* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

\+ **ITA No. 79/2001 and 80/2001**

Reserved on: 23rd July, 2014
% Date of Decision: 30th September, 2014

Commissioner of Income Tax Delhi - I ...Appellant
Through Ms. Suruchi Aggarwal,
Sr.Standing Counsel.

Versus

M/s Voest Alpine A.G. …Respondent
Through None

CORAM:
HON'BLE MR. JUSTICE SANJIV KHANNA
HON'BLE MR. JUSTICE V. KAMESWAR RAO

SANJIV KHANNA, J.

The present appeals by the Revenue under Section 260A of the Income Tax Act, 1961 ('Act', for short) pertain to Assessment Years 1989-90 and 1990-91 and stand admitted for adjudication on the following substantial questions of law:-

ITA No. 80/2001

"Whether the Tribunal was correct in law in holding that a sum of Rs.41,61,083/- received by the assessee in terms of Article 4.1 of the technical assistance agreement dated 23 May 1986 was in the nature of royalty?"

ITA No. 79/2001

"Whether the Tribunal was correct in law in holding that a sum of Rs.30,07,889/- received by the assessee in terms of Article 4.1 of the technical

assistance agreement dated 23 May 1986 was in the nature of royalty?"

2. Answer to the aforesaid questions centres on Articles VI and VII of the Double Taxation Avoidance Agreement (DTAA) between India and Austria dated 24th September, 1963 and notified on 5th April, 1965. The said Articles are reproduced below:-

"**ARTICLE VI**

1. Royalties derived by a resident of one of the territories from sources in the other territory may be taxed only in that other territory.
2. In this article, the term "royalty" means any royalty or other like amount received as consideration for the right to use copyrights, artistic or scientific works, cinematographic films, patents, models, designs, plans, secret processes or formulae, trade marks and other like property or rights.

ARTICLE VII

Amounts paid by an enterprise of one of the territories for technical services furnished by an enterprise of the other territory shall not be subject to tax by the first-mentioned territory except insofar as such amounts are attributable to activities actually performed in the first-mentioned territory. In computing the income so subject to tax, there shall be allowed as deductions the expenses incurred in the first-mentioned territory in connection with the activities performed in that territory."

3. Articles VI and VII delineate that a perspicuous distinction was endorsed and accepted by India and Austria between 'royalty' paid as consideration for right to use copyrights, artistic or scientific works, designs, secret processes etc.; and consideration paid for 'technical services'. The difference between the two Articles has been elucidated below. However, at this stage, we notice that 'royalty' derived by a non-resident as per Article VI, could be subjected to tax in India if received

from sources in India and vice versa. Article VI incorporated the s rule for taxation. On the other hand, under Article VII, 'technical services' furnished by a non-resident enterprise, was not taxable in the country of source, except insofar as such amounts were attributable to the activities actually performed in the country of source. In such cases, income could be subjected to tax after allowing deduction of expenses in the country of source in connection with activities performed in the source country.

4. However, before we go into detailed discussion on the core aspect and draw a distinction between 'royalty' under Article VI and 'technical services' under Article VII, we would first like to refer to the relevant facts in brief.

5. The respondent-assessee, a company incorporated and resident of Austria had entered into 'Technical Assistance Agreement for Small Hydro Power Plants' ('Agreement', in short), dated 23rd May, 1986, with Punjab Power Generation Machines Limited (PPGML). Austria, therefore, was the country of residence and India, the country of source.

