IN THE INCOME TAX APPELLATE TRIBUNAL, DELHI 'D' BENCH, NEW DELHI (THROUGH VIDEO CONFERENCING]

BEFORE SHRI N.K. BILLAIYA, ACCOUNTANT MEMBER, AND SHRI CHALLA NAGENDRA PRASAD, JUDICIAL MEMBER

ITA No. 7619/DEL/2017 [A.Y 2014-15]

M/s Faber Castell Aktiengesellschaft Numberger, Strasse 2, 90546 Stein Bavaria, Germany PAN: AAHPB 6307 N	Vs.	The A.C.I.T. International Taxation Circle -1(3)(1) New Delhi
(Applicant)		(Respondent)

Assessee By	:	Shri Nishant Thakkar, Adv Ms. Jasmine Amalsedvala, Adv
Department By	:	Ms. Shashi Kajle, Sr. DR

Date of Hearing	**:**	**07.12.2021**
Date of Pronouncement	**:**	**09.12.2021**

ORDER

PER N.K. BILLAIYA, ACCOUNTANT MEMBER:

This appeal by the assessee is preferred against the order of the Commissioner of Income Tax [Appeals] – 42, New Delhi dated 01.09.2017 pertaining to Assessment Year 2014-15.

2. The assessee has raised the following grounds of appeal:

"On the facts and in the circumstances of the case and in law, the learned CIT(A)/Commissioner of Income-tax (Appeals) - 42 on fact and in law has;

General

1. Erred in taxing the royalty income erroneously offered to tax amounting to Rs. 2,36,54,858 by the Appellant which had been waived by the Appellant;

2.Erred in not appreciating the factual and legal submissions/ documents submitted by the Appellant substantiating that the royalty income has been offered to tax erroneously.

Taxability of royalty income on accrual basis

3.Erred in not appreciating that royalty income is taxable on a cash basis as per the provisions of India-Germany tax treaty;

4. Erred in upholding the taxation of notional royalty income against well-established principle that only real income can be taxed.

Stating of incorrect facts

5. Erred in stating that the Appellant had offered the royalty income on an accrual basis in the return of income.

6. Erred in not appreciating that the tax authorities are under obligation to charge, levy and collect only the legitimate tax and if the Appellant due to any reason fails commits a mistake in showing any income which is otherwise not taxable or shown any income in the return the authorities are bound to assess in respect of correct income.

Rejection of cash basis of accounting

7. Erred in rejecting the cash basis of accounting consistently adopted by the Appellant;"

3. Briefly stated, the facts of the case are that the assessee filed its return of income on 29.11.2014 declaring an income of Rs. 2,60,39,833/- and claimed refund of Rs. 26,04,040/-. Return was selected for scrutiny and, accordingly, statutory notices were issued and served upon the assessee.

4. The assessee company has entered into royalty agreement with A.W. Faber Castell [India] Pvt. Ltd for use of its trademark in relation to marketing and sale of products procured by FC India for its local operations. FG Germany is eligible to earn royalty and interest income

from FC India in respect of the said trademark. FG Germany is following cash basis of accounting for offering its Indian sourced income to tax in India. Since FC Germany is tax resident of Germany and eligible to claim benefits under India-Germany DTAA had offered to tax in India its income based on the DTAA provisions.

5. For the year under consideration, FC Germany had offered to tax in India royalty and interest income as under:

Nature of income	Amount (Rs.)	Applicable tax rate	Tax Income [INR]	Amount of TDS [INR]	Tax payable/ Refundable
Royalty	2,36,54,858	10% [as per Article 12 of the DTAA]	23,65,485	47,30,972	[23,65,486]
Interest	23,84,975	10% [as per Article 12 of the DTAA]	2,38,497	4,77,051	[2,38,554]
Total	2,60,39,833		26,03,983/-	52,08,023	[26,04,040]

6. During the course of scrutiny assessment proceedings, it was explained that during reconciliation it was observed that royalty income was not received by FC Germany and it had inadvertently filed original

return of income including royalty income. It was further explained that since FC India was facing liquidity crisis and was not able to make royalty payment, FC Germany entered into termination agreement with FC India thereby waiving off the royalty liability from F.Y. 2011–12 to 2015-16 to be paid by FC India to FC Germany.

