

# Lubrizol Advanced Materials Inc., ... vs The Acit (International Taxation), ... on 31 May, 2021

IN THE INCOME TAX APPELLATE TRIBUNAL,  
' ' D ' ' BENCH, AHMEDABAD  
(CONDUCTED THROUGH VIRTUAL COURT AT AHMEDABAD)

BEFORE SHRI RAJPAL YADAV, VICE PRESIDENT  
And  
SHRI WASEEM AHMED, ACCOUNTANT MEMBER

./ITA No. 2455/AHD/2018  
/Asstt. Year: 2015-16

Lubrizol Advanced Materials Inc., C/o. 6th and 7th Floor, Jaswanti Landmark, Mehra Industrial Estate, LBS Marg, Vikhroli (West), Mumbai-400079.	Vs.	A.C.I.T(International Taxation), Vadodara.
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PAN: AABCL7375B

(Applicant)

(Respondent)

Assessee by	:	Shri Nishant Shah, A.R
Revenue by	:	Shri Mohammed Usman, Sr.D.R

/Date of Hearing	:	12/04/2021
/Date of Pronouncement:		31/05/202 1

/O R D E R

PER WASEEM AHMED, ACCOUNTANT MEMBER:

The captioned appeal has been filed at the instance of the Assessee against the order of the Learned Assistant Commissioner of Income Tax, (International Taxation), Vadodara dated 28/12/2017 under s. 143(3) r.w.s. 144C of the Income Tax Act, 1961 (here-in-after referred to as "the Act") as per the direction of the Learned Dispute Resolution Panel-2, dated 26/09/2018 relevant to the Assessment Year 2011-2012.

ITA no.2455/AHD/2018 A.Y. 2015-16

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

1. On the facts and in the circumstances of the case and in law, the Learned Assessing Officer (Ld.AO) and Hon'ble Dispute Resolution Panel (Hon'ble DRP) erred in concluding that Mr. Timothy Earl Madden (Tim) and Mr. Matthew Scott Timmons (Matt) are in effect working for the Appellant and are rendering supervisions services on behalf of the Appellant.
2. On the facts and in the circumstances of the case and in law, the Ld.AO and Hon'ble DRP erred in concluding that the Appellant constitutes a Service Permanent Establishment (PE) in India under Article 5(2)(1) of India - USA Double Taxation Avoidance Agreement (DTAA).
3. On the facts and in the circumstances of the case and in law, the Ld.AO and Hon'ble DRP erred in taxing the reimbursement of salary as business profits under Article 7 of the India-USA DTAA, without appreciating the fact that these are recovered on cost to cost basis (i.e without any mark-up) and hence does not represent income.
4. Without prejudice to the above, assuming without admitting, if reimbursement of salary is considered as business profits, the Ld.AO and Hon'ble DRO erred in not allowing a corresponding deduction in computing alleged PE's income for amount disbursed by the Appellant to Tim and Matt under the provisions of Article 7(3) of India-USA DTAA.
5. On the facts and in the circumstances of the case and in law, the Ld.AO and Hon'ble DRP erred in computing the attribution to alleged Service PE based on total salary of Tim and matt amounting to Rs.5,12,19,548/- and not based on the actual reimbursement of salary to the Appellant of Rs.2,54,71,345.
6. On the facts and in the circumstances of the case in law, the Ld.AO and Hon'ble DRP erred in concluding that Tim and Matt are dependent agents of the Appellant and hence the Appellant constitutes and Agency PE in India under Article 5(4) of India-USA DTAA.
7. On the facts and in the circumstances of the case and in law, the Ld.AO and Hon'ble DRP erred in taxing the profits earned from offshore sales under Article 7(1) of the India-USA DTAA, without appreciating the fact that such sales have been concluded outside India, the title to the goods have passed outside India, profits from such sales have accrued/arisen outside India and therefore the profit from such sales are not taxable in India under section 5 of the Income-tax Act, 1961 (IT Act) and such profits are not taxable even under the India-USA DTAA.

8. On the facts and in the circumstances of the case and in law, the Ld.AO and Hon'ble DRP erred in considering attribution ratio of 100% of profits on offshore sales to the ITA no.2455/AHD/2018 A.Y. 2015-16 alleged Agency PE of Appellant, without considering the profit attribution principles as prescribed under the IT Act and Income-tax Rules 1962.

9. On the facts and in the circumstances of the case and in law, the Ld.AO erred in computing consequential interest under Section 234A of the Act.

10. On the facts and in the circumstances of the case and in law, the Ld.AO erred in computing consequential interest under Section 234B of the Act.

11. On the facts and circumstances of the case and in law, the Ld.AO erred in computing tax liability, by erroneously considering a refund of Rs.976,810 without appreciating the fact that the Appellant has not received any refund of Rs.9,76,810 not has it received any intimation under Section 245 of IT Act for adjustment of refund.

