VERENDRA KALRA & CO
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Australian Federal Court Declares Payments Made to PepsiCo are Not ‘Income Derived’ under ITAA, Hence Royalty Withholding Tax Not Applicable

Facts

The assessee Schweppes Australia Pty Ltd, was appointed as the sole distributor and bottler in Australia of the famous beverages Pepsi, Mountain Dew and Gatorade under separate EBAs in the relevant income years ending 30 June 2018 and 30 June 2019, by PepsiCo Inc and its group entity Stokely-Van Camp Inc (collectively known as “PepsiCo”).

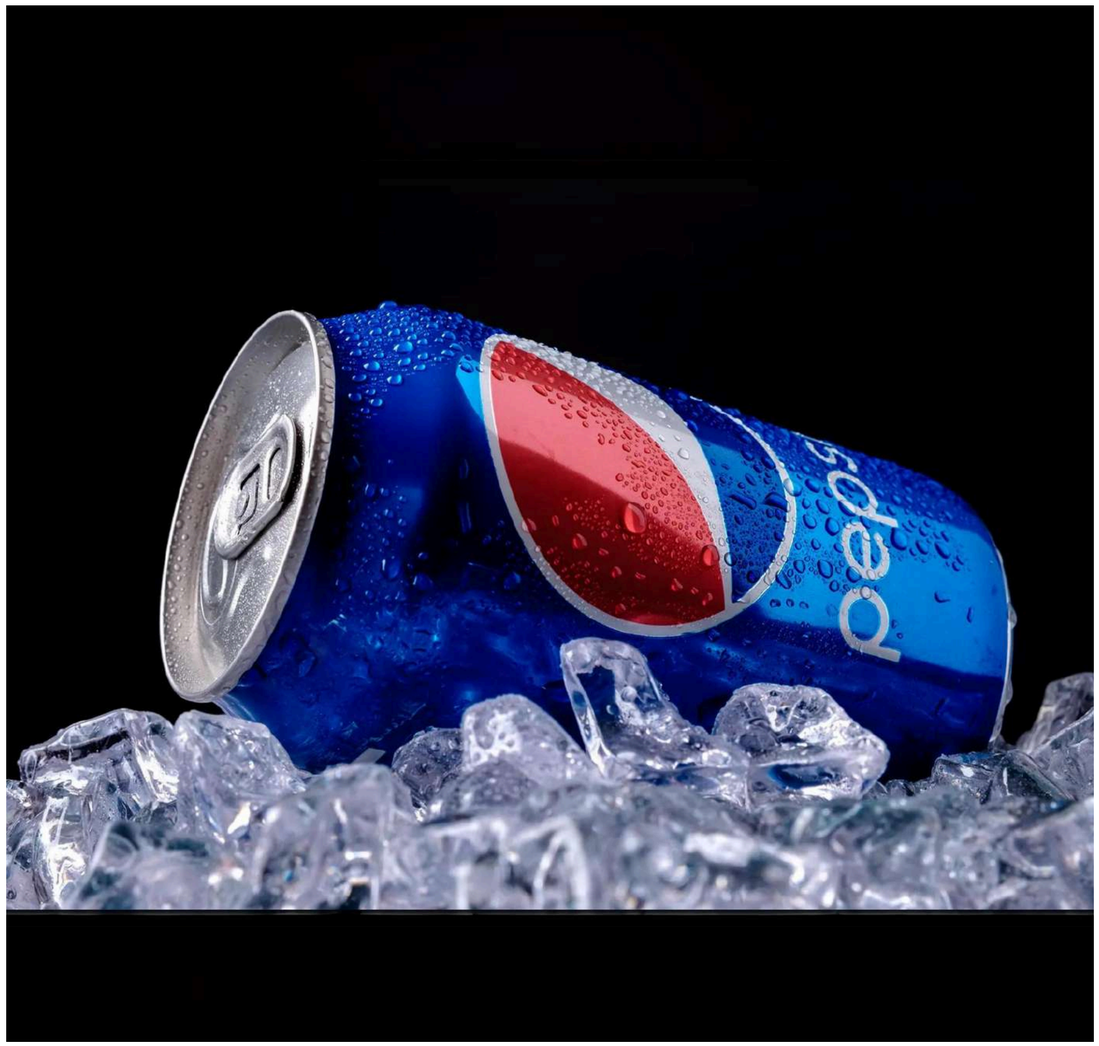
The assessee was a tax resident of Australia, whereas both PepsiCo Inc and Stokely-Van were tax residents of USA. For the years ending 30 June 2018 and 2019, PepsiCo Bottling Singapore Pty Ltd, an Australian company was nominated as the seller.

