SATURDAY INTERNATIONAL TAX GYAN !!!

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SITG No. 169

GE Precision Healthcare LLC
Vs
ACIT (IT)

Income covered but not taxable as per specific provision of DTAA, cannot be brought to tax under residuary provisions of other source income as per DTAA or as per act

02.09.2023

Jain Shrimal & co.

TS-456-ITAT_2023 (DEL)

Facts of the Case

- The assessee is a non-resident corporate entity and a tax resident of USA.
- It is primarily **engaged in healthcare business for the General Electric (GE) group,** and a global medical device provider that designs, develops, manufactures and distributes diagnostic imaging and clinical system, bio-pharmaceutical manufacturing and cellular technologies, and a range of Healthcare Information Technology (HIT) solutions.
- The assessee **received an amount towards software license fee cross charged to its affiliates in India**, namely, **Wipro GE Healthcare Pvt. Ltd**, **GE BE Pvt. Ltd**. and **GE India Industrial Pvt. Ltd.**, and such license fee received as reimbursement from the affiliates was **not offered to tax in India** by the assessee.
- The A.O. **issued a SCN seeking response**, as to why such fees shall not be brought to tax in India, against which assessee filed its reply explaining the nature of income. The **A.O. did not accepted the claim** of the assessee.
- Henceforth, the **A.O. issued a second SCN to the assessee** seeking explanation, as to **why such receipts should not be treated as income from other sources u/s 56(1)** of the act and as per Article 23(3) of India-USA DTAA, and brought to tax in India.
- Though the assessee filed its reply objecting the proposed addition, however the **A.O. rejected its reply and proceeded to treat such fees as income from other sources** u/s 56(1) of the act and Article 23(3) of the treaty.

Assessee's Contention

- Definition of **"Business" as per section 2(13)** is of a wide import and would cover activities performed by the assessee in the normal course of business and the assessee procured and sublicensed standardized software licenses to its affiliates in its normal course of business and not a standalone activity (since the assessee carried on healthcare business).
- Drawing an attention of the Hon'ble Tribunal to **Intercompany Reimbursement Agreement**, dated 01.01.2020, the Ld. Counsel submits that the **software licenses sublicensed to the affiliates are nothing but copyrighted articles** in the nature of standardized business software. It serves as a business tool required by the affiliates to smoothly conduct their business operations.
- The assessee **only recovers cost of the software licenses** which the assessee has paid to the third party licensor. Since such fees is for sale of copyrighted articles and not for right to use of copyrights, therefore **such fees shall not be regarded as royalty income**, both as per the act and as per treaty. Same view has been adopted in the following cases-
  i. Engineering Analysis Centre of Excellence Pvt. Ltd. V. CIT (decision pronounced by Hon'ble SC)
  ii.DIT V. Infrasoft Ltd. (decision pronounced by Hon'ble Delhi HC)
- The **receipts are purely in the nature of business income**, and once the receipts are not in the nature of royalty, it can **only be treated as business income** under Article 7, and if in case, **PE is not available in India**, such fees/ **income shall not be taxable in India**.
- The software licenses were sold as tools of business in furtherance of assessee's business activity, hence **such receipts are to be treated as business income**.

Assessee's Contention

- Regarding the allegation of department having no continuity to consider such fees in the nature of business, Ld. Counsel argued that the impugned year is the second year of operation, wherein such agreement was entered into and operational till date. Even in the subsequent A.Y.s 2021-22 and 2022-23, the similar transactions between parties took place. Therefore, it demolish the basic argument of the A.O. with regards to regularity, continuity and frequency.
- If the nature and character of a particular item is specifically identifiable and falls under any other head of income, however **not taxable due to non-satisfaction of conditions mentioned under those heads**. In such case, it **cannot automatically be brought under the ambit of residuary clause of other source income u/s 56(1)** of the act or Article 23(3) of the treaty.
- Moreover, in the first SCN itself, the **A.O. himself treated such fees as royalty income**, however being conscious of the fact that it **cannot be treated as royalty income in lights of the decision pronounces (stated above), he proceeded to invoke section 56 of the act to treat it as other source income**, with an intention to bring such amount to tax, when in fact **no such tax could have been imposed on it**.

Revenue's Contention

Opposing the appeal and the arguments presented by the Ld. Counsel of the assessee, the counsel for the Revenue, rejected the assessee's claim of business income on the following grounds:

- The Ld. A.O. believed that the **assessee is involved with solely its affiliates/ GE group entitles for the activity related to software licenses**.
- The assessee took **neither took any risk nor undertook any entrepreneurial activity in sub-licensing the software** applications from third parties and further sub- licensing the same to its affiliates, including Wipro GE.
- With regards to the software sub-licensed by the assessee to the Wipro GE (Indian AE), the **AE makes use of the software to earn service income constituting 21% of its overall revenue** from its operations. However, 97% of this software income (i.e., of 21% as mentioned earlier) was earned by the AE through sale of software services offered to the assessee.
- Through the software sub- licenses by the assessee to the AE on a per-user per-month basis, **sales are made back to the assessee and thus, generated its income from the services provided to the assessee**.

Legal Provisions

According to **Article 23(3)** of India- USA DTAA,

1. Subject to the provisions of paragraph 2, items of income of a resident of a Contracting State, wherever arising, which are not expressly dealt with in the foregoing Articles of this Convention shall be taxable only in that Contracting State.
2. The provisions of paragraph 1 shall not apply to income, other than income from immovable property as defined in paragraph 2 of Article 6 [Income from Immovable Property (Real Property)], if the beneficial owner of the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the income is attributable to such permanent establishment or fixed base. In such case the provisions of Article 7 (Business Profits) or Article 15 (Independent Personal Services), as the case may be, shall apply.
3. Notwithstanding the provisions of paragraphs 1 and 2, items of income of a resident of a Contracting State not dealt with in the foregoing articles of this Convention and arising in the other Contracting State may also be taxed in that other State.

