IN THE ITAT MUMBAI BENCH 'L'

ADIT (International Taxation) -2(2)

v.

Warner Brother Pictures Inc.*

N.V. VASUDEVAN, JUDICIAL MEMBER AND B. RAMAKOTAIAH, ACCOUNTANT MEMBER
I T APPEAL NO. 3160 (MUM.) OF 2010 C.O. NO. 17 (MUM.) OF 2011
[ASSESSMENT YEAR 2006-07]
DECEMBER 30, 2011
Jitendra Yadav *for the Appellant.* **W. Hasan** *for the Respondent.*

ORDER

B. Ramakotaiah, Accountant Member - The Revenue has raised the present appeal against the order of the CIT (A)-2 Mumbai dated 29.01.2010. The Revenue is aggrieved that the CIT (A) erred in holding that the royalty received by the assessee from WBPIPL is not taxable in India under the Act as it is not hit by the rigors of *Explanation* 2(*v*) to Section 9(1)(vi) of the Act. It also filed additional grounds that the CIT (A) erred in holding that the appellant does not have a PE in India. The cross appeal is with reference to contesting the findings of the CIT (A) that the royalty is not specifically exempted under any provision of the Act and the same is covered by clause(i) of Section 9(1) of the I.T. Act and that the assessee has business connection in India. It was further contesting that other arguments of the assessee were not adjudicated upon particularly with reference to the fact that the assessee does not carry out any business activity in India and since the royalty is paid at arm's length, the income is not taxable in India.

2. We have heard the learned Departmental Representative Shri Jitendra Yadav and the learned Counsel Shri W. Hasan in detail. Briefly stated, the assessee is a non-resident company having business in production and distribution of films. The assessee entered into an agreement with Warner Bros Pictures (India) Pvt. Ltd (WBPIPL) dated 1st February, 2005. Under this Agreement, the assessee granted exclusive rights of distribution of Cinematographic films on payment of royalty in terms of the said Agreement. During the year under consideration the assessee received Rs. 3,88,02,093/- as royalty. WBPIPL while remitting the said royalty deducted tax at source amounting to Rs. 58,17,227/-. Being advised that the royalty received by the assessee is not a taxable income in India, the assessee filed its return of income for the year under consideration on 29th November, 2006 claiming refund of the tax deducted at source amounting to Rs. 58,17,227/-.

3. The Assessing Officer issued intimation under section 143(1) (a) of the Income Tax Act, 1961 (the Act) dated 30th January, 2008 making certain adjustments and raising a demand of Rs. 1,60,55,291/. Being aggrieved with the said information, the assessee filed appeal to the learned CIT (A) XXXI-Mumbai. The learned CIT (A) XXXI-Mumbai disposed of the appeal vide her order dated 16/05/2008 holding that 'the intimation dated 30th January, 2008 issued by the learned Assessing Officer under section 143(1) of the Income Tax Act, 1961 is void *ab initio*'.

4. Subsequently, the Assessing Officer selected the case for scrutiny by issuing a notice under section 142(1). In the submissions made *vide* assessee's letter dated 31/10/2008, it was explained in detail that the royalty received by the assessee from WBPIPL is not taxable in India either under the Income-tax Act, 1961 or under India-USA Tax Treaty. In support of its claim, the assessee relied on several judgments of the Hon'ble Supreme Court and various High Courts including the judgment of the Hon'ble Bombay High Court in the case of *SET Satellite (Singapore) Pte. Ltd.* v. *Dy. DIT (International Taxation)* [2008] 173 Taxman 475 (Bom.). The Assessing Officer passed the impugned assessment order dated 18/12/2008 without making any reference to above submissions of the assessee. The Assessing Officer rejected the claim of refund of the assessee and assessed the royalty of Rs. 3,88,02,093/- @ 15% applying, Article 12(2) of the India-USA Treaty.

