IN THE HIGH COURT OF DELHI AT NEW DELHI

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Judgment reserved on : 14.02.2011
Judgment delivered on: 10.03.2011

ITR Nos.87-89/1992

COMMISSIONER OF INCOME TAX CENTRAL-II, NEW DELHI ..... PETITIONER

Vs

D.C.M. LIMITED .... RESPONDENT

Advocates who appeared in this case:
For the Appellant : Ms. Prem Lata Bansal, Sr. Advocate with Mr. Deepak Anand, Advocate
For the Respondent : Mr. S.K. Aggarwal, Advocate

CORAM :-
HON'BLE MR. JUSTICE SANJAY KISHAN KAUL
HON'BLE MR JUSTICE RAJIV SHAKDHER

1. Whether the Reporters of local papers may be allowed to see the judgment ? Yes

2. To be referred to Reporters or not ? Yes

3. Whether the judgment should be reported in the Digest ? Yes

RAJIV SHAKDHER, J

1. The captioned references arise out of the orders passed in ITC No.95-97/1990. We were informed that only question of law which was to be answered is as follows :-

> "Whether on the facts and in the circumstances of the case, the Tribunal was right in law in holding that no tax was to be deducted at source under the Act on payment of 38750 pounds, 77500 pounds, 23250

Industries Ltd., London under the Technical Collaboration Agreement, dated 12.10.1983?"

1.1. As a matter of fact, we had recorded the same, after confabulation with the counsels for parties, in our order dated 10.02.2011.

2. The question of law detailed out above arises in the background of the following facts as culled out from the orders of the authorities below:-

2.1 The assessee which is in the business of manufacture of sugar had entered into an agreement dated 12.10.1983 (in short 'agreement') for transfer of comprehensive technical information, know-how and supply of equipment with one Tate & Lyle Process Technology; a division of Tate & Lyle Industries Limited, London (hereinafter referred to as 'Tate').

2.2 The said agreement envisaged payment of a sum of £1,55,000 in four (4) instalments towards supply of documents concerning, what was known as "*TALO processes*".

2.3 It appears that Tate being a pioneer in sugar technology; was not only engaged in the manufacture of specialized equipment but was also in possession of know-how required for installation and operation of specialized equipment, processes and use of essential specialty chemical products, which assisted in elimination of use of lime stone and hard coke while, greatly conserving energy bringing

about reduction in pollution as well as loss of sugar during manufacture of plantation white sugar.

2.4 The assessee wanting to adopt the "TALO processes" for its factory at Daurala, in India entered into the aforementioned agreement.

2.5 The first, of the four (4) instalments, was to be remitted to Tate on the execution of the aforementioned agreement. Accordingly, the assessee, in its capacity as a representative assessee for Tate, applied to the Inspecting Assistant Commissioner (in short, 'IAC') for permission to remit the first instalment in the sum of £ 38750. The IAC accorded its no objection vide certificate dated 27.03.1984 albeit with a caveat that the assessee would have to deduct tax at source at the rate of 20% towards tax on the gross amount of remittance. Resultantly, the assessee could remit to Tate the amount only after deduction of tax at source. A similar no objection certificate was issued by the IAC vide its certificate dated 17.05.1984 in respect of the second remittance in the sum of £1,16,250.

2.6 It is pertinent to note that, in the two certificates issued by the IAC, no reasons were supplied as to why the assessee had been called upon to deduct tax at source at the rate of 20%.

2.7 The assessee being aggrieved by the said action of the IAC preferred an appeal to the Commissioner of Income Tax (Appeals) [in short, CIT(A)]. Several grounds were raised in

the appeal by the assessee. The principle ground being that the remittance to Tate was not in the nature of royalty; the remittances in the hand of Tate constituted industrial or commercial profits and since Article VIII of the Double Taxation Avoidance Agreement (in short 'DTAA') obtaining between India and the United Kingdom was applicable, the said remittances could be taxed only if Tate was shown to have a permanent establishment in India.

