

IN THE INCOME TAX APPELLATE TRIBUNAL
DELHI BENCHES : D : NEW DELHI

BEFORE SHRI G.S. PANNU, HON'BLE VICE PRESIDENT
AND
SHRI ANUBHAV SHARMA, JUDICIAL MEMBER

ITA No.2324/Del/2022
Assessment Year: 2019-20

Charles River Laboratories
Montreal, ULC,
22022 Transcanadienne,
Quebec, Senneville,
Canada-H9X3R3,
Canada.

Vs ACIT,
Circle-1(2)(1),
International Taxation,
New Delhi.

PAN: AAGCC4061J

(Appellant)

(Respondent)

Assessee by : Shri Chavali S. Narayana, CA
Revenue by : Shri Vizay B. Vasanta, CIT-DR

Date of Hearing : 25.04.2024
Date of Pronouncement : 23.07.2024

ORDER

PER ANUBHAV SHARMA, JM:

This appeal is preferred by the assessee against the final assessment order dated 29.07.2022 passed u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (hereinafter referred as 'the Act'), by the ACIT, Circle International Taxation 1(2)(1) (hereinafter referred to as the Ld. AO), for assessment year 2019-20.

2. The relevant facts are that assessee (hereinafter also referred as "CRL Montreal") was incorporated under the laws of Canada in 1996. Assessee claims to be engaged in rendering pre-clinical laboratory services to enable the determination of a safe dose and assess the potential toxicity of new drugs prior to human clinical trials by way of conducting in vitro and in vivo tests and trials. These services are largely catered towards Indian customers in the pharmaceutical, medical device and biotechnology industries. The Indian customers provide samples prior to undertaking human clinical trials which is tested by the Assessee. By way of rendering such preclinical laboratory services, the Assessee also provides a report to its customers containing a generic protocol of the test procedure and results to conclude the preclinical phase of testing. It is the case of assessee that in rendering the above services, no technology / know-how / knowledge is transferred to the customers nor any right to access/ use of such property is granted.

2.1 On hearing both the sides it comes up that the return of income of Rs. Nil/was filed by assessee which was selected for scrutiny on the basis of CASS for following reasons;

2.2 During the assessment proceedings, AO found that the assessee has received revenue receipt amounting to Rs.4,28,68,986/- However no revenue was offered for taxation for the year under consideration. Accordingly, a show-

cause notice was issued and served to the assessee dated 19.09.2021 which is reproduced as under:-

"On the perusal of form 26AS for the year under consideration, it is found that you have not disclosed whole amount of revenue received in the ITR filed by you for the year under consideration.

Accordingly, you are requested to show cause as to why the difference between revenue receipt as per form 26AS and the revenue offered for taxation as per ITR filed by you for F.Y. 2018-19 relevant A.Y. 2019-20 should not be added back to the total income and taxed accordingly."

2.3 As no reply was filed by the assessee in response to the above mentioned show-cause, the revenue receipt amounting to Rs.4,28,68,896/- were disallowed and proposed to be added to the total income of the assessee treating it as FIS/FTS for the year under consideration and accordingly the draft assessment order dated 22.09.2021 was passed. The Assessee filed objections before the DRP, on which following directions were issued by the DRP;

"4.1.3 The Panel has carefully considered the journey of the assessment proceedings in view of the facts mentioned above. The Panel takes a note that the assessing officer has passed the draft order in haste without providing an adequate opportunity of being heard to the assessee. The assessee had filed two submissions on 02.04.2021 and 20.08.2021 prior to show-cause notice dated 19.09.2021 was issued by the AO. The AO has not recorded his observation and any discussion thereon as to what submissions were adduced by the assessee in the above submissions. The AO further has failed to record the assessee's adjournment request dated

20.09.2021. Finally, the AO has passed the draft order without any factual discussion and also without incorporating the merits of the case. Under the above circumstances, the Panel considers the impugned draft order having passed without following the principles of the natural justice. Accordingly, the AO is directed to consider all the submissions filed by the assessee including the submissions filed before the Panel. The AO is directed to make a factual verification of the assessee's contentions in terms of all the extant rules and regulations and then pass a reasoned and speaking order to complete the assessment proceedings. Hence, the grounds of objections in this regard are disposed of accordingly.”

2.4 In furtherance of the DRP directions the AO issued a notice u/s 142(1) of the Act and the assessee was asked how the receipts in the hands of assessee are not in the nature of FTS/FIS, to which assessee's reply was:-

"Article 12(4) of the Treaty, defines FIS to mean payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of a technical or other personnel) if such services, makes available technical knowledge, experience, skill, know-how or processes, or consist of the development and transfer of a technical plan or technical design.