5. Before the CIT (A) the claim of the assessee is that this royalty is not taxable in India for the following reasons:

- ♦ In view of section 90(2) of the Act in cases covered by a Tax Treaty, the provisions of the Act or the Tax Treaty whichever is more beneficial to the assessee will apply.
- ♦ In view of *Explanation* 2(*v*) to section 9(1)(vi) of the Act the consideration for the sale, distribution or exhibition of cinematographic films is excluded from the definition of royalty. Thus it is not taxable under the Act.
- ♦ The royalty is also not taxable under the DTAA.
- ♦ Assuming, though not accepting, that the payment received by the assessee is covered by the definition of royalty under the DTAA/the Act, even then it is not taxable in India for the following reasons.
  - (1) The assessee does not have business connection in India as the Agreement between the assessee and WBPIPL is signed outside India and the payment of royalty is also made outside India.
  - (2) Assuming, though not accepting, that there is a business connection in India, the royalty received by the assessee from WBPIPL is not taxable in India as the assessee does not carry out any business activity in India to earn this income. Reliance is placed on the decision of *Ishikawajma-Harima Heavy Industries Ltd* v. *Director of Income Tax* 2007-(158)-TAXMAN 0259-SC.
  - (3) Even if it is held that the royalty is income arising from business connection in India the same is not taxable as the assessee does not have a PE in India.
  - (4) Assuming, though not accepting, that the assessee earns the royalty through a PE, the same cannot be taxed in India as the royalty is paid at arm's length. Reliance is placed on the case of *SET Satellite (Singapore) Pte. Ltd.* v. *Dy. Director of Income Tax (International Taxation)* in appeal No.944 of 2007 dated 22nd August, 2008.
  - (5) In view of Article 23 of DTAA royalty is also not taxable as "income from other sources".

6. On the above contentions of the assessee the learned CIT (A) passed detailed order *inter alia* holding that the amount is not taxable, in following Paragraphs, as under:

"3.14 In this regard it first becomes imperative to analyse the definition of Royalty in the Explanation 2 to Section 9(1)(vi) of the Income Tax Act 1961. The relevant portion of the said section is extract below:

Section 9

(1) The following incomes shall be deemed to accrue or arise in India:-

(*i*) to (*v*) ** ** **

(*vi*) income by way of royalty payable by

(*a*) The Government or

(*b*) A person who is a resident, except where the royalty is payable in respect of any right, property or information used or service utilized for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India or

(*c*) A person who is a non-resident where the royalty is payable in respect of any right, property or information used or service utilized for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India:

** ** **

Explanation 2 - For the purpose of this clause, "royalty" means consideration (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for-

(*i*) The transfer of all or any rights including the granting of a license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property:

(*ii*) The imparting of any information concerning the working of, or the use of a patent, invention, model, design, secret formula or process or trade mark or similar property;

(*iii*) The use of any patent, invention, model, design, secret formula or process or trade mark or similar property;

(*iv*) The importing of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill;

(*iv a*) The use or right to use any industrial, commercial or scientific equipment but not including the amounts referred to in section 14BB;

(*v*) The transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting, but no including consideration for the sale, distribution or exhibition of cinematographic films: or

(*vi*) The rendering of any services in connection with the activities referred to in sub-clauses (i) to (iv), (iva) and (v)"

3.15 A simple analysis of the said definition in clause (v) of the said *Explanation* would reveal that the *consideration for the sale, distribution or exhibition of cinematographic films* is kept outside the purview of the definition of royalty unless royalty arises on the transfer of all or any rights (including the granting of license) in respect of any copyright, literary, artistic or scientific work including films or video tapes for use in connection with the television or tapes for use in connection with radio broadcasting.

** ** **

3.17 I have carefully considered the submissions of the learned Counsel. I have also gone through the Agreement. A perusal of the assessment order shows that it is not the case of the Assessing Officer that the said Royalty has arisen on account of transfer of rights of films or video tapes for use in connection with television or tapes for use in connection with radio broadcasting. In fact, the Assessing Officer has accepted that as per the agreement dated February 01, 2005 executed by the assessee with Warner Bros Pictures (India) Pvt. Ltd (WBPIPL), the assessee has licenses the India distribution rights in respect of its films to WBPIPL, in consideration for the payment of the agreed license fees. This being the fact of the case, it transpires that such *consideration for the sale, distribution or exhibition of cinematographic films* cannot be taxed as Royalty on account of specific exclusion given in *Explanation* 2(*v*) of section 9(1)(vi) per the Income Tax Act 1961.

