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TAX FLASH NEWS

7 June 2017

Payment for 'standard operating procedure' amounts to sharing of information concerning industrial, commercial or scientific experience and therefore taxable as royalty under India-Germany tax treaty

Background

Recently, the Ahmedabad Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Oncology Services India Pvt. Ltd.[1] (the taxpayer) held that the payment for 'standard operating procedure' (SOP) is taxable as royalty under India-Germany tax treaty (the tax treaty). The sharing of SOP amounts to sharing of information concerning industrial, commercial or scientific experience which comes in the ambit of 'royalty' under the tax treaty.

Facts of the case

- During the year, the taxpayer (Indian company) made payments, aggregating to EUR45,000, to one Germany based entity by the name of OSE Oncology Services Europe (OSE) without any tax deduction at source.
- The Assessing Officer (AO) was of the view that these payments are made for 'using the name, goodwill and market reputation' of OSE and, therefore, taxable in India as royalties under Section 9(1)(vi) of the Income-tax Act, 1961 (the Act).
- The Assessing Officer (AO) required the taxpayer to show cause as to why it should not be treated assessee in default for not having deducted tax at source from the payments made to OSE.
- It was explained by the taxpayer that OSE did not have any Permanent Establishment (PE) in India, and since the payments made to OSE were only for the purpose of sharing SOPs, access to database, email server, hardware and software, these payments, in the absence of the PE of OSE in India, were not taxable in India. These receipts by the OSE were required to be treated as business profits in the hands of the OSE, and taxability could arise only if the OSE had a PE in India.
- The taxpayer also explained that OSE permitted the use of brand name, logo and website without any cost or financial obligation.
- These arguments were rejected by AO holding that the taxpayer has made payments for the use of technology, patent, trademark and accordingly the same is treated as royalty under Section 9(1)(vi) of the Act and as per India-Germany tax treaty.
- The taxpayer filed an appeal before the CIT(A) but without any success.

Tribunal ruling

- As per the agreement, OSE agreed to permit the taxpayer to use its name, brand, logo and website without any costs or financial liability. Therefore, it

[1] Oncology Services India Pvt Ltd v. ADIT (ITA No. 2990/Ahd/2013) (Ahd) – Taxsutra.com

cannot be said that any part of the payment of EUR45000 is for the purposes of use of name, brand or logo, etc. What is the true consideration is SOPs and access to database, email server and hardware or software for this purpose'.

- The agreement specifically states that OSE and the taxpayer both agree to have the same SOPs and agree to harmonise all required software systems, policy and processes and that the incidental cost of implementation of and updating of software will be borne by the taxpayer.

- This is also clear from the invoices raised by the OSE which categorically state that the invoice is for transfer of knowhow, i.e. SOPs.

- The sharing of standard operating procedures, even going by the claim of the taxpayer, does amount to sharing 'information concerning industrial, commercial or scientific experience'. As evident from the extracts from the written submissions reproduced above, these SOPs are 'matured validated standard procedures' which have been developed by OSE over a period of time and approved by the regulatory bodies.

- As the taxpayer himself puts that these SOPs are non-transferable and the taxpayer is not allowed to make any changes in it, it is only sharing of the information about the scientific experiences by the OSE. It is consideration for such a sharing of scientific, or for that purpose industrial and commercial, experiences that is covered by Article 13(3) of India-Germany tax treaty. The access to database, and allied activities like harmonisation of software systems, policy and process, are only incidental to this main object of sharing the SOPs and cannot thus be viewed in isolation.

- In view of the above, the payment for sharing of the SOPs is taxable as 'royalties' under the India-Germany tax treaty.

- It is only elementary that existence of PE is sine qua non only for taxation of business profits but that the foreign entity not having a PE in India does not come in the way of taxation of royalties.

Our comments

The issue with respect to characterisation of payments made for 'information concerning industrial, commercial or scientific experience' has been a matter of debate before the Courts/Tribunal.

The Madhya Pradesh High Court in the case of HEG Ltd[2] has held that payment for all information concerning industrial or commercial venture cannot be 'royalties' unless such information has some special features. Thus, it does not include payments for providing 'bland' or 'routine' commercial information.

The UN commentary[3] interprets the phrase 'information concerning industrial, commercial or scientific experience' to mean specialised knowledge having intrinsic value relating to industrial, commercial, or managerial processes, conveyed in the form of instructions, advice, teaching or formulas, plans or models, permitting the use or application of experience gathered on a particular subject. The Authority for Advance Rulings (AAR) in the case of Lanka Hydraulic Institute[4] observed this phrase to mean an accumulated fund of knowledge acquired by years of observation, search, experimentation and experience.

In Hasbro Canada Inc. v. The Queen[5], the Tax Court of Canada held that the concept involves the notion of imparting knowledge derived from experience that is more than 'general special knowledge' or 'mere knowledge of the state of the art', hence, skills in trade practices in a particular area of the world or general business acumen in handling day-to-day commercial transactions for others cannot be the subject matter of know-how.

The Ahmedabad Tribunal in the instant case observed that the taxpayer has made payments for SOPs which 'matured validated standard procedures' developed by OSE over a period of time and approved by the regulatory bodies. Such SOPs were non-transferable and the taxpayer is not allowed to make any changes in it, it is only sharing of the information about the scientific experiences by the OSE. Therefore, payments for SOPs were for sharing of scientific, industrial and commercial experiences that is covered by Article 13(3) of India-Germany tax treaty.

[2] CIT v. HEG Ltd [2003] 263 ITR 230 (MP)
[3] UN Commentary 2011 – Paragraph 16
[4] Lanka Hydraulic Institute [2011-TII-09-ARA-INTL]
[5] Hasbro Canada Inc. v. The Queen (1998) 1 ITLR 341.

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