6. The respondent-assessee as per recitals in the said Agreement was custodian of advance and valuable technology for producing hydro power equipment on the basis of information gathered, researched and developed over years. The respondent-assessee had agreed to furnish to PPGML, know-how and technical assistance for manufacture of such equipment and marketing the same on the terms and conditions set out therein. The information to be made available was set out in the Agreement in clause 1.1 for the products defined in clause 1.2. For the completeness, clause 1.1 of the Agreement is reproduced as below:-

"1.1 Information:

The term "Information" as used herein shall mean any one or more of the following and the information contained therein for the manufacture by PPGML of Products as defined in Section 1.2 of this Article:

i) design manuals, standard and representative drawings and including input and output data and computation formulae for typical cases

ii) process specifications

iii) materials specifications

iv) performance specifications including model test performance charts of runners

v) purchasing specifications

vi) test data (for inspection)

vii) apparatus instructions books

viii) written or otherwise recorded technical assistance

ix) drawings for testing equipment, tools, dies, jigs and fixtures employed in the manufacture of Products.

x) Typical foundation drawings (including forces)

xi) any other data generally known as engineering and manufacturing information; and

xii) information furnished under Article III below"

7. Clause 1.4 of the Agreement, referred to the term 'patents', that it meant letters patents, utility models, licences, rights and privileges to or under letters patent and utility models in connection with the product etc. Article II of the Agreement in clause 2.1 stipulated that PPGML, during and after the Agreement, was entitled to use the information in the territory of India, Nepal, Bhutan, Bangladesh and Sri Lanka. Further, PPGML was entitled to call upon the respondent-assessee to furnish,

without additional charge, typical workshop drawings of exe projects within the product range. PPGML had exclusive right to manufacture and sell the product within 'the territory' and use patents relating to the product owned and controlled by the respondent-assessee etc. Further, PPGML had the right to export products outside "the territory" except Austria and other countries where the respondent-assessee had entered into arrangements as on the effective date of the Agreement. Names of the said countries stand mentioned in clause 2.3 of the Agreement.

8. Article III of the Agreement began with heading 'Engineering Development/Visitation' and stipulated that the respondent-assessee would undertake engineering development with respect to products at the request of the PPGML. Clause 3.1 of the Agreement read as under:-

> "… Engineering development shall consist of (a) preparing and supplying to PPGML such manufacturing, engineering, or other information as is not at the time in current use by VA in its commercial manufacturing operations or not at the time available in the records of VA, but which is specifically prepared at the request of PPGML; (b) development carried out by VA upon such request; and (c) furnishing technical experts in connection-with such requests and for clarification of the information furnished and assisting in problems encountered by PPGML. Such technical experts shall be at the services of PPGML for such time as they may be needed for attention to specific matters. For such engineering development and special or additional information, PPGML shall reimburse to VA the charges including travelling and living expenses which shall be mutually agreed and subject to the approval of the Reserve Bank of India."

9. Clause 3.2 of the Agreement related to visitation and stated that the respondent-assessee would depute its technical experts to PPGML's

factory to assist them in setting up and commissioning manufact g facilities in the design and manufacturing of products. It read as under:-

> "3.2 Visitation:
>
> Upon prior written request from PPGML, VA shall depute its technical experts to PPGMLs factory to assist PPGML in setting up and commissioning manufacturing facilities and in the design and manufacture of the Products. The number of such technical experts to be so deputed by VA and the duration and date of such deputation shall be as may be mutually agreed by and between VA and PPGML. PPGML shall reimburse VA all expenses including travelling and living expenses of its technical experts visiting India on such deputation which shall be mutually agreed and subject to the Reserve Bank of India.
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> VA will permit a reasonable number and not to exceed total of ten (10) man-months in the first year and thereafter, one man month per year of collaboration Agreement of vising representatives of PPGML at PPGMLs expense to visit such plants of VA in Austria as may be designated by VA from time to time, and for such periods as may be necessary; in order to study the design techniques and the method used by VA in its manufacture of Products. VA shall make best efforts to make available to such visiting representatives of PPGML all information relating to the method [sic, methods] of manufacturing, inspection and performance testing engineering and design techniques in respect of Products."

