' inasmuch as it adopts the 'make available' clause which restricts the taxation of fees for technical services only in such cases which "make available" technical knowledge, experience, skill, know-how or processes or consist of the development and transfer of a technical plan or technical design which enables the person acquiring the services to apply the technology contained therein. Therefore, respectfully following the coordinate bench decision in the case of **ITC Ltd** (*supra*), which has been specifically approved by Hon'ble Delhi High Court in the case of **Steria India Ltd** (*supra*), we hold that the provisions of article 12 (4)(b) of the Indo Portuguese tax treaty, being more restricted in scope vis-à-vis article 12(3)(b) of Indo Swedish tax treaty, apply in the Indo Swedish tax treaty as well.

23. As for the connotations of 'make available' clause in the treaty, this issue is no longer *res integra*. There are at least two non-jurisdictional High Court decisions, namely Hon'ble

Delhi High Court in the case of **DIT v. Guy Carpenter & Co Ltd. [(2012) 346 ITR 504 (Del)]** and Hon'ble Karnataka High Court in the case of **CIT v. De Beers India (P.) Ltd. [(2012) 346 ITR 467 (Kar)]** in favour of the assessee, and there is no contrary decision by Hon'ble jurisdictional High Court or by Hon'ble Supreme Court. In De Beers India (P.) Ltd. case *(supra)*, their Lordships posed the question, as to "what is meaning of 'make available'", to themselves, and proceeded to deal with it as follows:

> **'.....The technical or consultancy service rendered should be of such a nature that it "makes available" to the recipient technical knowledge, know-how and the like. The service should be aimed at and result in transmitting technical knowledge, etc., so that the payer of the service could derive an enduring benefit and utilize the knowledge or know-how on his own in future without the aid of the service provider. In other words, to fit into the terminology "making available", the technical knowledge, skill, etc., must remain with the person receiving the services even after the particular contract comes to an end. It is not enough that the services offered are the product of intense technological effort and a lot of technical knowledge and experience of the service provider have gone into it. The technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider. Technology will be considered "made available" when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service that may require technical knowledge, skills, etc., does not mean that technology is made available to the person purchasing the service, within the meaning of paragraph (4)(b). Similarly, the use of a product which embodies technology shall not *per se* be considered to make the technology available. In other words, payment of consideration would be regarded as "fee for technical/included services" only if the twin test of rendering services and making technical knowledge available at the same time is satisfied.'**

24. In order to decide whether or not the services rendered by the assessee fit the definition of 'fees for technical services', as applicable under the Indo Swedish tax treaty, the question that we must ask ourselves is not only whether the technical services are performed on the facts of this case, but whether "the technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider." In this light when we analyze the nature of services, which are set out in detail earlier in this order, we find that in none of the cases, these services enable the recipient of these services to perform the same services, in the future, without recourse to the assessee. The consultancy services are in the nature of leading the setting up of factory, including planning and steering execution of work, being responsible for managing project within budget constraints, leading the project team from different locations, coordination and follow up with the contractors, securing communication and good flow of information between those directly or indirectly involved with the project, preparing project progress report and updating all concerned with the project progress. Just because the assessee renders these services does not mean, and by no stretch can imply, that the recipient can next time do all this work without recourse to the assessee. As regards learned DRP's observations that the project leading work "will include

scheduling charts, timelines, bar charts which are contemplated in the case of the assessee under Project Administration….project and financing controls including necessary charts and controls for implementation of the project", that "the assessee is not executing the project but is rendering consultancy service to the AE", and that "when project implementation tools are provided to the employees of the AE, they are enabled to employ these tools in implementing their own project," these observations are factually incorrect inasmuch as the assessee's representative is executing the work and is the key person at the factory site who is doing all the needful and inasmuch as there is no mention anywhere of developing these tools and handing over the same to the recipient of services. In any case, just because the Indian entity is interacting with the project leader and getting inputs from him does not mean that the Indian entity is transferred the technology of being a project leader of this type and next time Indian entity can perform similar services without recourse to the same- which is the core test for the fulfilment of 'make available' clause. We are unable to approve the stand of the authorities below on this point. In our considered view, in the light of the discussions above, the make available clause is not satisfied, in the course of rendition of services by the assessee, and, as such, the consultancy fees of Rs 1,97,94,209 cannot be brought to tax, in the hands of the assessee, under article 12 of Indo Swedish tax treaty.