7. The Assessing Officer asked the assessee to explain “how can the agreement be permitted from the back date since Faber Castell India had already used the brand name and, therefore, income has been accrued?” The Assessing Officer further asked the assessee to explain “since royalty is taxed on gross basis, any claim in the nature of bad debts cannot be allowed” and the assessee was show caused to explain how claim of revised computation of income be permitted.

8. The assessee filed the following reply:

> “At the outset, we submit to state that the termination of royalty agreement and request for waiver of liability should be regarded merely as an acceptance for waiving off the unpaid royalty income to be received by PC Germany. It would also be noted that the said acceptance was only consequent to FC India’s request vide a request

letter dated 30 June 2016 to FC Germany for waiving of the said unpaid royalty considering its liquidity crisis.

> Further, your good self would recognize that though the nomenclature of the agreement entered is termination of royalty agreement and request for waiver of liability the intention was only to waive off the royalty payment which FC Germany was eligible to receive. Accordingly, your good self would appreciate the fact that it may not be tenable to contend that the trademark agreement has been terminated on a back dated basis.

> As provided vide submission dated 26 October 2016, we wish to reiterate the facts that FC Germany has adopted cash/receipt basis of accounting for offering its Indian sourced income to tax in India and FC Germany has not received any royalty income during the captioned AY. Accordingly, the question of accruing the royalty income does not arise and the same may not be justifiable."

9. Submissions of the assessee did not find any favour with the Assessing Officer who observed as under:

"During the course of assessment proceedings, the assessee claimed that it had not received the royalty income from Faber Castell India due to the cash crunch faced by Faber Castell India. Also, the

> assessee signed a royalty waiver agreement with Faber Castell India which has been put on record. The assessee also pleaded the permission of the undersigned to file a revised return. The submission of the assessee are rejected on merits as there is no provision under the Income Tax Act that allows it to file a fresh claim before the Assessing Officer, if it has not done so by filing a revised return of income within statutory time limit. Further reliance is place on the decision of the Hon'ble Supreme Cout in Goetze [India] Ltd Vs. CIT 284 ITR 323."

10. The Assessing Officer finally concluded by holding that no business income has been computed under the Income-tax Act or DTAA in the assessee's case, hence no deduction of any sort can be allowed.

11. Aggrieved by the assessment order, the assessee carried the matter before the ld. CIT(A) and reiterated what has been stated during the course of assessment proceedings.

12. After considering the facts and submissions, the ld. CIT(A) was not convinced with the contention of the assessee. Referring to Article 12 of India Germany DTAA and, in particular, drawing support from Para 2 of

Article 12 and further drawing support from the decision of the Hon’ble Supreme Court in the case of Standard Triumph Motor Co Ltd, the ld. CIT(A) held that the assessee has rightly shown royalty income on accrual basis in the income tax return and the plea of inadvertent mistake is not acceptable as royalty is taxable on accrual basis and not on receipt basis and, accordingly confirmed the assessment.

13. Before us, the ld. counsel for the assessee vehemently stated that FC Germany had inadvertently returned royalty as its income when it has not received the same from FC India. The learned counsel drew our attention to the fact that FC India and FC Germany have mutually agreed for waiver of royalty and since payment of royalty has been waived, there was no question of receipt of the same.

14. In support of its contention, the ld. counsel for the assessee relied upon the decision of the Co-ordinate Bench of the Tribunal, Mumbai in the case of UHDE GMBH 54 TTJ 335 and also relied upon the decision of the Hon’ble High Court of Bombay in the case of Siemens Aktiengesellschaft ITXA 124 of 2010.

15. Reliance was also placed on the decision of the Delhi Bench of the Tribunal in the case of CSC Technology, Singapore Pte. Ltd 19 Taxmann.com 123 and Pizza Hut International LLC 22 taxmann.com 111.