There were certain stipulations on the total manpower, the time period, the visitations etc. Clause 3.3 was a general provision and for the sake of completeness is reproduced below:-

> "3.3 General:
>
> The technical experts, representatives and other personnel at any time made available or furnished by either party hereto to the other in accordance with the provisions of this Agreement shall (unless otherwise mutually agreed to) at all times be the employees or representatives of the party furnishing such personnel or making them available, and shall not be the employees or representatives of the party to whom furnished or made available. Each party shall be responsible for,

and shall pay, all such salaries, living allowances, travelling expenses and other remuneration to which its said employees or representatives may be entitled, and shall assume full responsibility for any and all claims (including personal injury to such employees or representatives) asserted by or against any of such employees or representatives and which arise during the course of their activities in the plant or offices of the other party or otherwise under this Agreement. Such employees or representatives of either party, while on the property of the other party, shall at all times act in accordance with the rules and regulations adopted by the other party with respect to the conduct of its own employees or representatives."

10. Article IV of the Agreement dealt with consideration and read as under:-

"ARTICLE IV

CONSIDERATION

In consideration for the Information and services to be furnished and rendered by VA hereunder:

4.1 PPGML shall pay, subject to deductions at source of Indian income tax and any other taxes as applicable and provided in Article A-VIII hereof, to VA as follows:

a) ATS 2,150.000,- within sixty (60 days of the Effective Date;

b) ATS 2,150.000,- within sixty (60) days from the date of receipt of the Information; and

c) ATS 2,150.000,- within sixty (60) days from the date of Commencement of Commercial Production.

4.2 Royalty :

For using Information and Patents furnished or licenced by VA, PPGNL shall pay to VA, a royalty at the rate of five percent (5%) of the Net Ex Factory Sale Price of the Products manufactured and sold by PPGML after Commencement of Commercial Production and during the term of this Agreement.

> 4.3 Products shall be considered sold (a) at the time of billing to a customer, if it is sold; b) at the time of transfer thereof to a customer, if it is bartered, exchanged for goods or services or otherwise transferred to such customer or (c) at the time of transfer thereof for use anywhere within PPGML.
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> 4.4 The payment of royalty shall be made bi-annually within ninety (90) days counting from the last day of each semester, i.e. within ninety (90) days from June 30th and within ninety (90) days from December 31st respectively. As to the last royalty payment, PPGML shall make this payment within ninety (90) days from the termination of this Agreement.
>
> 4.5 Royalty shall be paid by PPGML on the total annual sales upto the maximum of licenced capacity of Products plus twenty-five percent (25%) thereof as allowed by the Government of India. In case of sales in excess of the aforesaid aggregate of annual licenced capacity and the aforesaid 25%, prior approval of the Government of India and Reserve Bank of India will have to be abtained [sic, obtained] for payment of fee on such excess sales.
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> 4.6 All amounts which shall become due and payable by PPGML pursuant to any provisions of the Agreement shall be paid promptly when due and payable after obtaining the approval of Reserve Bank of India."

11. A reading of the aforesaid Article of the agreement with PPGML would indicate that under the heading 'Consideration', clause 4.1 delineated and treated lump-sum payment as attributable to 'information and services, to be furnished' and clause 4.2 delineated and treated recurring payments as 'royalty'. The description in clauses 4.1 and 4.2 under Article IV relating to consideration and method of payment thereof, was the primary reason for differentiation adopted by the Tribunal to determine whether the consideration paid was for 'technical services' or 'royalty'. This was the method/mode accepted to bifurcate

or divide the consideration received between income treated as ex under Article VII and income that was taxable. Thus, primacy stands accorded to the bifurcation of consideration as made in the agreement. Whether the said division/bifurcation could be ignored or whether the division was reasonable and fair have not been elucidated and examined. Perhaps these aspects were never argued and raised by the Revenue.

12. Now, we come to the assessment order and the order of the first appellate authority. The Assessing Officer, unfortunately, did not even notice Article VII of the DTAA, neither did he advert to the distinction between 'royalty' and 'technical services' manifest in the two Articles. This was inappropriate and undesirable manner of dealing with the issue, which mandated consideration and answer. The assessment order records that the respondent-assessee had received consideration in three installments. Rs.41,61,083/- representing the first two installments in clause 4.1 were received in the period relevant to the assessment year 1989-90 and the third installment of Rs.30,07,889/- was received in the period relevant to the assessment year 1990-91. The payments received were claimed to be exempt or not taxable being consideration for 'technical services'. The assessing officer treated the entire amount received under clause 4.1 as royalty taxable under Article VI of the DTAA. No elucidation and justification was recorded, why and for what rationale and reason no part of the consideration could be treated as paid for rendering 'technical service'.

