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.2044/Del/2023
Assessment Year: 2020-21

R1 RCM Holdco Inc. (Formerly known as R1 RCM Inc.), 434, W Ascensio Way, Murray, 6th Floor, Utah-84123, United States of America.	Vs	DCIT, Circle Int. Taxation , Gurgaon.

PAN: AAICR8023M

(Appellant) (Respondent)

Assessee by	:	Shri S.K. Aggarwal, CA
Revenue by	:	Shri Vijay B. Vasanta, CIT-DR
Date of Hearing	:	25.07.2024
Date of Pronouncement	:	26.07.2024

ORDER

PER ANUBHAV SHARMA, JM:

This appeal is preferred by the Assessee against the final assessment order dated 26.05.2023 passed u/s 143(3) r.w.s. 144C(13) of the Income Tax Act, 1961 (hereinafter referred as 'the Act'), by the ACIT, International Taxation, Gurgaon (hereinafter referred to as the Ld. AO), for assessment year 2020-21.

2. The assessee is a tax resident of United States of America and is engaged in the business of providing outsourced revenue cycle management (RCM) solutions to various large hospitals, healthcare systems, physicians in the USA. The assessee has a wholly owned subsidiary in India namely R1RCM Global Private Limited (R1 India) which is a captive information technology enabled back-office service provider and provides medical coding & transcription services, accounts receivable/collection services, underpayment services, measurement modeling services, data analysis to the assessee.

2.2 During the year, the assessee received payments of Rs.11,52,38,019/- from R1 India which the assessee claimed to be reimbursement of software licenses cost. The assessee had disclosed the above receipt in its original return of income; however, consequent upon decision of the Hon'ble Supreme Court in the case ***of M/s Engineering Analysis Centre of Excellence Private Limited vs CIT [2021] 125 taxmann.com 42 (SC),*** the assessee revised its return of income and claimed the above receipts non-taxable.

3. During the scrutiny proceedings, the assessee was requested to provide details of services/goods provided to R1 India against which the above income was received. The assessee submitted that it was procuring various softwares for the group centrally and subsequently, allocating the cost to each user on actual consumption basis on cost to cost basis. The assessee filed a copy of intercompany services agreement dated 27.03.2018. The assessee also filed a copy of Advance

Pricing Agreement u/s 92CC of the Act between the assessee and R1 India which was effective from 2013-14 to 2017-18.

3.1 Documents filed by the assessee were examined in the light of facts of the case and relevant provisions of the law and AO found that the assessee was maintaining IT infrastructure for the whole group and charging group concerns on actual usage basis which amounted to use or right to use of a scientific equipment and amount received by the assessee was found to be chargeable to tax as royalty under the Act and under the provisions of India-USA DTAA (the tax treaty). Accordingly, a show cause notice was issued to the assessee on 19.03.2022 affording the assessee an opportunity to explain as to why the above receipts may not be taxed as royalty income. Relevant part of the show cause notice is reproduced

> *"Details furnished by you have been examined in the light of facts of the case and relevant provisions of law. A perusal of your response reveals that you have contended that receipts from Indian AE are not in the nature of royalty Income. However, your response has not been found to be satisfactory. It is seen that IndianAE had entered into an advance pricing agreement with Government of India. A perusal of the said agreement reveals that you have specialized softwares (page 18 of the agreement) with patent rights. It has been further mentioned that no cost was charged by you for third party softwares to Indian AE during the currency of APA. It is noted that you are maintaining a complete IT Infrastructure which consists of in-house developed and patented softwares and softwares purchased from third parties. Cost of such third party softwares which are essential for overall functioning of IT Infrastructure of R1RCM Inc., is charged on group concerns on actual usage basis. Thus, it is found that charges recovered from group concerns (including Indian AE) are towards allowing access to IT Infrastructure of R1RCM Inc. which consist of in-house developed and patented softwares and third party softwares. Therefore, receipts from Indian AE are in the nature of royalty for allowing access to IT infrastructure which is well covered under explanation 2 to section 9(1)(vi) of the Act and Article 12 of India-USA DTAA, the same being in the nature of right to use any*

industrial equipment since IT Infrastructure is a form of industrial, scientific and technical equipment only. Therefore, receipts from Indian AE are in the form of industrial royalty Income and the same are liable to tax in India.

You are hereby afforded an opportunity to show cause as to why the above receipts may not be taxed as royalty. You may submit your response on or before 23.03.2022. Kindly note that your response must be supported by adequate documentary evidence. Further, kindly note that no separate opportunity of personal hearing shall be provided. If you wish to be heard in person, you may appear at 1600 hours on 23.03.2022".

3.2 Further, vide notice dated 03.09.2022, the assessee was requested to provide certain additional details viz. copy of agreements/contracts with software suppliers which were subsequently supplied to R1 India, copy of contract with R1 India under which third party software were provided to R1 India and complete IT Policy of the assessee.