The assessee made payments to the seller company at the rates dictated by the EBAs rather than following an agreement made between themselves. The EBAs had provided the assessee with the right to use trademarks and other intellectual property, such as bottle and can designs. Additionally, under the PepsiCo Inc EBA, an implied license was legally granted to the assessee for distributing beverages like Pepsi and Mountain Dew, however, for the Stokely-Van EBA, a license had been explicitly permitted.

The Commissioner had considered the payments made by the assessee to the seller as royalties under the Income Tax Assessment Act 1936 (ITAA) and accordingly applied royalty withholding tax at the rate of 5%.

Additionally, the Commissioner further held that PepsiCo was liable under the law to deferred profit tax at 35% on account of executing schemes with ‘a principal purpose’ of serving tax benefits.

On appeal, the Hon’ble Trial judge upheld the Commissioner’s case against the assessee and dismissed the one against PepsiCo. Aggrieved, the assessee approached the Full Federal Court of Australia for relief.



Ruling

The Hon’ble Court ruled in favor of the assessee. It opined that the right to use trademarks and other IP, should have been laid down in the contract itself. It concluded its judgement by holding that the Commissioner had failed to undertake a holistic approach by not considering the mutual benefits and the limitations employed by PepsiCo on the assessee with respect to the use of the trademarks and IP. It was the majority view that the payments were not even remotely connected to the consideration for use of trademarks and IP. Thus, it was evident that they could not be royalties within the meaning of the law.

The Court further dismissed rejected the Commissioner’s view that the payments were made to PepsiCo instead of the Seller as the payments were made by direction. The Court opined that held that no payment by direction could be considered as made unless there existed an antecedent monetary obligation owed by the assessee to PepsiCo. Hence, the payments were not ‘income derived’ by a non-resident as per Section 128B(2B) of the ITAA and would not be levied with royalty with holding tax.

Source: Federal Court of Australia in PepsiCo Inc vs. Commissioner of Taxation vide [2023] FCA 1490 dated June 26, 2024.

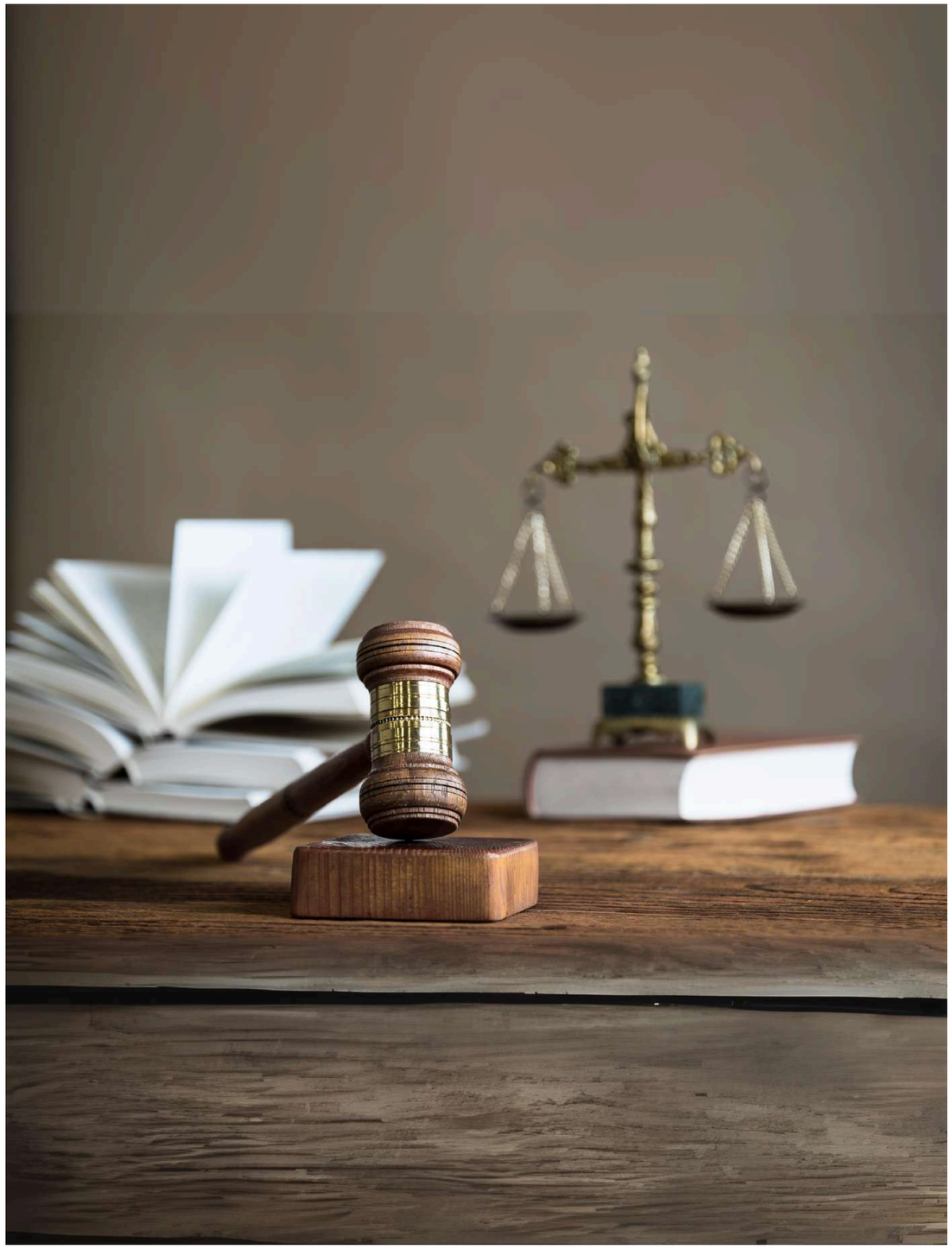
ITAT Holds Services Rendered Ancillary to Interconnect Services; Not Taxable as FTS Under the Act