13. During the course of hearing before us, we had asked the Senior Standing Counsel for the appellant-Revenue, whether the income earned under the head 'Royalty' in Article 4.2 was subjected to tax in India under Article VI of the DTAA. She drew out attention to the assessment

order dated 19th January, 1993 which records that payments under Article 4.2 of Rs.1,54,623/- were treated as royalty and therefore, was taxable income in India. We assume that in the subsequent assessment years when the production commenced and increased, the payments received under clause 4.2 of the Agreement were taxed in India as royalty in the hands of respondent-assessee.

14. The Commissioner of Income Tax (Appeals) deleted the said addition, observing that the Agreement between the respondent-assessee and PPGML was a composite one, wherein royalty as well as technical services had to be paid for. The lump-sum fee payable under clause 4.1 was for technical services furnished in Austria and covered under Article VII of the DTAA, whereas payments made under clause 4.2 would be covered under Article VI of the DTAA. Thus, he was of the opinion that the Assessing Officer was not right in treating Rs.41,61,083/- and Rs.30,07,889/- as royalty.

15. The Tribunal in the impugned order examined clauses 4.1 and 4.2 and Articles of the DTAA to hold that the payments made under clause 4.1 were for technical service covered by Article VII of DTAA which were furnished in Austria, whereas clause 4.2 dealt with rights and consideration covered by royalty under Article VI of the DTAA. The respondent-assessee did not have place of work in India, and therefore, payments made under clause 4.1, being lump-sum payments were not liable to tax in India. Thus, Rs.41,61,083/- and Rs.30,07,889/- could not be included in the taxable income of the respondent-assessee for the assessment years 1989-90 and 1990-91, respectively.

16. As noticed above, Articles VI and VII of the DTAA, drew a distinction between 'royalty' and 'technical services'. Being different and tax treatment being dissimilar, the two Articles of the DTAA should be contrasted and dissimilitude marked.

17. Royalty normally means rent or hire charges, but in the context of Articles VI of the DTAA, it would not be proper to give royalty a restricted meaning to draw a distinction between Articles VI and VII on the basis of periodical or lump sum payments. As per Article VI, royalty meant royalty or other like amount received as consideration. The Gujarat High Court in ***Commissioner of Income Tax vs. Ahmedabad Manufacturing & Calico Printing Co.***, [1983] 139 ITR 806, has elaborately and lucidly interpreted the term 'royalty' making reference to legal dictionaries, Australian and Canadian law to opine that the term would mean share of profit reserved by the owner for permitting another to use his intellectual property. The term is usually and commonly used in connection with the agreement for use of patents, copyrights, designs, licences for supply of technical know-how etc. in addition to minerals. It may be a single payment covering the whole use of the patent, copyright, trademark etc. for the whole term but the usual practice is to make periodic payment and the amount relates to actual use of the intellectual property rights granted under the licence. Thus, it would not be right to confine royalty to payment like rent or hire charges i.e. charges paid periodically. Article VI assimilated and encompassed royalty and "like payments", whether paid in lump sum or from time to time. Payment for 'royalty' and 'technical services' could be of recurring nature and this might not in the facts of a case, be the relevant distinguishing factor.

18. Term 'royalty' in Article VI was defined to mean royalty o payments received for right to use copyrights, artistic or scientific works, patents, models, designs, secret processes and formulae, trademarks and other property and like. Reference and contextual significance was accorded on the expression "right to use" technical know-how, patents, technical information, and also copyright, trademark etc. Consideration paid for grant of "right to use" the stipulated intellectual property/asset by a resident of one State to a resident of the other State would squarely fall within the ambit of Article VI of DTAA. Grant of "right to use" such intellectual property/asset could be taxed in the source State. Making available and permission to use technical know-how, information etc. as such would conceptually fall within the four corners of the expression 'right to use'. Contra, in the expression 'technical service' preeminence was on the word 'service' and this, we believe was the substantial and essential difference between Articles VI and VII of the DTAA. Article VII would apply if there was obligation to render and provide "technical services".

