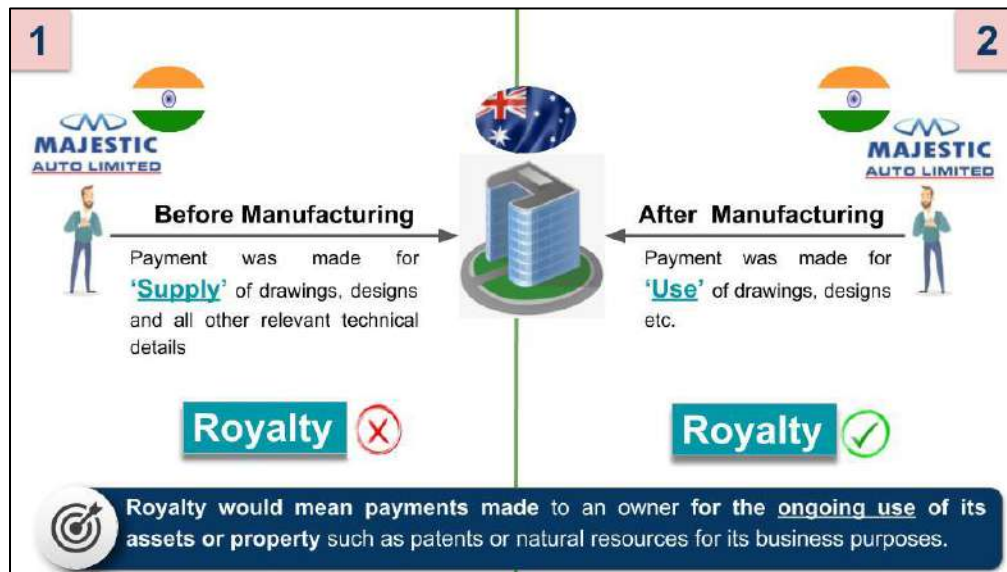


## SATURDAY INTERNATIONAL TAX GYAN !!!

#taxmadeeasy

### Majestic Auto Ltd. v. CIT<sup>1</sup>

Payment for the mere supply of design is not considered as usage and is therefore not Royalty.



#### Facts:

- The assessee, an Indian Co., entered into an agreement with an Austrian Co. whereby the assessee was granted an exclusive individual right and a license to use manufacturing-related information to be supplied by the said Austrian Co. for the purpose of manufacturing and selling vehicles in India.
- As per the agreement, the Austrian Co. supplied the requisite drawings, designs, specifications, processes, schedule and all other relevant technical details and documents to the assessee for which the assessee paid an amount of **3 Million Austrian Schilling. (Lump Sum Payment)**
- Further, the agreement contained another clause, whereby the assessee would pay a royalty to the Austrian Co. once the production started, the quantification of the said amount was based on the quantum of the vehicles produced by the assessee. **(Based on %)**.

<sup>1</sup> [2019] 110 [taxmann.com](http://taxmann.com) 261 (Punjab & Haryana)



### Assessee's contention:

- The assessee sought an income tax clearance certificate u/s 195(2), from the AO for making the lump sum consideration without deducting any taxes on the ground that the **captioned payment was made for 'supply' of drawings, designs etc., and not for their 'use'**.

### Revenue's contention:

- However, AO was of the belief that it doesn't matter whether payment has been made lump sum or on the basis of use/ units as the nature of payment was that of royalty, the same would be liable to tax in India and hence liable to TDS in India. CIT(A) and ITAT passed the order in favour of assessee and hence department went into appeal before High court
- As per revenue - there is no difference between the term "supply" of drawing, design etc. and "use" of drawing, design etc and hence the same would be covered under royalty and liable to tax in India.

### Ruling:

- The Court held that the term **royalty would mean payments made** to an owner **for the ongoing use of its assets or property** such as patents or natural resources for its business purposes.
- The Court placed reliance on the **decision of the Supreme Court** in case of **Entertainment Network (I) Ltd. v. Super Cassette Industries Ltd.**<sup>2</sup>, wherein the Supreme Court had defined the term 'royalty' as "**the remuneration paid to an author in respect of the exploitation of a work, usually referring to payment on a continuing basis rather than a payment consisting of a lump sum in consideration of acquisition of rights.**".
- The High Court observed that the Austrian Co. had merely authorized its use to the taxpayer, however its **actual use** would arise only on commencement of production and that would be the stage at which royalty would become payable.

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<sup>2</sup> [2008] 13 SCC 30





## Our comments:

- The above decision brings our following important aspects related to Royalty
  1. Royalty means **the transfer of right to use and not just a mere supply of property.**
  2. The payment made for use of royalty is usually on a **continuing basis** rather than a lump sum.
- Even if the nature of the transaction is the same, the fact that it is bifurcated between **pre and post manufacturing** may change the categorization for Income Tax purposes.
- The above interpretation opens a tax planning route where total payment to be made during the tenure of the project can be **bifurcated** for pre actual usage (not taxable in India) and post actual usage (taxable in India) with the former constituting a major chunk of the amount.
- Such an arrangement could be subject to GAAR in forthcoming years.

<b>Section</b>	<b>9(1)(vi)/ Article 12</b>
<b>DTAA/Country</b>	<b>India-Austria</b>
<b>Court</b>	<b>Punjab &amp; Haryana</b>
<b>Date of decision</b>	<b>24.07.2019</b>

**Note:** Case law name in **Red**- in favour of the Revenue, **Green**- In favour of the Assessee, **Orange** = Partial.

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**Stay Healthy! Stay Safe!**

**Thank you**