16. Per contra, the ld DR strongly supported the findings of the lower authorities. It is the say of the ld. DR that waiver of royalty is merely an arrangement of convenience between the two related parties and, therefore, the same cannot be of much weightage.

17. We have given thoughtful consideration to the orders of the authorities below. It is true that FC Germany has shown royalty from FCI in its return of income. It is equally true that since FC India was facing liquidity crisis, payment of royalty was waived off by FC Germany. At this stage, the contention of the ld. DR that it was merely an arrangement of convenience between the two related parties is not acceptable, as this arrangement has backing of RBI which, vide letter dated 26.10.2016 reads as under:

Annexure 7

भारतीय रिज़र्व बैंक
RESERVE BANK OF INDIA
www.rbi.org.in

FE.CO.EPD/4396/21.52.001/2016-17

October 26, 2016

The Associate- Global Cash Operations
Deutsche Bank AG
Global Cash Operations
Deutsche Bank House
Hazarimal Somani Marg
Fort, Mumbai-400 001

1 NOV 2016

Kind attention: Shri Rahul Mahamunkar

Dear Sir,

Request for write off royalty- M/s A W Faber Castell (India) Pvt. Ltd.

Please refer to your letter Ref.No. DB/GCO-REM/RBI2016/0458 dated September 21, 2016 on the captioned subject.

2. In this connection, we advise that we have no objection from FEMA angle to the write off of the amount of Euro 2,249,293.00 by the applicant company M/s A W Faber Castell (India) Pvt. Ltd. payable to its parent company towards royalty, subject to you satisfying yourself about the bonafides of the transaction.

Yours faithfully,

Madhusmita Dutta
Manager

This communication is issued from the foreign exchange angle under the provisions of FEMA and should not be construed to convey the approval by any other statutory authority or Government under any other laws/ regulations. If further approval or permission is required from any other regulatory authority or Government departments/Agencies under the relevant laws /regulations, the applicant should take the approval of the concerned agency before effecting the transaction. Further, it should not be construed as regularizing or validating any irregularities, contravention or other lapses, if any, under the provisions of any other laws/ regulations.

18. Coming to Article 12 of India Germany DTAA under the head 'Royalties and Fees for Technical Services', which reads as under:

"ARTICLE 12

ROYALTIES AND FEES FOR TECHNICAL SERVICES

1. Royalties and fees for technical services arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that other State.

2. However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that State, but if the recipient is the beneficial owner of the royalties, or fees for technical services, the tax so charged shall not exceed 10 per cent of the gross amount of the royalties or the fees for technical services.

3. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematograph films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience.

4. The term "fees for technical services" as used in this Article means payments of any amount in consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel, but does not include payments for services mentioned in Article 15 of this Agreement.

5. The provisions of paragraphs 1 and 2 shall not apply if the beneficial owner of the royalties or fees for technical services, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties or fees for technical services arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right, property or contract in respect of which the royalties or fees for technical services are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 or Article 14, as the case may be, shall apply.

6. Royalties and fees for technical services shall be deemed to arise in a Contracting State when the payer is that State itself, a land or a political sub-division, a local authority or a resident of that State. Where, however, the person paying the royalties or fees for technical services, whether he is a resident of a Contracting State or not, has in a Contracting State a permanent establishment or a fixed base in connection with which the liability to pay the royalties or fees for technical services was incurred, and such royalties or fees for

technical services are borne by such permanent establishment or fixed base, then such royalties or fees for technical services shall be deemed to arise in the State in which the permanent establishment or fixed base is situated.

7. Where, by reason of special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of royalties or fees for technical services paid exceeds the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In such case, the excess part of the payments shall remain taxable according to the laws of each Contracting State, due regard being had to the other provisions of this Agreement."

19. A perusal of the above shows that in Clause 1, Royalty and FTS arising in a Contracting State **and paid** to a resident of the other Contracting State may be taxed in that other State. Clause 3 has defined 'Royalty' as a payment of any kind **received as a consideration**. A conjoint reading of Clause 1 and Clause 3 shows that royalty has to be paid to a resident and royalty means payment of any kind received as a consideration.