The term 'make available' has not been defined under the Treaty. Hence, reliance can be placed upon the following judicial precedents to ascertain satisfaction of 'make available' test:

In the case of CIT v. De Beers India Minerals Pvt Ltd [2012] 346 ITR 467, the Karnataka HC held that where a Dutch company rendered technical services to the assessee, without making available any technical expertise so as to enable assessee to use those services independently in future, payment made for services in question could

not be termed as 'fee for technical services', in the context of the India- Netherlands tax treaty.

Karnataka HC has also interpreted the meaning of the term "make available" and observed that:

"The service should be aimed at and result in transmitting technical knowledge etc., so that the payer of the service could derive an enduring benefit and utilize the knowledge or know how on his own in future without the aid of the service provider.

In other words, to fit into the terminology "making available", the technical knowledge, skills etc must remain with the person receiving the services even after the particular contract comes to an end. It is not enough that the services offered are the product of intense technological effort and a lot of technical knowledge and experience of the service provider have gone into it. The technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the service provider...payment of consideration would be regarded as FIS only if the twin test of rendering services and making technical knowledge available at the same time is satisfied." (emphasis supplied)

The Karnataka HC in the case of Director of Income-tax (International taxation) vs Sun Micro Systems India Private Limited (ITA no. 35/2010) held that -

"it is clear that Sun Singapore has not made available to the assessee the technology or the technological services which is required to provide the distribution, management and logistic services. When factually it is held that the technical services have not been made available, then in view of the law declared in the Judgment of De

Beers India Minerals Pvt Ltd (supra), there is no liability to deduct tax at source.

In the case of EOS Power India (P.) Ltd. vs Deputy Commissioner of Income-tax, Central Circle-9(1)(1), Mumbai (Appeal No. 1043 (MUM.) OF 2017), the Mumbai tribunal held that the payments made to the non-residents for services being rendered outside India is not chargeable to tax in India unless such fee is towards services which includes make available, technical knowledge, experience, skill, know-how and a process or transfer of technical plans or designs in accordance with Article 12(4) of the India-USA treaty.

The ruling of Advance Authority of Rulings ("AAR") in case of Akamai Technologies Inc (A.A.R. NO. 1107 OF 2011) held as follows -

"In view of the foregoing, we are of the view that the Solutions provided by the Applicant to the customers only enable faster content delivery of the customer's website, etc. to the end users. They do not provide the customers/end users with any technological knowledge, skill, etc. which enable them to apply it on their own in future to enjoy faster content delivery without recourse to the Applicant. Hence, we hold that the consideration received by the Applicant from Akamai India cannot be considered to be in the nature of fees for technical services as referred to in Article 12 of the India-US DTAA." (emphasis supplied).

Further, in the case of Anapharm Inc., In re (A.A.R. NO. 746 OF 2007) held that payment of consideration would be regarded as fee for technical/included services only if the twin tests of rendering services and making technical knowledge available at the same time are satisfied in accordance with provisions of Article 12 of the Treaty.

In view of above, the Company humbly submits with your goodself that the preclinical laboratory services only provide a generic

protocol of the test procedure and does not transfer any knowledge/skill on use of proprietary equipment for carrying out testing process. Therefore, such report cannot be used for testing different sets of samples. Hence, the said services do not satisfy the make available test such that the receiver can deploy similar technology or techniques in the future without depending upon the service provider.

Accordingly, the services rendered would not be liable to be taxed in India in accordance with the beneficial provisions of the Treaty, since preclinical laboratory services does not qualify as either royalty or FIS under the Treaty.

Accordingly, the fees received by the Company for pre-clinical services shall not be taxable in India."

2.5 The AO was not satisfied and on examination of the sample contractual agreement and sample test reports provided by the assessee, AO concluded that the assessee is providing a technical and specialized service to its client. The assessee as per the reports is providing the services like Toxicokinetic reporting, Immunogenicity analysis, dose formulation analysis etc., to the clients to determine the feasibility and utility of the drug sample made by the client (of the assessee). Further, AO observed from the income receipts of the assessee, that primarily in this case for the relevant AY, the client is an Indian multinational pharmaceutical manufacturing company. Further, this company manufactures generic medicines and active pharmaceutical ingredients (APIs). The company markets these products in over 125 countries. These generic medicines and APIs are then sold further to earn profits by the client (of the

assessee). To sell these generic medicines and APIs to various big firms and governments, the client (of the assessee) needs to get its drugs tested by a credible and authentic testing agency to enhance its marketability and authenticity. AO highlighted that the assessee provides that credibility and authenticity to the drug samples of the client (of the assessee).

2.6 AO observed that the reports produced by the assessee via using its technical staff and intellectual property is an authentic report which provides credibility to the samples to the clients. Further, the assessee is a leading company in providing pre-clinical and clinical trials and testing. Once the report is provided, the results of it can be used by the client to derive an enduring benefit by further scaling up the drugs production in accordance to the report results.