25. That leaves us with the taxability of Rs 57,47,684 on account of Information Technology Services. The main reason for its taxability by the DRP is stated to be that **"the services is found to be intrinsically linked with enjoyment of the SAP system and hence, would fall within the ambit of Article 12(4)(a)".** In the assessment order, there is also mention about "**resulting in overall improvement in business and the income generating capacity of SCA India, which is a clear enduring benefit**" and about the stand that the rendition of these services are "**also providing a skill level and relevant training which will be readily available to personnel of SCA India and thereby a clear enduring benefit is provided**". It is also mentioned that "**specific support in the form of implementation of SAP project amd Project Vinadalloin the form of pre-implementation, testing, post-implementation is also provided which is clearly technical in nature and intended to increase the efficiency and improve the functioning of SCA India**". It is to be noted that so far as the enduring benefit and increase of efficiency in the recipient entity is concerned, that has nothing to do with the satisfaction of "make available" clause. As we have seen in our analysis earlier, what is important is transfer of technology and not the incidental benefit. Unless the recipient of a service is not enabled to perform that service on his own, without recourse to the service provider, the requirements of the make available clause are not satisfied. The concept of enduring benefit, increase in efficiency, improvement in income-generating capacity and incidental skill development is wholly irrelevant for this purpose. The authorities below have been thus swayed by considerations not germane in this context. So far as these services being incidental to SAP system being the reason for taxation under article 12(4)(a) is concerned, we have noted that providing support services for SAP implementation is a small part of the services and in any case what article 12(4)(a) covers is the services which "are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received" and the information technology services, as set out in Annexure B to the agreement, cannot be described as ancillary and subsidiary to the SAP system. At best, a small part of these services could fall in that category, but that payment is not even separately identified. These things apart, 12(4)(a) would come into play when the assessee receives a payment in the nature of royalties under article 12(3) and the services ancillary and subsidiary to the

application or enjoyment of that right, payment for which is described in article 12(3). In other words, the person receiving the money as royalty, such as the actual seller of the software in this case, and the person providing service ancillary or subsidiary to the enjoyment of that right, must be the same. That's not the case here. In the present case, the payment received by the assessee has been held to be in the nature of reimbursement, which is outside the ambit of taxation. The person selling the SAP software is Be One Solution, Switzerland, whereas the person providing the services in question is the assessee. Article 12(4)(a) will not, therefore, come into play at all. In our considered view, therefore, the taxation under article 12 in the present case can come into play only when the "make available" clause is satisfied, but then the Assessing Officer's justification for the satisfaction of 'make available' clause, for the detailed reasons set out earlier in this paragraph, does not meet our judicial approval. In view of these discussions, as also bearing in mind the entirety of the case, we uphold the plea of the assessee on this point as well. Accordingly, we hold that the income of Rs 57,47,684 on account of Information Technology Services is also not taxable under article 12.

26. Ground nos. 2 and 3 are also thus allowed.

27. In the result, the appeal is allowed. Pronounced in the open court today on the 8th day of January, 2021.

Sd/- Sd/-

Saktijit Dey **Pramod Kumar**

(Judicial Member) (Vice President)

Mumbai, dated the 8th day of January, 2021

Copies to: *(1)* *The appellant* *(2)* *The respondent*
(3) *CIT* *(4)* *CIT(A)*
(5) *DR* *(6)* *Guard File*

By order

Assistant Registrar
Income Tax Appellate Tribunal
Mumbai benches, Mumbai