20. In light of waiver of royalty, neither FC India paid royalty nor FC Germany received the same as a consideration for the use of any trade mark.

21. A similar issue was considered and decided by the coordinate bench at Delhi in the case of CSC Technologies Singapore Pte Ltd [supra]. The relevant findings of which read as under:

> "The first question is-whether, revenues received by way of royalty/FTS are liable to be taxed on accrual basis or receipt basis? In paragraph no. 2, the AO has mentioned that the assessee has offered to tax all sums received from India as royalty/FTS. However, it has not offered certain sums for taxation in this year and not even till date. Some examples have been mentioned. It is also noted that the Indian subsidiary has claimed deduction in respect of certain amounts but the assessee-company has not offered such amounts for taxation. The Id. DRP has recorded a finding that the assessee is required to maintain accounts on mercantile basis as it is a company. The case of the Id. counsel is that the assessee is not required to maintain India-specific accounts as it has no PE in India. This submission is contrary to the representation made in the return of income that it is obliged to maintain accounts u/s 44AA. In this connection, we have already held that in so far as the provisions of

the Act are concerned, the assessee is obliged to maintain India-specific accounts and to get them audited under sections 44AA and 44AB respectively. Being a company, the accounts are expected to be maintained on mercantile basis in so far as the provisions of Income Tax Act are read alongside the provisions of the Companies Act. However, it is also the case of the assessee that it is covered under the DTAA. A number of cases have arisen in which this matter had been considered and decided. Therefore, we may discuss the cases on which rival parties have placed reliance.

6.1 In the case of *Dy. CIT* v. *Uhde Gmbh* [1996] 54 TTJ 355 (Bom.), the only ground before the Tribunal was that the Id. CIT(Appeals) was in error in directing the AO to tax the income on various projects on receipt basis as against accrual basis and further erred in directing that provisions of section 145 were not applicable for determining the total income of the assessee. It is mentioned that there cannot be any dispute that where there is a conflict between the DTAA and the domestic law relating to taxation of income arising in the Contracting State, the former has to prevail. In earlier years, FTS was not taxed at all in India as it did not have a PE in India. The fees were in the nature of industrial and commercial profits. The income of this nature became liable to be taxed in India because of new treaty entered into between India and the Federal Republic of Germany. Paragraph no. 2 of Article VII1A provides that FTS could be taxed in the Contracting State in which they arose and according to the law of that State. Although under section 5(2)(b) of the Act,

applicable in the case of a non-resident person, income which accrues or arises or is deemed to accrue or arise in India is taxable, the specific provision of Article VIIIA provides for taxation of only those sums which have been paid to him. This means that the liability arises only when the sum is received and it is not taxable on accrual basis.

6.2 In the case of *National Organic Chemical Industries Ltd.* v. *Dy. CIT* [2005] 96 TTJ 765/[2006] 5 SOT 317 (Mum.), it is mentioned that the remittance made by the assessee is liable to be taxed in India as FTS under Article 13 of Indo-French DTAA. The remittance in question was payment in respect of invoice no. OS- 25181, dated 25.05.1996. In terms of provisions of Article 12 of Indo-Swiss Tax Treaty, twin conditions of accrual and payment are to be satisfied for the purpose of taxation. Thus, even if FTS has accrued or has arisen, but the same is not paid, the taxability under Article 12 in the source country does not come into play.

6.3 As against aforesaid case, the Id. senior DR relied on the decision of Madras High Court in the case of *CIT* v. *Standard Triumph Motor Co. Ltd.* [1979] 119 ITR 573 . The question before the Court was-whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in holding that royalty amounts should be assessed on cash basis for assessment years 1967-68 to 1969-70 if the books and balance-sheet of such receipts are found to be maintained on cash basis and in directing fresh assessment on such basis? The court mentioned that it must be remembered that section

145 is only a machinery provision and it cannot control the charging section so as to make the latter otiose. Therefore, section 145(1) should not be permitted to apply in such circumstances as those which arise from the facts of the case. It is immaterial whether the assessee is keeping accounts on a regular basis by following cash method. Even in this situation he is liable to be assessed u/s 5(2)(b). To hold otherwise would be to take the income outside the purview of taxation under the Act, though such income had accrued in India to a non-resident.