2.8 In support of the aforesaid stand, it was argued that Tate had no permanent establishment in India. It appears, in this regard, a reference was made to a certificate dated 02.03.1984 to establish that Tate had no establishment in India in terms of Article V of the DTAA

2.9 The CIT(A), however, came to the conclusion that the remittances made to Tate by the assessee fell within the purview of the expression *"payments of any kind"* appearing in Article XIII (3) of the DTAA The CIT (A), however, accepted the position that the provisions of Section 9(1)(vi) of the Income Tax Act, 1961 (in short, 'I.T. Act') would be overridden in view of the provisions of Article XIII (3) of the DTAA. The CIT (A) was of the view that the term 'technical know-how' was wide enough to include not only outright sales of design or know-how but also any other provision of technical assistance. He also went on to hold that for a payment to be construed as royalty under the provisions of

the payments made were lump-sum or, were made periodically or, even on a recurring basis. For these reasons, the CIT(A) concluded by holding that: “in the present case, it is clear that technical know how was provided by the foreign enterprise including lending of services of foreign technicians. The payment was clearly in the nature of royalty and it could not be said that payment had to be treated as commercial or industrial profits.”

2.10 Consequently, the CIT (A) sustained the order of the IAC even while noting that there was no reasoning contained in the certificate issued by the IAC mandating the deduction of tax at source at the rate of 20% in respect of the remittances in issue. The CIT(A) was of the view that a reading of the order would show that the impugned certificate issued by the IAC was otherwise in accordance with law.

3. Aggrieved by the order of the CIT (A), the assessee carried the matter in appeal to the Income Tax Appellate Tribunal (hereinafter referred to as the ‘Tribunal’). The Tribunal, in the impugned judgment, noted the difference in the definition of royalty as contained in Article XIII(3) of the DTAA and that which obtained in explanation 2 to Section 9(1)(vi) of the I.T. Act. The Tribunal opined that the definition of royalty as appearing in the DTAA was narrower than that under the Income Tax Act. The Tribunal also noted the fact that the CIT(A) had correctly construed the position in law, which is that, the provisions of DTAA would override those of

the I.T. Act. In these circumstances, the Tribunal examined the agreement dated 12.10.1983 in the light of the provisions as contained in the DTAA. On examination of the aforementioned agreement, the Tribunal observed as follows:-

> "A perusal of the Technical Collaboration Agreement shows that the amount of £1,55,000 was to be paid by DCM to TL once for all as consideration for the grant of licence and the disclosure of the know-how. Para 2 of the said Agreement provided that TL was to grant DCM the right and full but non-transferable licence to practice the TALO Processes at its existing factories. The DCM could sub-licence its rights to another Indian party with the consent of TL and with the approval of the Government of India. Para 3 of the said agreement provides for the disclosure of the know-how, of which the details appear from paras 3.1 to 3.9. We find that the definition of 'royalty' under Explanation 2 to section 9(1)(vi) of the Income Tax Act, 1961 is not the same as the definition of the term under Article XIII(3) of the double taxation avoidance agreement. As rightly submitted on behalf of the assessee, the definition under the double taxation avoidance agreement is a truncated one i.e., it is narrower than the definition under the Income Tax Act. A comparative look at the two definitions shows that the following part of the definition which occurs in Explanation 2 to section 9(I)(vi) of the Income Tax Act, 1961 does not figure under Article XIII(3) of the double taxation avoidance agreement :-
> (i). The transfer of all or any rights (including the granting of the licence) in respect of a patent,

invention, model, design, secret formula or process or trade mark or similar property; &

(ii). The imparting of any information concerning the working of, or the use of, a patent, invention, model, design, secret formula or process or trade mark or similar property.

The know-how is intellectual property and excluded clauses referred to above pertained to the know-how of secret formula or process and the imparting of any information concerning the working thereof. The assessee, in our view, is right in submitting that the things for the transfer of which DCM agreed to pay to TL 81,55,000 as such squarely fell within these two exclusionary clauses which do not form part of the definition of the term 'royalty' under Article XIII(3) of the double taxation avoidance agreement. The Income Tax authorities in our view, were not right in being influenced by the term 'payments of any kind' preceding the definition of this term under the double taxation avoidance agreement."