19. The word 'technical' could mean and would include scientific work, patents, designs or secret processes etc. expressly covered under Article VI. However, what was not covered and mentioned in the said Article was 'services'. The word 'service' in the context of Article VII endorses reference to rendering consultation, providing guidance, imparting skills and "technical" information relating to implementation and actual working, in contradiction to grant of "right to use" technical know-how, patent, secret processes etc. Making available and permission/grant of 'right to use' stood contrasted from rendering of 'services' in relation to technology and technical matters. Rendering 'service' would be beyond or greater than simply or solely granting

'right to use' in the 'goods' specified in paragraph 2 of Article VI. I present case, the respondent-assessee provided services to PPGML which were of technical nature as they were related to and required special knowledge of applied science, thus would qualify and were 'technical services'. Continuing the discussion in the light of DTAA, it implies that where the foreign entity had provided technical services and received consideration for the same, it would be covered under Article VII and not under Article VI of the DTAA.

20. The aforesaid distinction is well recognized and accepted in the field of International taxation. Klaus Vogel in his work '*Klaus Vogel on Double Taxation Conventions*', South Asian Reprint Edition, 2007, at page 782, paragraph 33 while delving into Article 12 of Organisation for Economic Co-operation and Development – Model Convention (OECD-MC) has referred to know-how in the following manner:-

> "11. [**'Know-how'**] In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 alludes to the concept of 'know-how'. Various specialist bodies and authors have formulated definitions of know-haw which do not differ intrinsically. One such definition, given by the 'Association des Bureaux pour la protection de la Propriete Industrielle' (ANBPPI), states that 'know-how' is all the undivulged technical information, whether capable of being patented or not, that is necessary for the industrial reproduction of a product or process, directly and under the same conditions; inasmuch as it is derived from experience, know-how represents what a manufacturer cannot know from mere examination of the product and mere knowledge of the progress of technique.' In the know-how contract, one of the parties agrees to impart to the

other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof. This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party. Thus, payments obtained as consideration for after-sales service, for services rendered by a seller to the purchaser under a guarantee, for pure technical assistance, or for an opinion given by an engineer, an advocate or an accountant, do not constitute royalties within the meaning of paragraph 2. Such payments generally fall under Article 7 or Article 14. In business practice, contracts are encountered which cover both' know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then it seems possible to apply to the whole amount of the consideration the treatment applicable to the principal part."

(emphasis supplied)

21. In paragraph 49 on page 790, Klaus Vogel has observed:-

> "**49 bb) Imparting of experience:** Whenever the term royalties relates to payments in respect of experience ('know-how'), the condition for applying Art. 12 is that the remuneration is being paid for 'imparting' such know-how (as to that term, see *infra* m.nos. 50f.). In this connection, a distinction between 'use' and 'alienation' of the licensed assets would be irrelevant. Where there is a mixed agreement, such as one licensing a patent in connection with imparting know-how, the patented knowledge must be 'let' in the above-described sense, whilst know-how need only be 'imparted'. Where the imparting of experience is of a mere **ancillary character** under a patent licence, there need not be any separate characterization at all (regarding the distinction between a mixed contract and one that also involves ancillary services, cf. the concluding sentence of para 11 MC Comm. Art. 12, *supra* m.no. 33; see also *BFH* BStBl. II 623, 624 (1977)."