6.4 After considering the facts of the case and precedents relied upon by the rival parties, we find that the Id. senior DR has primarily relied upon the provision contained in section 5(2). The decision in the case of *Standard Triumph Motors Co. Ltd. {supra)* also deals with harmonious interpretation of the provisions contained in sections 145 and 5(2). The decision and the submissions do not take into account the provisions of the DTAA as probably none existed at that time. These have been considered by the Tribunal in the case of *Uhde Gmbh {supra)* and *National Organic Chemical Industries Ltd. {supra).* It has been mentioned that in case of conflict between the provisions of the DTAA and Act, the provisions contained in the treaty shall prevail. Consequently, it has been held that the taxation of royalty/FTS is on receipt basis. In other words, the amount which has accrued as income to a foreign company cannot be taxed in the source country, being India in this case, unless the amount has been received by the foreign company. It is also the case of the Id. senior DR that such an

interpretation can lead to deferment of payment of tax for some time or for indefinite time. We have considered this matter also. This issue has to be decided on the basis of conduct of the two parties, which are associated enterprises (AEs) in this case. It is no doubt true that the provision may be used as a device to defer the tax for any length of time by mutual understanding of the parties. However, to come to such a conclusion in a particular case, the conduct of the parties has to be seen and thereafter a conclusion has to be arrived at that deferment of payment was a device used for the purpose of delaying the payment of tax. No such finding his been recorded in this case. Such is also not the case of Id. senior D.R. Therefore, even if there is force in the argument that the interpretation may lead to delay in payment of tax, it will be useful only in such cases where the AO makes out a case that the delay was with a view to defer the payment of tax. In absence of such a finding by the AO, it is held that the argument is not applicable to the facts of this case. Accordingly, it is held that royalty and FTS are taxable on payment basis and not on accrual basis."

22. In another case, the coordinate bench in the case of Pizza Hut International LLC [supra] has considered a similar situation. The relevant findings read as under:

"7. The second question is - whether, the income by way of royalty is taxable on cash basis or mercantile basis?

We find that this issue has been decided by 'B' Bench of Delhi Tribunal in the case of *CSC Technology Singapore Pte. Ltd.* v. *Asstt. DIT* [2012] 50 SOT 399/ 19 taxmann.com 123 (Delhi). This decision takes care of the submissions of the Ld. Sr. DR and the Ld. Counsel in our case. The Tribunal considered the decision in the case of *Dy.* CIT v. *Uhde Gmbh.* [1996] 54 TTJ 355 (Bom), *National Organic Chemical Industries Ltd.* v. *Dy. CLT* [2006] 5 SOT 317 (Mum.) and *CIT* v. *Standard Triumph Motor Co. Ltd.* [1979] 119 ITR 573 (Mum.). In the decision it has been mentioned that paragraph No. 1 uses the words " royalties and fees for included services arising in a contracting state and paid to a resident of the other contracting state". Thus the initial point of taxation is the arising of the royalty in India, but it is finally taxed on the basis of amount of royalty paid to the non-resident.

8. In another words, irrespective of the system of accounting, royalties are taxable on cash basis. The findings are contained in paragraph No. 6.4 which is reproduced below:

"We find that the ld. Senior DR has primarily relied upon the provision contained in section 5(2). The decision in the case of *Standard Triumph Motors Co. Ltd. {supra)* also deals with harmonious interpretation of the provisions contained in sections 145 and 5(2). The decision and the submissions do not take into account the