3.1 In view of the aforesaid observations, the Tribunal came to the conclusion that the consideration paid by the assessee for transfer of drawings, designs, etc., outside India by Tate to the assessee did not constitute royalty "as contemplated under Article XIII of the DTAA". It went on to observe that the consideration received by Tate constituted business profits of Tate, which could not be taxed through assessee in India as Tate did not have a permanent establishment in India.

4. Being aggrieved, the Department sought a reference to this court. As noticed hereinabove, we are called upon to decide the references in the light of the question of law framed.

5. Mrs. Bansal, learned senior counsel appearing on behalf of the revenue has confined her submissions to the interpretation of the clauses of the agreement executed between Tate and the assessee. Mrs. Bansal drew our attention to various clauses of the agreement, and consequently, contended that a reading of the provisions would demonstrate that what had been obtained by the assessee was a mere use of the know-how and the technology owned by Tate. In other words, Mrs. Bansal contended that there was no transfer of technology and / or know-how by Tate to the assessee. Mrs. Bansal, however, fairly conceded that the issue at hand would have to be looked at only in the light of the definition of royalty obtaining in Article XIII(3) of the DTAA, and also the fact that it was no longer *res integra* that in case of a conflict between the provisions of the I.T. Act and the DTAA, the provisions of DTAA would override. In support of her submissions, the learned senior counsel cited the following judgments :-

> *N.V. Philips Vs. CIT (1988) 172 ITR 521; Alembic Chemical Works Co. Ltd. Vs. CIT (1989) 177 ITR 377; Shriram Pistons and Rings Ltd. Vs. CIT(Del.) (2008) 307*

ITR 363; and CIT Vs. J.K. Synthetics Ltd. (2009) 309 ITR 371.

6. Mr. Agarwal appearing for the assessee refuted the contentions of the revenue. Mr. Aggarwal largely relied upon the order of the Tribunal in support of his plea. A particular emphasis was laid by Mr. Aggarwal on the terms of the aforementioned agreement executed between Tate and the assessee. It was Mr. Aggarwal's say that a reading of the agreement would show that Tate had sold the technology and / or know-how in issue (i.e., the 'TALO' processes) albeit based on certain conditions. The learned counsel submitted that it was a case of conditional sale and not a mere use of technology and know-how as was sought to be contended by the learned senior counsel for the revenue. Mr. Aggarwal in support of his contention relied upon the judgment in the case of *CIT Vs. Davy Ashmore India Ltd. (1991) 190 ITR 626*.

7. We have heard learned counsel for the parties and also perused the documents on record. In our view, the answer to the question framed would largely depend upon our being able to ascertain the intent of the parties based on the language employed in the agreement. For this purpose, the agreement in issue will have to be read as a whole and not in a piecemeal fashion. The first recital i.e., recital 'A' suggests that Tate was in possession of the necessary expertise i.e., the technical know-how, which is, broadly referred to as the 'TALO' processes used in the sugar industry. Recital 'B'

indicates that the assessee was *'desirous of acquiring'* technical know-how offered by Tate for its existing sugar factories in India.

7.1 Clause 1 specifies that the agreement envisages transfer of *'comprehensive technical know-how and also supply of equipment'* by Tate to the assessee in order to enable it to adopt the 'TALO' processes. The said clause clearly provides that the term '*know-how*' used in the clause (1) shall include the following:-

> "…. all trade secrets and technical information, tangible and intangible, including documents, process description, process flow diagrams, specification of speciality chemicals and TL's standards of purity and performance for these chemicals, equipment specifications, equipment layout, design, drawings, piping drawings, laboratory testing methods, operation and use of analytical instruments, and all other related technical information as are or may be available from and used by TL on the date hereof with regard to the TALO processes."

7.2 Moving further, in particular, clause 2.1 and 2.2 confer on the assessee full rights in the form of non-transferable licences to practice 'TALO' processes at the assessee's existing factories, with an added right to sub-licence the rights conferred to another Indian party provided the terms and conditions of sub-licence were previously agreed to by both parties. This right was, however, subject to a caveat,

which was, to obtain necessary approval in that regard, of the Government of India.

7.3 Under clause 3.2, the assessee was required to maintain confidentiality of any drawings, specification or technical information forming part of the know-how received by it.