(emphasis supplied)

22. At this stage, it would be appropriate to refer to '*Commentary on Article 12 Concerning the Taxation of Royalties*' by OECD, 2010. Paragraph 2 thereof contains the sub-paragraphs that read as under:-

> "11. In classifying as royalties payments received as consideration for information concerning industrial, commercial or scientific experience, paragraph 2 is referring to the concept of "know-how". Various specialist bodies and authors have formulated definitions of know-how. The words "payments ... for information concerning industrial, commercial or scientific experience" are used in the context of the transfer of certain information that has not been patented and does not generally fall within other categories of intellectual

property rights. It generally corresponds to undivulged information of an industrial, commercial or scientific nature arising from previous experience, which has practical application in the operation of an enterprise and from the disclosure of which an economic benefit can be derived. Since the definition relates to information concerning previous experience, the Article does not apply to payments for new information obtained as a result of performing services at the request of the payer.

11.1 In the know-how contract, one of the parties agrees to impart to the other, so that he can use them for his own account, his special knowledge and experience which remain unrevealed to the public. It is recognised that the grantor is not required to play any part himself in the application of the formulas granted to the licensee and that he does not guarantee the result thereof.

11.2 This type of contract thus differs from contracts for the provision of services, in which one of the parties undertakes to use the customary skills of his calling to execute work himself for the other party. Payments made under the latter contracts generally fall under Article 7.

11.3 The need to distinguish these two types of payments, i.e. payments for the supply of know-how and payments for the provision of services, sometimes gives rise to practical difficulties. The following criteria are relevant for the purpose of making that distinction:

— Contracts for the supply of know-how concern information of the kind described in paragraph 11 that already exists or concern the supply of that type of information after its development or creation and include specific provisions concerning the confidentiality of that information.

— In the case of contracts for the provision of services, the supplier undertakes to perform services which may require the use, by that supplier, of special knowledge, skill and expertise but not the transfer of such special knowledge, skill or expertise to the other party.

— In most cases involving the supply of know-how, there would generally be very little more which needs to be done by the supplier under the contract other than to supply existing information or reproduce existing material. On the other hand, a contract for the performance of services would, in the majority of cases, involve a very much

greater level of expenditure by the supplier in order to perform his contractual obligations. For instance, the supplier, depending on the nature of the services to be rendered, may have to incur salaries and wages for employees engaged in researching, designing, testing, drawing and other associated activities or payments to sub-contractors for the performance of similar services.

11.4 Examples of payments which should therefore not be considered to be received as consideration for the provision of know-how but, rather, for the provision of services, include:

—payments obtained as consideration for after-sales service,

—payments for services rendered by a seller to the purchaser under a warranty, — payments for pure technical assistance,

—payments for a list of potential customers, when such a list is developed specifically for the payer out of generally available information (a payment for the confidential list of customers to which the payee has provided a particular product or service would, however, constitute a payment for know-how as it would relate to the commercial experience of the payee in dealing with these customers),

—payments for an opinion given by an engineer, an advocate or an accountant, and

—payments for advice provided electronically, for electronic communications with technicians or for accessing, through computer networks, a trouble-shooting database such as a database that provides users of software with non-confidential information in response to frequently asked questions or common problems that arise frequently.

11.5 In the particular case of a contract involving the provision, by the supplier, of information concerning computer programming, as a general rule the payment will only be considered to be made in consideration for the provision of such information so as to constitute know-how where it is made to acquire information constituting ideas and principles underlying the program, such as logic, algorithms or programming languages or techniques, where this information is provided under the

condition that the customer not disclose it without authorisation and where it is subject to any available trade secret protection.

11.6 In business practice, contracts are encountered which cover both know-how and the provision of technical assistance. One example, amongst others, of contracts of this kind is that of franchising, where the franchisor imparts his knowledge and experience to the franchisee and, in addition, provides him with varied technical assistance, which, in certain cases, is backed up with financial assistance and the supply of goods. The appropriate course to take with a mixed contract is, in principle, to break down, on the basis of the information contained in the contract or by means of a reasonable apportionment, the whole amount of the stipulated consideration according to the various parts of what is being provided under the contract, and then to apply to each part of it so determined the taxation treatment proper thereto. If, however, one part of what is being provided constitutes by far the principal purpose of the contract and the other parts stipulated therein are only of an ancillary and largely unimportant character, then the treatment applicable to the principal part should generally be applied to the whole amount of the consideration."