According to **Section 56(1)** of the Income Tax Act,

(1) Income of every kind which is not to be excluded from the total income under this Act shall be chargeable to income-tax under the head "Income from other sources", if it is not chargeable to income-tax under any of the heads specified in section 14, items A to E.

Ruling

- From the facts stated above, we can conclude that –
  - ✓ the **assessee is not the owner and manufacturer** of the software, and
  - ✓ Licensed softwares are used as business tools by the affiliates to generate service income from the assessee,

  And hence it is **incorrect on the part of A.O.** to treat the receipts of sublicensing as other income.

- The assessee has **not sublicensed the software on standalone basis**, since it is clear that **such software is meant to be used by the affiliates in their day-to-day business activity** of healthcare, which is the business of the entire group. Therefore, it is **incorrect on part of A.O. to say that the receipts related to sublicensing is not in the course of business** activity and hence **cannot be characterized as business income**.

- **The residuary provisions of Article 23 of the tax treaty will not apply to items of income, which can be classified under other provisions of the treaty, but their taxability is subjected to fulfillment of conditions mentioned therein.**

- In the present case, the **receipts could have been covered under the ambit of Article 12 as royalty income**, however in view of the judicial precedents, such **income cannot be taxable as royalty**. Alternatively, it could have been taxed according to Article 7 of the tax treaty as business income, however in the absence of PE, it cannot be taxed in India.

- Since the income in dispute can be **classified under other relevant articles of the tax treaty**, therefore they **cannot be brought to tax under the residuary provision** contained under Article 23 of the treaty. Hence **such income in dispute cannot be treated as other income** under Article 23(3) of the treaty.

- Therefore, we direct the A.O. to **delete the addition** of such income.

Our Comments

- Let's try and understand the issue through an example, i.e., if such specific income is not **falling under the ambit of 'Royalty' as per DTAA** and as per the act, then you have to **check its taxability according to the next closely linked provision, which in this case is Business Income**.
- Such income/ fee shall be covered under Business Income (in case at hand), however it is **not taxable according to the provisions of the act**. Therefore, just because such specific income/ fee is **not taxable under business income, does not mean that it should be shown under the head 'Income from other sources'** and taxed accordingly.
- It is important to note that if such **income fall under the ambit of particular head**, then irrespective of whether it is taxable or not, one can not continue to test such income under other alternative heads.
- We can also consider that if the group company transfers or reimburses amount for any group service on cost to cost basis, it would be a **part of business income** and if the foreign company providing such **services does not have PE in India, such income would not be taxed in India**.
- Would the treatment be the same if the **service which was provided is covered under FTS** and it is **provided on cost-to-cost basis**. Would it not be liable for tax?

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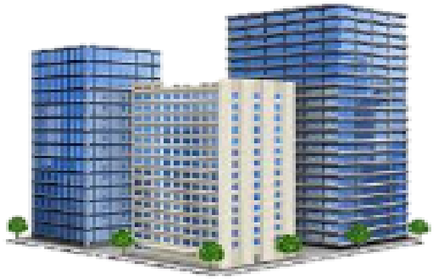

Wipro GE **(AE of GE Precision)**

The assessee (tax resident of USA) received a reimbursement of software license fee from its India AE on sub-licensing of software)

GE Precision Healthcare LLC **(The Assessee)**

The Ld. A.O. issued a SCN and made an addition of such reimbursement fees by treating such receipts as income from other sources u/s 56(1) of the act and as per Article 23(3) of the treaty.

A.O.

Royalty ✗
- Does not fall under the ambit of Royalty, hence not taxable

Business Income ✓
- Falls under the ambit of Business Income, but not taxable as No PE in India

Other Sources ✗
- Since falls under specific head of business income, hence cannot be covered under the residual head.

The Hon'ble Tribunal held that the revenue was incorrect while treating such software license fees as income from other sources.

Also, it has been categorically held by the Hon'ble ITAT that such fees can be treated under Article 7 as business income of the treaty, however cannot be taxable since the assessee is not having PE in India.

Section/Article	Section 56(1) of Income Tax Act, Article 23(3) of DTAA
DTAA/Country	India- USA DTAA
Court	Delhi Tribunal
Date of decision	14.08.2023

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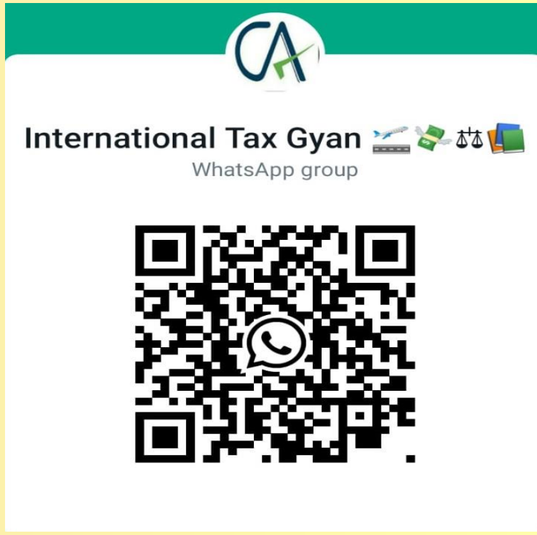

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