2.7 The AO observes that necessary professional and support personnel would be provided to the clients by the assessee as and when required in accordance to the contractual agreement. This suggest that the services provided are not automated and there is human knowledge and know-how involved in it. Further, this knowledge and know-how equips the client to use it in the future. Thus the AO concluded that the receipts in the hands of the assessee are in the nature of Fees for technical services. AO also concluded *“Further, the services are being “Made available” to the client by the assessee in accordance with the*

Article 12(4) of the India-Canada DTAA. The AO relied following decisions, to support aforesaid conclusions:-

- (i) Mahindra and Mahindra Ltd. v DCIT (Mumbai) (SB) 313 ITR 263 (AT);
 - (ii) The Chennai bench decision dated 05.02.2016 (Foster Wheeler France SA-ITAT, Chennai [TS-62-ITAT-2016(CHNY)])
 - (iii) US Technology Resources Private Limited vs. ACIT(TS-511-ITAT-2013)
3. The assessee is in appeal before this Tribunal raising following grounds:-

“On the facts and circumstances of the case and in law, the learned Assistant Commissioner of Income Tax, International Taxation, - Circle 1 (2)(1), New Delhi (‘the learned AO’), has erred in assessing the total income of the Appellant in the assessment order passed under section 143(3) read with section 144C of the Income Tax Act, 1961 (“ the Act”) for the captioned Assessment Year (“AY”).

Each of the ground is referred to separately, which may be kindly considered independent of each other.

1. Ground 1: Income earned by the Appellant erroneously characterized to be in the nature of Fees for Technical Services/ Fees for Included Services under the Act and the India - Canada Tax Treaty (“Tax treaty”) and is consequently subject to tax in India

1.1 On the facts and in the circumstances of the case, and in law, the learned AO erred in holding that the income earned by CRL Montreal from its customers in India is in the nature of Fees for Included Services (“FIS”) / Fees for Technical Services (“FTS”) and consequently liable to tax in India, without having due regard to Article 12(4) of the Tax Treaty.

1.2 The Hon’ble DRP/learned AO has failed to appreciate that the testing services provided by CRL Montreal does not make available its services to the recipient in accordance with Article 12(4) of the Tax Treaty.

2. Ground 2: Incorrect levy of interest under section 234B of the Act

On the facts and in the circumstances of the case and in law, the learned AO erred in levying additional interest under section 234B of the Act.

3. Ground 3: Initiation of penalty proceedings under section 270A of the Act

On the facts and in the circumstances of the case and in law, the learned AO erred in initiating penalty proceedings under section 270A of the Act.

All the above grounds are without prejudice to each other. The Appellant craves for leave to add, amend, vary, omit or substitute or withdraw any of the aforesaid grounds at any time before or at the time of hearing of the matter with the Income Tax Appellate Tribunal.

The Appellant prays that appropriate relief be granted based on the said grounds of appeal and the facts and circumstances of the case.”

4. The ld. AR has primarily relied the submissions which were made before the ld. tax authorities below and further submitted that in the case of sister concern, the issue stands settled in favour of the assessee. It was further submitted that the judgements relied by the AO are distinguishable.

4.1 The ld. DR, however, relied the order of the ld. tax authorities below.

5. In order to understand the nature of services provided by the assessee, we find that at page 244 to 266, a copy of a master service agreement between the assessee and Dr. Reddy's Laboratories Ltd. is provided. Similarly, at page 271-280, master service agreement between the assessee and Vyome Biosciences Pvt. Ltd. is provided. A perusal of these two master service agreement show that what the assessee provides is conduct of a study on a non-exclusive basis. The study has to be conducted not on a continuous basis, but the specific details of each study agreement has to be separately negotiated and specified in writing.

The study has to be as per the protocol which will be provided by the sponsor. The protocol will specify study, design, purpose, desired information, experimental procedures, estimated duration of the study and any other relevant matters which shall be part of the agreement. Further, the agreement provide that what study material is to be provided by the sponsor and sufficient and comprehensive data concerning the suitability of the study material, storage and safety requirements has to be provided by the sponsor. The agreement further provides that the assessee was to conduct the study as specified by the sponsor as per the protocol. This kind of raw data and specimen of each study excluding the frozen/refrigerated samples for which sponsor had required a quality assurance were supposed to be kept by the assessee for a period of one year after the submission of the draft report and if beyond its detention period sponsor wanted to keep the material stored, the assessee was to charge further. The agreement shows that the sponsor derived an exclusive title, ownership and proprietary rights on the data, know-how, methodology, generated pursuant to the study agreement and same would vest in the sponsor as intellectual property and all the aspects of data processing and management systems which include hardware, software, written materials manifested in programmes, documentation, design and discovery or improvement developed or exclusively owned by CRO shall continue to vest with the assessee.