(emphasis supplied)

23. The aforesaid paragraphs eloquently interpret the differentiation between 'technical know-how' and 'technical services'. In know-how or under a know-how contract, one party agrees to grant 'right to use' or simply provide to the other special knowledge and experience not revealed to the public. In such cases, the granter may not guarantee the result of the formulae, information and for which licence for use is granted. Such contracts differ from contracts for services which require one of the parties to undertake customary skills to execute the work for other, impart skills to the recipient, provide guidance or render assistance of technical nature to the recipient. This 'service' element goes beyond mere providing of technical know-how. The said distinction is clearly made out in sub-paragraphs 11.3 and 11.4 of the '*Commentary*

on Article 12 Concerning the Taxation of Royalties' (supra). aforesaid elucidation is relevant to distinguish consideration, which would get covered under Article VI or Article VII of the DTAA.

24. In the earlier portion of the judgment, we have elaborately dealt with the different parts of the Agreement with PPGML. The said Agreement would fall in the category of contract involving supply of technical know-how etc. as well as technical services. Thus, Articles VI and VII of the DTAA would both be applicable. The respondent-assessee provided tangible/intangible property in the form of know-how like design manuals, data, computation formula, process specification, material specification etc. But, obligation of the respondent-assessee was not restricted to make the said technical information available. The service element was equally significant and given due importance. Implementation and rendering of service was an integral and significant obligation of the respondent-assessee. Implementation and help in adopting, habituating and converting the know-how/information, was a crucial contractual term. The respondent-assessee was to furnish services such as rendering advice and information on manufacturing, engineering and other aspects, even when the information or technology was not in use in the respondent-assessee's commercial manufacturing operations. These were to be specifically prepared at the request of PPGML. The Agreement mandated providing service of development, clarification, furnishing information, assistance in rectifying problems encountered by PPGML and providing technical experts in connection with PPGML's request. PPGML was to reimburse charges etc. as per the Agreement that included travelling and living expenses subject to the approval of Reserve Bank of India. Thus, clauses 3.1 and 3.2 demonstrated the expansive and comprehensive scope of the Agreement and commitment

accepted. Clause 3.2 referred to visitation right in Austri[illegible] representatives of PPGML. Technical experts of the respondent-assessee were to be deputed to come to India to assist PPGML in setting up and commissioning of manufacturing activities, design and manufacture of products. The technical experts required, their duration and date of deputation were subject matter of the Agreement. No doubt PPGML was to reimburse all expenses including travelling and living expenses subject to the approval of the Reserve Bank of India but reimbursement of expenses would not account for consideration paid towards proprietary rights and earning/profit for technical services to be rendered. Expenses were distinct and should not be equated with income or profits and question would arise whether the consideration mentioned in clauses 4.1 and 4.2 included the consideration for providing technical services? The answer clearly is that the Agreement was for both, furnishing and grant of 'right to use' technical specifications/information/know-how; and 'technical services'.

25. Under Article VII, technical services component would be taxable in India in so far as such amounts were attributable to the activities actually performed in India i.e. the country of source. For the activities performed in Austria and not in India, the payments towards technical services would not be taxable in India. The word 'attributable' is much wider than the expression 'derived from' and, therefore, all activities which were performed by the respondent-assessee in India as technical services would be taxable in India but activities performed in Austria would not be taxable in India. In respect of activities in India, deductions of expenditure incurred in India by the respondent-assessee had to be allowed.

26. In view of the aforesaid discussion, it has to be held tha consideration paid for right to use technical know-how etc. under the Agreement would be taxable in India as 'royalty' under Article VI and consideration paid for technical services would be taxable in India to the extent of such amounts were attributable to the activities actually performed in the country of source, after allowing deduction of expenditure incurred in India. However, payments made for technical services furnished by the non-resident assessee outside India would not be taxable in India.