3.18 The next question for consideration is if the royalty received by the assessee is not covered by the definition of royalty either under the Act or the DTAA whether the same is not liable to tax or it is covered by the general clause (i) of section 9(1). In this regard the learned Counsel reiterated the following submissions which have been referred to earlier in this order:

(*A*) When there is a special provision dealing with a specific type of income such a provision would exclude the general provision.

(*B*) Appellant does not have business connection in India. Hence the appellant has no business income in India.

(*C*) Even if it is held that the royalty is income arising from business connection in India, the same is not taxable as the appellant does not have a PE in India.

(*D*) The royalty received by the appellant is not taxable in India as the appellant does not carry out any business activity in India.

(*E*) Since the royalty is paid at arm's length the income of the appellant is not taxable in India.

3.19 Regarding the submission at (A) the learned Counsel invited my attention to Paragraphs 9 & 10 of the written submission dated October 31, 2008 filed before the Assessing Officer and argued that when there is a special provision dealing with a specific type of income, here royalty, such a provision would exclude the general provision dealing with the income accruing or arising out of any business connection in India. In this regard he relied on the following decisions:

(1) *Metro Satellite Ltd.* v. *Income Tax Officer Companies Circle-ix* Ahd, 121 ITR 311 (Guj.)

(2) *CIT* v. *Cape Vulcan Inc.* 167 ITR 884 (Mad.)

(3) *United Commercial Bank Ltd.* v. *CIT West Bengal* 32 ITR 688 (SC)

(4) *CIT Bombay City - III* v. *Smt. T.P. Sidhwa* 133 ITR 840 (Bom.)

3.20 I have carefully considered the submissions of the learned Counsel but do not find force in the same. Once it is held that the royalty is not covered by its definition under the Act, the next question to be considered is whether the said income is taxable under any other provision of the Act. As royalty is not specifically exempted under any provision of the Act I hold that the same is covered by the general provision of clause (i) of section 9(1). This argument of the learned Counsel, is therefore, rejected.

** ** **

3.27 I have carefully considered the submissions of the learned Counsel. I have also gone through the Agreement. On the basis of the facts mentioned above I am of the opinion that the License (WBPIPL) does not constitute a PE of the appellant. This is also not disputed by the Assessing Officer as he has himself assessed the income of the appellant as royalty. The Assessing Officer has not invoked the provisions of Paragraph 6 of Article 12 of the DTAA which provides that if the beneficial owner of the royalty carries on business through a permanent establishment and the royalty is attributable to such PE, it will be taxed under Article 7 as business profits. Since the appellant does not have a PE in India, the royalty received by the appellant is not taxable in India. Since the income of the appellant (royalty) is held not taxable in India, other arguments of the appellant in this behalf are not adjudicated upon.

** ** **

3.30 In this regard the legal position is that if royalty received by the appellant is not taxable under the Act, then there is no need to refer to the provision of the DTAA. There is overwhelming judicial precedence on the issue that if an income is not taxable under the domestic law, the same cannot be taxed under the DTAA as the DTAA does not create a charging provision to assessee an income which is not otherwise chargeable to tax under the domestic law. The Apex Court has, in no uncertain terms held in the case of P.V.A.L. Kulandagan Chettiar 267 ITR 654 (SC) that

"The provisions of such agreement cannot fasten a tax liability where the liability is not imposed by a local Act. Where tax liability is imposed by the Act, the agreement may be resorted to either for reducing the tax liability or altogether avoiding the tax liability" [Emphasis supplied].