3.3 In response to the show cause notice, the assessee filed response on 23.03.2022, 02.09.2022, 06.09.2022 & 13.09.2022. The assessee also requested for opportunity of personal hearing which was allowed. In response assessee filed a copy of Enterprise License Agreement with Microsoft and also filed a copy of Global IT Policy of the assessee. The assessee contended that receipts from R1 India are not taxable for the following reasons:

(i) License fee has been recovered on cost to cost basis

(ii) Third party softwares can be downloaded by R1 Indian from website/servers of third party software providers.

(iii) Payment is not for use of IT Infrastructure or equipment but merely for use of software application/license

(iv) Even if assumed that payment is for use of IT Infrastructure, the same cannot be characterized as royalty under the Act or under the tax treaty because

(a) There is no use/right to use of equipment or process provided to R1 India &

(b) Possession and control of such IT infrastructure is not with R1 India and relied upon case laws of Asia Satellite and DIT vs Shin Satellite

(v) The receipts are not taxable in the light of decision of Hon'ble SC in the case of M/s Engineering Analysis Centre of Excellence Private Limited vs CIT

(vi) The case of the assessee is covered by decision of jurisdictional ITAT in case of ***Perfetti Van Melle ICT & BV vs DCIT in ITA No. 139/Del/2021***.

4. However, the AO was not satisfied and concluded that the following conclusion emerged from the facts of the case:-

(a) That the assessee maintains a huge IT infrastructure for the group and administers use of the same through Global IT Policy.

(b) The assessee a central Information technology Department who deals with technical resources acquisition, identification, configuration, maintenance, distribution and retirement.

(c) The assessee owns number of IT systems which are owned, leased, supported and hosted by it.

(d) IT department of the assessee manages IT resources (tangible and intangible assets) of the assessee through formulating policies and ensuring compliance for the same.

(e) The assessee has licensed software through Enterprise License Agreements which form integral part of IT Systems of the assessee.

(f) The assessee has provides use or right to use of its IT systems through intercompany services agreements against charges.

(g) The assessee allocates charges to various group concerns on usage basis and such charge is for use of or right to use of IT infrastructure.

(h) The IT infrastructure owned and managed by the assessee is a scientific equipment and receipts against use of such equipment constitute equipment royalty as per the tax and under provisions of the tax treaty.

5. The assessee filed objections before the DRP and the DRP did not intervene and decided the objections against the assessee with the following relevant findings:-

"4.1.3 The Panel has carefully considered the rival averments as mentioned above. The Panel has observed that the AO has considered the assessee's all contentions made from ground no. 1 to 7 of the objections in his draft assessment order from para no. 4 to 4.4. The Panel further takes note that the assessee revised its return of income for the year under consideration. As reported by the AO, during the year, the assessee received payments of Rs. 11,52,38,019/- from R1 India which the assessee claimed to be reimbursement of software licenses cost. The assessee had disclosed the above receipt in its original return of income, however, consequent upon decision of the Hon'ble Supreme Court in the case of M/s Engineering Analysis Centre of Excellence Private Limited vs CIT [2021] 125 taxmann.com 42 (SC), the assessee revised its return of income and claimed the above receipts non-taxable. However, this

is also a fact that the Revenue has filed a review petition before the Apex Court in case of M/s Engineering Analysis Centre of Excellence Private Limited vs CIT [2021] which has been admitted and is pending for final adjudication.

In view of the above the Panel does not find any infirmity in theAO proposal for assessment as per the draft order for the year under consideration. Accordingly, the AO's action is upheld, and the assessee's objections made from around no 1 to 7, are rejected and disposed of."

6. Accordingly, the assessee is in appeal raising the following grounds:-

"On the facts and in the circumstances of the case and in law, the Deputy/Assistant Commissioner of Income Tax, International Taxation, Gurgaon ('Ld. AO') has erred in passing the assessment order under Section 143(3) read with Section 1440(13) of the Income-tax Act, 1961 ('the Act'), and the Hon'ble Dispute Resolution Panel ('DRP'), New Delhi has erred in confirming the assessment order, which is wrong and bad in law. The impugned assessment order has been passed on assumptions, ignoring facts and legal submissions of the Appellant and hence, liable to be quashed.

1. *On the facts and circumstances of the case and in law, the Ld. AO has erred in holding that the total income of INR 11,52,38,019 of the Appellant is chargeable to tax under section 115A of the Act.*

2. *On the facts and circumstances of the case and in law, the Ld. AO/DRP erred in concluding that amount of INR 11,52,38,019 received by the Appellant from its Associated Enterprise ("AE") i.e. R1 RCM Global Private Limited ('Rl India') towards pure cost reimbursement of third party (such as Microsoft) software licenses is taxable as royalty under the Income-Tax Act, 1961 (the 'Act') and the India-USA Double Taxation Avoidance Agreement ('DTAA'), based on the findings made in the final assessment order. In doing so:*

a. *The Ld. AO has erred in holding that the charges received by the Appellant from its AE on actual usage basis amounted to use or right to use of scientific equipment, and receipts against use of such equipment constitute equipment royalty as per the Act and under provisions of the DTAA. The allegations of the Ld. AO are unfounded, without any cogent material and on the basis of surmises and conjectures.*

b. *The Ld. AO erred in holding that the Appellant maintains global IT infrastructure for the whole group which is made of various hardware devices and software/ applications and the same is in the nature of scientific equipment. The Ld. AO further erred in holding that the IT*

infrastructure is also in the nature of commercial equipment as the same is being exploited in the business of the Appellant.