7.4 Clause 3.5 obliged Tate to send its engineer and technologists, and also specialists, as and when the assessee sought its assistance, in that regard.

7.5 Under clause 3.9, Tate was obliged to inform the assessee of any research and development and, as such, improvements in the 'TALO' processes which became available commercially, from time to time. The obligation, however, was confined to a period of 5 years from the effective date of the contract.

7.6 Under clause 4.1, Tate was required to supply the necessary control equipment required for the 'TALO' processes. The terms with respect to the supply of such equipment were required to be contained in a separate agreement.

7.7 The manner of payment of the once-for-all consideration in the sum of £ 1,55,000 was contained in clause 6 of the agreement.

7.8 Performance Guarantee was provided for in clause 7.

7.9 Similarly, warranties were required to be furnished by Tate with respect to its know-how in terms of clause 8 of the aforesaid agreement.

7.10 Under clause 12, parties were prohibited from assigning or transferring rights under the agreement to any third party directly or indirectly without the written consent of the other party.

7.11 Clause 13 of the agreement provided for termination on the grounds of insolvency. The right in this was conferred on both the 'Tate' and the assessee.

7.12. Clause 18 which dealt with the validity of the agreement provided that the terms and conditions contained in the agreement are conditional upon commissioning of the 'TALO' processes before 01.01.1987.

8. As is noticed above, we have only referred to what according to us, were the essential clauses of the agreement. A reading of the aforementioned clauses would show that what was intended by the parties was as follows :-

(i) Tate would transfer to the assessee technical know-how for a lumpsum consideration of £ 1,55,000 to be paid in the manner provided in clause 6 of the agreement. The agreement provided for transfer of *"comprehensive technical information"* and know-how, which included all trade secrets and technical information, designs and drawings, etc.;

(ii) The transfer of technical know-how was on a non-exclusive basis, in order to enable the assessee to adopt 'TALO' processes, in respect of its existing factories in India.

(iii) In addition to the above, the assessee had also the right to sub-licence the technology and/or the know-how transferred to it, to another Indian party, subject to the terms and conditions of sub-licence being agreed to by both 'Tate' and the assessee.

8.1 In our view, it is quite clear by virtue of the aforementioned agreement what the assessee obtained was a complete transfer of technology and know-how albeit on a non exclusive basis which was confined to its factories in India with a conditional right to sub-licence it to third parties. The sub-licencing of technology and/or know-how had to have, however, the consent of Tate and also the approval of the Government of India. The obligation of Tate to update the technology and/or know-how transferred to assessee based on research and development carried out by it, had obviously to be restricted in point of time, bearing in mind that it was a transaction which dealt with complete transfer of technology. The time span provided was 5 years from the effective date of the contract.

8.2. It was not, according to us, therefore, as contended by the learned counsel for the revenue, a mere use of the technology and/or know-how owned by Tate. Therefore, the mere fact that Tate retained with it the right to transfer

technology and / or know-how to other parties did not in our view reduce the right obtained by the assessee under the agreement to one of a mere user of technology and know-how. The transfer of technology is thus quite often, as in the present case, brought about by executing agreements which give rights far greater than a mere right to use albeit on a non-exclusive basis. The argument made on behalf of the revenue that the transaction does not constitute a sale, misses the point that, for it to fall within the four corners of the provisions of Article XIII(3), the right conferred should be of usage; anything more than that, takes it out of ambit of definition of royalty as provided in the DTAA. We, therefore, agree with the conclusion arrived at by the Tribunal with regard to the terms of the agreement. Having come to this conclusion, it is quite obvious that the remittances made by the assessee to Tate would not fall in the definition of Article XIII(3) of the DTAA.

8.3 Another argument raised before us was that the definition of the term of royalty was very wide as it brought within its wings payments of any kind. To deal with this submission it would be appropriate to extract the relevant portion of Article XIII(3) of the DTAA.

> "The term 'royalties' as used in this Article means payments of any kind including rental received as a consideration for the *use of*, or the *right to use*:
> (a). any patent, trademark, design or model, plan, secret formula or process;

(b). industrial, commercial or scientific equipment, or information concerning industrial, commercial or scientific experience;

(c). any copyright of literary, artistic or scientific work, cinematographic films, and films or tapes for radio or television broadcasting;

But does not include royalties or other amounts paid in respect of the operation of mines or quarries or of the extraction or removal of natural resources."