6. Thus, we find that the pre-clinical laboratory services rendered by the assessee to its customers in India were quite limited items of the benefit which the client would derive from any intellectual property, hardware, software or knowledge of its employees. The clients of the assessee, on receiving the report may use it for commercial or technical knowledge to evaluate the product and material, but that report is not of the nature by which, independently, any technological knowledge was transferred to the customers. This report does not contain any information that would enable the client to carry on the clinical test on new products in future on its own accord. It is not disputed that this study/testing of samples was conducted by the assessee outside India based laboratories and merely the samples were provided by the clients and the assessee was supposed to conduct the study only according to the protocol provided by the assessee.

6.1 The decision of the Bangalore Bench in the case of **Charles River Laboratories Inc. vs. ACIT (2023) 152 taxmann.com 568 (Bangalore-Trib)** relied by the Id. AR pertains to a sister concern. It comes up that in that decision also the Bench had taken into consideration the master service agreement entered between that assessee with Dr. Reddy's Laboratories Ltd. and, thereafter, considering the nature of services and the concept of 'make available' in case of the India-US DTAA as applicable pari materia with India-Canada DTAA applicable in case of the assessee relied the judgement of the

Hon'ble Karnataka High Court in the case of **CIT vs. De Beers India Minerals (P) Ltd. (2012) 21 taxmann.com 214** for the meaning of the phrase 'make available' as follows:-

"22. What is the meaning of 'make available'. The technical or consultancy service rendered ""should be of such a nature that it 'makes available' to the recipient technical knowledge, know-how and the like. The service should be aimed at and result in transmitting technical knowledge, etc., so that the payer of the service could derive an enduring benefit and utilize the knowledge or know-how on his own in future without the aid of the service provider. In other words, to fit into the terminology 'making available', the technical knowledge, skills, etc., must remain with the person receiving the services even after the particular contract comes to an end. It is not enough that the services offered are the product of intense technological effort and a lot of technical knowledge and experience of the service provider have gone. The technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider. Technology will be considered 'made available' when the person acquiring the service is enabled to apply the technology. The fact that the provision of the service that may require technical edge, skills, etc., does not mean that technology is made available to the person purchasing the service within the meaning of paragraph (4)(b). Similarly, the use of a product which embodies technology shall not per se be considered to make the technology available. In other words, payment of consideration would be regarded as 'fee for technical/included services' only if the twin test of rendering services and making technical knowledge available at the same time is satisfied."

6.2 Thereafter, in the case of the sister concern of assessee, it was held as follows:-

"21. In the instant case, the Indian customers/clients have to repeatedly seek the assessee's services in respect of testing/research followed by a report on the outcome of such testing/research undertaken by the assessee. The assessee is not involved in supporting system which is put in place or is already in place by the Indian customers/clients. The assessee is not getting its Indian customers/clients equipped to carry on the testing/research independently of the assessee. The utility of the services available in the form of a report, though highly technical in nature, comes to an end, little thereafter, if not immediately, after its rendition. The Support that the Indian entity seeks after the report is delivered is to understand the report

from the assessee. The elements necessary for "make available" is absent in the services rendered by the assessee to its Indian customers/clients, inasmuch as even for the said reports, the customers have to continuously refer to the assessee and the same is not freely r made available to the Indian customers. Thus, technical services rendered by the affiliates do not "make available" technical knowledge, experience, skill, know-how or process while preparing these reports for their, Indian customers/clients. In light of the aforementioned judicial decisions, we are of the considered view that the service recipient of the assessee is unable to make use of the said technology only by itself in its business or for its own benefit without recourse to the assessee year after year."

6.3 The aforesaid reasoning is also supported by the following decisions :

- (i) Inspectorate International Ltd. vs. ACIT, Circle 2(1)(1) (ITA Nos.4938 of 2016 and 6365 of 2017 (Delhi ITAT)
- (ii) Romer Labs Singapore Pte Ltd. vs. ADIT, Tax Circle 2(1) (ITA No.3883 of 2009 (Delhi ITAT)
- (iii) Wockhardt Ltd. vs. ACIT (ita No.4624 and 4757 of 2009) (Mumbai ITAT)

7. In the light of the aforesaid, we are convinced that the ld. tax authorities below have fallen in error to consider the receipt as FIS/FTS and, consequently, we sustain the grounds and allow the appeal of the assessee with consequential effects.

Order pronounced in the open court on 23.07.2024.

Sd/-

(G.S. PANNU)
VICE PRESIDENT

Dated: 23rd July, 2024.

Sd/-

(ANUBHAV SHARMA)
JUDICIAL MEMBER

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Copy forwarded to:

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

Asstt. Registrar, ITAT, New Delhi