c. *The Ld. AO erred in concluding that the Microsoft/ third-party software license procured by the Appellant by entering into End-user License Agreements ('ELAs') form part of IT infrastructure of the Appellant.*

d. *The Ld. AO has erred in alleging that use of such third-party software by Rl India by directly accessing/ downloading such software from the website of Microsoft/ third party constitutes use of equipment / IT infrastructure of the Appellant by Rl India and is hence, taxable as equipment royalty.*

e. *The reliance placed by the Ld. AO on the APA, IT Policy and inter-company service agreement concluding that the pure cost reimbursement made to the Appellant by Rl India is for the use of equipment / IT infrastructure is completely erroneous, inaccurate, and misplaced.*

f. *The Ld. AO erred in holding that R1 India is availing facility of software through the intercompany services agreement for which it was charged on actual usage basis and thus, concluding that the inter¬company agreement provides for use of or right to use of equipment of the Appellant by R1 India constituting equipment royalty.*

3. *The Ld. AO/DRP grossly erred in law in disregarding the jurisprudence of the Hon'ble Supreme Court in the case of Engineering Analysis Centre of Excellence (P.) Ltd v. Commissioner of Income-tax [2021] 125 taxmann.com 42 (SC) in holding that payment cross charged for third-party software license is taxable as Royalty.*

4. *On the facts and circumstances of the case and in law, the Ld. AO/DRP has erred in violating the principles of judicial discipline in not following the order of the Hon'ble Supreme Court as well as the jurisdictional High Court and the Income Tax Appellate Tribunals where under similar facts it was held that reimbursement of third-party software expenses is not taxable as Royalty.*

5. *Without prejudice to the above, the Ld. AO has erred in disregarding the Appellants's contention that there is no equipment royalty in absence of any control/ possession by R1 India over the alleged equipment of the Appellant and in holding that the judicial precedents relied upon by the Appellant in the case of DIT Vs. New Skies Satellite BV and Shin Satellite Public Company Limited (ITA No. 473, 474, 500 and 244 of 2012) are redundant in light of the amendments in the Act.*

6. Without prejudice to the above, the Ld. AO failed to appreciate that the beneficial provisions of the relevant tax treaty would continue to apply inspite of the retrospective amendments to Explanations 4, 5 and 6 vide Finance Act, 2012 (with retrospective effect from 1 June 1976) to section 9(l)(vi) of the Act, as upheld by the Supreme Court in the case of Engineering Analysis Centre of Excellence (supra) and the jurisdictional Hon'ble Delhi High Court in the case of Shin Satellite (supra).

7. On the facts and in law, the Ld. AO erred in initiating the penalty under section 270A of the Act.

a. The Ld. AO erred in initiating the penalty under section 270A for under-reporting of income in consequence of misreporting without appreciating the fact that there is no under-reporting of income by the Appellant;

b. Without prejudice to the above, the Ld. AO has failed to specify the specific clause of section 270A(9) while initiating the penalty for under-reporting of income in consequence of misreporting and therefore, the notice issued is bad in law.

All the above grounds of objections are mutually exclusive and without prejudice to each other.

The Appellant prays for leave to add, alter, amend, rescind from or withdraw any of the above grounds of appeal at or before the time of hearing of the appeal."

7. Heard and perused the record.

7.1 During the course of hearing, it transpired that the AO and the DRP denied the benefit to the assessee of the judgement of the Hon'ble Supreme Court in the case of ***Engineering Analysis Centre of Excellence Private Limited (supra***) for the reason that a Review Petition was pending before the Hon'ble Supreme Court. The conclusion which the AO has drawn as reproduced above being part of para 0.5 of the final assessment order, leave no doubt in the mind of this Bench that the AO has tried to distinguish the judgement of the Hon'ble Supreme Court in the case of

Engineering Analysis Centre of Excellence Private Limited (supra) on the basis that he considered the case of the assessee to be not of copyright royalty, but, equipment royalty. On the contrary, the nature of services extended by the assessee is allowing access to IT infrastructure which consists of in-house development and patented software and third party software. Thus, we are of the considered view that the tax authorities below have fallen in error in not giving benefit to the assessee of the judgement of the Hon'ble Supreme Court in the case of ***Engineering Analysis Centre of Excellence Private Limited (supra***). The grounds are allowed.

8. In the result, the appeal filed by the assessee is allowed.

Order pronounced in the open court on 26.07.2024.

(G.S. PANNU)	(ANUBHAV SHARMA)
VICE PRESIDENT	JUDICIAL MEMBER

Dated: 26th July, 2024.

dk

Copy forwarded to:

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

Asstt. Registrar, ITAT, New Delhi