3.31 However, the Assessing Officer has held that the definition in the India USA treaty makes the royalty received by the appellant as taxable in India. Assuming this to be the case, the matter still does not end here. The law on this issue is that where a matter is governed by the provisions of the Act and also by a DTAA, the provisions of the DTAA should prevail unless the statutory provision

is more beneficial to the assessee. In this regard the reliance placed by the appellant on the CircularNo.333 dated 02/04/1982 137 ITR (St) of CBDT and the two case laws of *CIT* v. *V.R.S.R.M. Firm* 208 ITR, 400 (Mad) and Advance Ruling P.No.13 of 1995 228 ITR 487 (AAR) is perfectly in order. So by the application of the said legal principles we will arrive at the same conclusion *viz.* that *consideration for the sale, distribution or exhibition of cinematographic films* not being taxable as 'royalty' under the Income Tax Act cannot be brought to tax as per the DTAA when such consideration has been kept out of the purview of the said DTAA.

3.32 Hence in view of the above facts and circumstances of the case discussed above and respectfully following the legal position applicable to the appellant's case, it is held that the royalty amount of `3,88,02,093/-received by the appellant from WBPIPL is not taxable as Royalty either under the Indian Income Tax Act or the DTAA. Having held so the other submissions of the appellant pertaining to arm's length payments, and service rendered outside India need not require any discussion".

7. Learned Departmental Representative referring to various findings of the CIT (A) submitted that the CIT (A) erred in not considering the provisions of section 5 of the ACT and Article 7 of Treaty while deleting the above as he has held that there is a business connection and accordingly the income is taxable under the Indian Income Tax Act Sec. 9(1)(i) r.w.s Section 5 (2).

8. However, the learned Counsel submitted that by virtue of exclusion under section 9(1)(vi) from the definition of royalty by *Explanation 2* of the said provisions and by virtue of Article 12(3) which also excludes the sale, distribution and distribution of cinematograph films from the definition of royalty, income is not taxable either under the Indian Income Tax Act or under the DTAA. He then referred to the findings of the Hon'ble I.T.A.T in the case of *Asiavision Home Entertainment (P.) Ltd.* v. *Asstt. CIT* [2010] 37 SOT 111 (Mum.) wherein on similar payment paid under license agreement for exhibition of the programmes for rental and sale through distribution, it was held that the said amount fall outside the purview of the royalty within the meaning of Section 9(1)(vi) and therefore, no TDS is required to be made from such payment and consequently no disallowance under section 40(a)(i) was called for. Similar view was also held in the case of *Asstt. CIT* v. *Manish Dutta* [IT Appeal No.4017 (Mum.) of 2010, dated 17.6.2011] wherein the ITAT held that in view of the specific provision of *Explanation 2*, clause (v) of section 9(1)(vi) of the Act consideration for exhibition of cinematographic films are excluded from the purview of the definition of royalty. It was fairly submitted that the assessee has no rights for broadcasting on Radio and TV and therefore, the principles established in the above decisions would apply to the facts of the case. He then referred to the order of the CIT (A) to submit that on the facts, there is no dispute with reference to the issue that the amounts are not taxable under section 9(2)(vi) and Article 12(3) of the DTAA. He submitted that the assessee has objection with reference to the findings of the CIT (A) that the provisions of section 9(1)(i) which are general provisions would apply which the assessee was objecting to in the cross appeal. He referred to the decision of the Hon'ble Gujarat High Court in the case of *Meteor Satellite Ltd.* v. *ITO* [1980] 121 ITR 311/[1979] 2 Taxman 424 (Guj.) to submit that Clause (vi) of section 9(1) deals with a specific type of income, namely, income by way of royalty, whereas cl.(i) of section 9(1) is a more general provision which deals with all incomes accruing or arising, whether directly or indirectly, through or from, any business connection in India. Income by way of royalty is a species or one of the categories of a larger class mentioned in clause (i) of section 9(1) and, hence, the specific instance having been provided by clause (vi), one has to look at that clause (vi) and not to the more general provision of clause (i) of section 9(1). Similarly, income by way of fees for technical assistance, which is covered by clause (vii). Principle of excluding the general clause has to be applied in this case and once the case falls under clause (vi) and is exempted from the operation of clause (vi) by virtue of the proviso, then we cannot refer to clause (i) which is a general clause.