Facts

The assessee was a company incorporated under the laws of Hong Kong and was engaged in the business of distribution of telecommunication products. The assessee filed its ROI for AY 2018-19 declaring Nil income while claimed a refund of INR 35.37 Lakh. Subsequently, the case was selected for scrutiny and due notices were issued by the Revenue.

During the year, the assessee had received reimbursement of connectivity services for international communication. Despite the fact that there was no DTAA between India and Hong Kong, the assessee contended that the services rendered with respect to the reimbursement were only in the nature of connectivity charges and did not qualify as FTS under section 9(i)(vii) of the Act. However, the Revenue held that the services fell under the category of 'managerial/ consultancy services' and hence were FTS taxable under the Act. Accordingly, an addition of INR 3.27 crores was made. Similarly, for AY 2019-20, the Revenue made an addition of INR 3.85 crores on the same basis.

Aggrieved, the assessee preferred an appeal before the Hon'ble Tribunal.



Ruling

The Hon'ble Tribunal ruled partially in favor of both the assessee and the Revenue. The Tribunal opined that the services rendered by the assessee were merely ancillary to enabling the provision of interconnect services and part of processing the product.

The Tribunal further relied on the case of the Hon'ble Supreme Court in CIT vs. Bharti Airtel Ltd 159 taxman 315 and concluded by holding that the amount received was undisputedly not managerial/consultancy in nature. However, the Tribunal noted that the assessee had earned 1% mark up on the reimbursement of the connectivity charges and in actuality that was the amount that had been earned by the assessee. The Tribunal stated that such amount can be brought to tax by the Revenue under the relevant provisions of the Act.

Source: Tribunal, Delhi in Huawei International Co. Limited vs. ACIT, International Taxation vide ITA No. 1815/Del/2022 dated June 19, 2024.

ITAT Holds Fees Reimbursed to Temenos Not Royalty or Fees for Technical Services; Relies on Previous Covered Case of Assessee

Facts

The assessee, M/s. Temenos Headquarters SA, was a company incorporated under the laws of Switzerland and was a wholly owned subsidiary of Temenos AG. The assessee was engaged in the business of providing the software license to its customers and its registered office was located in Geneva, Switzerland. The assessee provided non-exclusive, non transferable basis with no right to modification of source code the IP rights in the software system and any material provided to the clients were the exclusive IP of Appellant.

During the assessment year 2016-17, the assessee filed its original return of income on 30.11.2016, admitting a total income of INR 10.26 crore and filed revised return of income on 10.07.2017, declaring its revised total income as INR 4.57 crore. The case was selected for scrutiny and notices were duly issued to the assessee. In response to the notices, the assessee filed a reply stating the background of the company, nature of services, break up of payments made etc. However, the AO passed the impugned assessment order u/s. 143(3) r.w.s. 144C (3) of the Act.

Aggrieved, the assessee appealed before the CIT(A) which upheld the view undertaken by the AO. Consequently, the matter reached the Tribunal for adjudication.

Ruling

The Tribunal ruled in favor of the assessee. It noted that the assessee had made payment to Microsoft on behalf of its group entities across the world towards license fee for using Microsoft utilities. Subsequently, the cost had been apportioned to the respective group entities on the basis of number of users and the same was then paid to the assessee as reimbursement.

Furthermore, the Tribunal noted that the assessee did not involve the use/right to use the copy right belonging to Microsoft and hence the assessee could not have commercially exploited such software by replication or by sale or lease of software to third parties.

The Tribunal concluded its judgement on the basis of a similar issue that had been decided in the case of the assessee's group company M/s. Kony Inc vs DCIT in ITA No. 7462/Del/2018, dated 11.01.2023, for the assessment year 2015-16, which was then decided in favour of the assessee.

Source: Tribunal, Chennai in Temenos Headquarters SA vs. Deputy Commissioner of Income Tax ITA No. 1574 & 1575/Chny/2023 dated June, 12, 2024.

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