27. Now comes the difficult part, not interpretative or legal but equitable, virtuous and just i.e. bifurcation of the consideration into non-exempt under Article VI and VII and exempt under Article VII of the DTAA. To some extent, it refers to the principle of good governance. The assessment order has been critically disapproved for failure to refer and examine Article VII of the DTAA. The entire amount paid including the periodical payments were treated as royalty, ignoring Article VII of the DTAA and the relevant clauses of the Agreement. Ignorance and nescience was not due to lack of awareness, but attributable to failure to understand and deal with the issue inspite of the submission/contention. It was propelled with the desire to ensure 100% taxation of the entire consideration. No attempt was made to elucidate, and painstakingly answer the objections with facts and to bifurcate and divide the consideration in a reasonable manner between right to use technical information or know-how etc. and the consideration paid for services. Again, in respect of services, differentiation regarding services rendered in the source state, i.e. India, the amount attributable to the activities actually performed in India and expenses incurred, was not undertaken. Consideration paid for technical services outside India had to be

examined and excluded. The assessment order records that the payı received under clause 4.2 of the Agreement were offered for taxation as 'royalty' under Article VI of the DTAA. The Commissioner of Income Tax (Appeals) and the Tribunal have primarily gone by the heading of clauses 4.1 and 4.2 to draw distinction between the consideration paid for services and consideration paid for royalty. They have not, examined the question of bifurcation of consideration or drawn distinction between the services which were actually rendered in India and services which were rendered outside India. The findings/division of the appellate authorities may not, therefore, be in terms of the reasoning and finding recorded by us. Option to remit the matter to the Assessing Officer for fresh determination may not be appropriate as the assessment years in question are 1989-90 and 1990-91, and in doing so we would be setting the clock back by about 25 years. Evidence and material, by passage of time would have disappeared and desiccated. As noticed above, in the present case, the respondent-assessee offered and stands taxed on 5% commission under clause 4.2. In case we ignore and reject the heading in clauses 4.1 and 4.2 as determinative as to taxability under Articles VI and VII of the DTAA, possibly the respondent-assessee would be entitled to partial relief for payments under clause 4.2 but a part of consideration under clause 4.1 would be taxable. In the facts of the present case, thus, we are not inclined to remit the case on the ground that the bifurcation/division made should be ignored and on a reasonable basis after ascertaining full facts, the amounts should be bifurcated and amounts covered under Article VI should be taxed in India and the amounts covered under Article VII should be taxed in India only if they were attributable to activities actually performed in India, after deducting expenditure. It does appear that the respondent-assessee

stands taxed on payments under clause 4.2 in India and therefore, paid tax in India.

28. In view of the aforesaid position, we are not inclined to pass an order of remand for fresh determination.

29. Accordingly, the questions of law mentioned above, are answered in the following manner:-

a) Consideration paid for technical services would be taxable under Article VII of the DTAA, to the extent the amounts were attributable to the activities performed by the respondent-assessee in India. Deduction of expenses would be made.
b) Consideration paid for right to use technical information and know-how would be taxable under Article VI of the DTAA.
c) The consideration paid for furnishing technical services outside India, shall not be taxable in India.

30. Before we close, two caveats and a note of caution; firstly, we have not examined or interpreted the expression 'the right to use' in the present decision as the said aspect was not raised before the authorities, including the Tribunal and there was no appearance on behalf of the respondent-assessee before us. Secondly, the difference between the expression 'royalty' under Article VI, as distinct from what was covered under the words 'technical service' under Article VII has been interpreted in relation to the applicable DTAA. The observations and findings in this judgment have been made with reference to the express language of the two Articles to draw the distinction. The expression 'royalty' and the other similar expressions used in other DTAAs or

under Section 9(1)(vi) of the Act may not or may warrant interpretation.

31. Thus, the questions of law are partly answered in favour of the appellant-Revenue and against the respondent-assessee, but we do not disturb the figures/income which has been held to be not taxable in view of the reasons as stated above. The appeals are disposed of. No costs.

-sd-
(SANJIV KHANNA)
JUDGE

-sd-
(V. KAMESWAR RAO)
JUDGE

September 30, 2014
vkr/kkb