8.1 Ld. Counsel also relied on the decision of the Hon'ble Madras High Court in the case of *CIT* v.

Copes Vulcan Inc. U.S.A. [1987] 167 ITR 884 / 30 Taxman 549 (Mad.) wherein with reference to the proviso to section 9(1)(vii) similar view was held and because of application of section 9(1)(vii) receipt was excluded by the proviso, the said payment cannot be automatically fall within the section 9(1)(i) of the I.T. Act. It was the submission that when there is a special provision dealing with special type of incomes accruing or arising out of any business connection, it is not possible to apply the general principles in section 9(1)(i). It was submitted that in view of the proviso and principles established, the amount on royalty received by the assessee Non-Resident Company is not taxable and therefore, the order of the CIT (A) to that extent is to be upheld.

9. We have considered the rival contentions and examined the facts on record. There is no dispute with reference to the fact that the assessee has entered into agreement with Warner Brothers Pictures India (P) Ltd outside India and the amounts were also received outside India. There is also no dispute with reference to the fact that the definition of royalty under section 9(1)(vi) *Explanation 2* to (v) excludes the payment received with reference to sale, distribution and exhibition of cinematographic films. There is also no dispute with reference to the provisions of DTAA entered into by India with USA, notified on 20th December, 1990, that the term royalty used in the Article 12 does not include payment of any gain received as consideration for the use of any copyright or literary, artistic or scientific work including cinematographic films or work on films, tape or other means of production for use in connection with Radio or T.V. broadcasting. In view of this specific provisions, the amount received by the assessee cannot be considered as royalty as was done by the Assessing Officer while invoking the Article 12(2) of the DTAA for taxing the amounts. To that extent the findings of the CIT (A) are correct and there is no need to deviate from such findings. In view of this the amount received by the assessee cannot be considered as royalty within the meaning of Indian Income Tax Act or under the DTAA.

10. The issue can be examined in another dimension whether the amount is taxable under the Indian Income Tax Act in India if not as royalty, but as business income. The CIT (A) finding is that assessee has a business connection in India. However, he considered that there is no PE to the assessee, the fact of which was also accepted by the Assessing Officer as he has invoked only Article 12(2) and not considered the amounts business income as per PE proviso. It was the contention of the learned Departmental Representative that the assessee having business connection, the findings of which was given by the CIT (A), the amount cannot be excluded without examining 'PE proviso' provisions of the DTAA. In this regard the learned Counsel's submission that under the Income Tax Act as well as under the provisions of DTAA the transaction between the assessee and Indian Company to whom license was granted by virtue of the agreement cannot be considered as Agency PE as the Indian assessee is not exclusively dealing with the assessee and referred to the receipts from another company 20th Century Fox to submit that the assessee is also dealing with the other Non Resident Companies, so assessee cannot be considered as Agency PE within the definition of Permanent Establishment.

11. We have examined this aspect also. As rightly held by the CIT (A) even if income arises to the Non-Resident due to the business connection in India, the income accruing or arising out of such business connection can only be taxed to the extent of the activities attributed to permanent establishment. In this case, the assessee does not have any permanent establishment in India. Since the Indian company who obtained the rights is acting independently, Agency PE provisions are not applicable to the assessee company. The assessee relied on the decision of *Ishikawajma-Harima Heavy Industries Ltd.* v. *DIT* [2007] 158 Taxman 259 (SC) that incomes arising to a Non-Resident cannot be taxed as business income in India, without a PE. As the assessee does not have any permanent establishment in India, the incomes arising outside Indian Territories cannot be brought to tax. Therefore, there is no need to differ from the findings of the CIT (A) and accordingly the Revenue Appeal is dismissed.

12. In the cross objection, the assessee is contesting about the findings of the CIT (A) that the general principles of section 9(1)(i) will apply in the absence of inclusion under section 9(1)(vi) and relied on

the two decisions of the Gujarat and Madras High Courts referred (*supra*). Even though the cross objection was raised on findings of CIT(A), in view of the observations given above, we are of the opinion that the issue is only academic and does not require any specific adjudication.

13. In the result, Revenue's appeal as well as the Cross Objection filed by the assessee are dismissed.