9. A bare perusal of Article XIII(3) would show that the expression *'payments of any kind'* is circumscribed by the latter part of the definition which speaks of consideration received (including in the form of rentals) for "*use of*" or "*right to use*" intellectual properties. The Tribunal, in our view, rightly observed that the CIT(A) had erred in coming to the conclusion that the expression 'payments of any kind' was broad enough to include even an outright sale. To drive home this point the Tribunal, once again, has correctly drawn a distinction between the definition of royalty as appearing in the DTAA and that which finds mention in explanation 2 to section 9(1)(vi) of the I.T. Act. A perusal of the provisions of the said explanation would show that it bring within the ambit of royalty a wider range of transactions which would include payments made for "*transfer of all*" or "*any right"* in patents, inventions, model, design, etc. apart from payments based for use of such right, patent, innovation, model, design, secret formula or process or trade mark or similar property. As a matter of fact, a perusal of clause (i) of

explanation 2 of section 9(1)(vi) of the I.T. Act would show that "*transfer of all*" or "*any right*" could take place by execution of licences as well, which was the methodology adopted by Tate and the assessee in the present case. For the sake of convenience and in order to draw a distinction between the definition of royalty as appearing in Article XIII (3) and that which obtains in the I.T. Act: the relevant portion of explanation 2 of Section 9(1)(vi) of the I.T. Act is extracted hereinbelow :-

> Explanation 2. – For the purposes of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for -
> (i). the transfer of all or any rights (including the granting of a licence) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property;
> (ii). The imparting of any information concerning the working of, or the use of, a patent invention, model, design, formula or process or trade mark or similar property;
> (iii). ....
> (iv). ....
> (v). ....
> (vi). The rendering of any services in connection with the activities referred to in sub-clauses (i) to (v)."

10. As is obvious, what is contended by the revenue, if at

Since the definition of royalty in DTAA has a limited scope, the remittances in issue cannot be construed as royalties, therefore, as is correctly concluded by the Tribunal, against the remittances in issue, tax at source could not have been deducted. We are also in agreement with the Tribunal that these payments could only constitute business profits of Tate. Mrs. Bansal during the course of the arguments, has fairly conceded that there is no permanent establishment of Tate in India. She had, therefore, accordingly confined her arguments to that aspect of the matter, which is discussed hereinabove by us. Given the fact that Tate did not have a permanent establishment in India, the remittances which constitute business profits cannot also be taxed in India.

11. In so far as the judgments cited by Mrs. Bansal are concerned, the same are distinguishable on facts. ***CIT Vs. J.K. Synthetics Ltd.*** *(supra)*, turned on its own facts. Significantly it did not involve interpretation of the provisions of the DTAA as is the situation in the present case. Similarly, the ***Shri Ram case*** is also distinguishable. A reading of various clauses would show that there was no transfer of technology and know-how. In this regard, reference may be had to clause 11 of the agreement which specifically prohibited the right of the transferee to manufacture products based on the transferors technology after its determination. No such limitation exists in the present case. As a matter of fact, in

eventuality only on the grounds of insolvency of the parties. There is no general right of termination obtaining in the agreement in the present case. Likewise, the judgment in the case of *N.V. Philips Vs. CIT (1988) 172 ITR 521* is not applicable since what was transferred was use of technology. In this regard, specific reference may be made to clause (c) appearing at page 524 which provided that any information disclosed by the assessee to the Indian company under the agreement would remain confidential and would not become the property of the Indian company until such time and to the extent that such information had *"become public"* by application and user. The judgment of the Supreme Court in the case of *Alembic Chemical Works Co. Ltd. (supra)* would also not be applicable on a similar rationale.

12. For the aforementioned reasons, we are of the view that the question of law framed, has to be answered in favour of the assessee and against the revenue. Accordingly, the captioned references are dismissed. However, in the given circumstances, parties shall bear their own cost.

RAJIV SHAKDHER, J.

SANJAY KISHAN KAUL, J.

MARCH 10, 2011