provisions of the DTAA as probably none existed at that time. These have been considered by the Tribunal in the case of *Uhde Gmbh and National Organic Chemical Industries Ltd. (supra).* It has been mentioned that in case of conflict between the provisions of the DTAA and Act, the provisions contained in the treaty shall prevail. Consequently, it has been held that the taxation of royalty/FTS is on receipt basis. In other words, the amount which has accrued as income to a foreign company cannot be taxed in the source country, being India in this case, unless the amount has been received by the foreign company. It is also the case of the Ld. Senior DR that such an interpretation can lead to deferment of payment of tax for some time or for indefinite time. We have considered this matter also. This issue has to be decided on the basis of conduct of the two parties, which are associated enterprises (AEs) in this case. It is no doubt true that the provision may be used as a device to defer the tax for any length of time by mutual understanding of the parties. However, to come to such a conclusion in a particular case, the conduct of the parties has to be seen and thereafter a conclusion has to be arrived at that deferment of payment was a device used for the purpose of delaying the payment of tax. No such finding has been recorded in this case. Such is also not the case of ld. Senior D.R. Therefore, even if there is force in the argument that the interpretation may lead to delay in payment of tax, it will be useful only in such cases where the AO makes out a case that the delay was with a view to defer the payment of tax. In absence of such a finding by the AO, it is held that the argument is not applicable to the facts of this case. Accordingly, it is

> held that royalty and FTS are taxable on payment basis and not on accrual basis."
>
> 8.1. Coming to the fact of this case, the payee had provided for the payment of royalty in the books of account of this year but such royalties were not paid to the assessee in absence of any agreement approved by the RBI or for which it could be deemed that the approval has been granted. What is important to note is that royalty for this period has not been paid. Since royalties are taxable on cash basis, it is not necessary for us to go into press note No. 8 (2000) relied upon by the Ld. Counsel and press note No. 9 (2000) relied upon by the Ld. Sr. DR. Accordingly it is held that the amount provided by the licensee in its books of account but not paid to the assessee is not taxable."

23. The Hon'ble High Court of Bombay in the case of Siemens Aktiengesellschaft [supra] was seized with the following substantial question of law, which reads as under:

> "Whether on the facts and in the circumstances of the case the Tribunal as right in law in holding that the Royalty and fees for technical services should be taxed on receipt basis without appreciating the fact that the Hon'ble Supreme Court has held in the case of Standard Drum Motors Private Limited V/s. CIT 201 ITR 391

that the credit entry to the account of the assessee non-resident in the books of the Indian company amounted to receipt by the non-resident?"

24. And answered the same as under:

"As regards first question is concerned, the Income Tax Appellate Tribunal referring to para-1 to 3 under Article IIX-A of the Double Taxation Avoidance Treaty with the Federal Germany Republic as per Notification dated 26th August 1985 held that the assessment of royalty or any fees for technical services should be made in the year in which the amounts are received and not otherwise. Counsel for the Revenue relied upon the Special Bench decision of the Tribunal in the assessee's own case, which in our opinion, has no relevance to the facts of the present case, as it relates to the period prior to the issuance of Notification dated 26th August 1985. In this view of the matter the decision of the Income Tax Appellate Tribunal in holding that the royalty and fees for technical services should be taxed on receipt basis cannot be faulted."

25. Considering the facts of the case in totality, in light of the judicial decisions discussed here in above, we decide all the grounds of appeal in favour of the assessee and against the revenue.

26. In the result, the appeal of the assessee in ITA No. 7619/DEL/2017 is allowed.

The order is pronounced in the open court on 09.12.2021.

Sd/-	**Sd/-**
[CHALLA NAGENDRA PRASAD] **JUDICIAL MEMBER**	**[N.K. BILLAIYA]** **ACCOUNTANT MEMBER**

Dated: 09th December, 2021

VL/

Copy forwarded to:

1. Appellant
2. Respondent
3. CIT
4. CIT(A)
5. DR

Asst. Registrar,
ITAT, New Delhi

Date of dictation	
Date on which the typed draft is placed before the dictating Member	
Date on which the typed draft is placed before the Other Member	
Date on which the approved draft comes to the Sr.PS/PS	
Date on which the fair order is placed before the Dictating Member for pronouncement	
Date on which the fair order comes back to the Sr.PS/PS	
Date on which the final order is uploaded on the website of ITAT	
Date on which the file goes to the Bench Clerk	
Date on which the file goes to the Head Clerk	
The date on which the file goes to the Assistant Registrar for signature on the order	
Date of dispatch of the Order	