12. On the facts and in the circumstances of the case and in law, the Ld.AO has erred in computing interest under Section 234D of the IT Act, without appreciating the fact that the Appellant has not received any refund not has it received any intimation under Section 245 of IT Act for adjustment of refund.

13. On the facts and circumstances of the case and in law, the Ld.AO erred in initiating penalty proceedings under Section 271(1)c of the IT Act.

The Appellant craves leave to add/or to alter, amend, rescind, modify the grounds herein above and/or produce further documents before or at the time of hearing of this Appeal.

3. The 1st interconnected issue raised by the assessee vide ground numbers 1 to 5 is that the learned DRP erred in treating Mr. Timothy Earl Madden(Tim) and Mr. Mathew Scott Timmons (Matt) as the employee of the assessee and accordingly attributed their salary to the supervisory PE.

4. The facts in brief are that the assessee in the present case is a foreign company, based in USA. The assessee has one associated enterprises (AE) namely M/s LZAM India in Vadodara Gujarat India. The associated enterprise of the assessee was in the process of establishing a new manufacturing plant at Dahej in India. For this purpose, the AE M/s LZAM entered into intercompany Services agreement vide dated 21-04-2010 with the assessee for providing engineering, technology, design and project supervisory services. As per the agreement, the AE ITA no.2455/AHD/2018 A.Y. 2015-16 was to pay actual cost plus markup @ 10% to the assessee. Accordingly the assessee sent its personnel to India for supervisory of the project.

4.1 As per clause 5(2)(k) of the DTAA, the assessee was treated as supervisory PE and accordingly filed its return of income declaring income of Rs. 1,89,21,572/- only.

4.2 However, the AO found that there were two more employees of the assessee namely Mr. Timothy Earl Madden (Tim) and Mr. Mathew Scott Timmons (Matt) who were involved with the supervisory services provided in connection with the establishment of plant of the associated enterprises in India. But their salary amounting to Rs. 2,54,95,912/- which was also partly reimbursed by the AE to the assessee was not considered in the income of the supervisory PE. Accordingly a show cause notice was issued upon the assessee.

4.3 The assessee in response to such notice submitted that the employees namely Tim and Matt were seconded to the AE M/s LZAM India as full-time working employee who are acting as the Managing Director and getting salary from the AE. However, for the administrative convenience part of the salary was paid by the assessee in the USA but the same was reimbursed to it on cost to cost basis by the AE. Furthermore, M/s LZAM India deducted taxes on the salary paid to impugned managing directors including the amount reimbursed to the assessee. Both the employees offered their income to tax in India. As such, these are not the employees of the assessee and did not render any services to the assessee with respect to the supervisory PE in India. As such, whatever work was looked after by those individual (Managing Directors) with respect to ongoing project of M/s LZAM India must be in the capacity of the managing director of the AE M/s LZAM India and not on behalf of the assessee. Accordingly, the salary of such employees cannot be attributed to the supervisory PE.

ITA no.2455/AHD/2018 A.Y. 2015-16 4.4 However, the AO found that in the event of opening ceremony of the manufacturing unit at Dahej in India a news release was published on the website of the assessee wherein Mr. Tim was referred as managing director of South Asia of the assessee. This information suggests that employee namely Mr. Tim was working with the assessee.

4.5 Furthermore, on perusal of the personal profile of these employees namely Mr. Tim and Mr. Matt, it is known that they were highly skilled, professional and specialized in supervising the growth and expansion plant. Likewise, these employees have been working on different projects at different locations throughout the globe as employee of the assessee. Thus, it is crystal clear that these employees were working in supervising capacity on behalf of the assessee and constituting the part of the activities carried on with respect to supervisory PE in India.

4.6 The AO also found that the contention of the assessee that the global income of these employees have been suffered the tax in India is not acceptable for the reason that the copies of the passport and bank statements were not furnished.

4.7 Similarly, the AO found that the assessee in the earlier assessment year has itself admitted that the employees namely Mr. Tim and Mr. Matt are visiting India for supervisory purposes in connection with the manufacturing plant at Dahej in India.

4.8 In view of the above, the AO disregarded the contention of the assessee and added salary of above mentioned individual (Managing Directors) including the amount reimbursed by the AE M/s LZAM India to assessee amounting for Rs. 2,54,95,912/- to the income of the supervisory PE of the assessee.

5. Aggrieved assessee preferred an appeal to the learned DRP.

ITA no.2455/AHD/2018 A.Y. 2015-16 5.1 The assessee before the learned DRP besides reiterating the submissions as made before the AO contended that the individuals namely Mr. Tim and MATT are not its employee and was nowhere shown in their profile on website that they are employee of the assessee and working as global business head of South Asia. Rather they are the managing director and employee of Indian AE M/s LZAM India.

5.2 The assessee has never admitted that these employees were visiting in India in supervising the project on behalf of the assessee. As such these employees are the full-time managing directors of the AE in India and based in India.

5.3 The assessee further submitted that those individual namely Mr. Tim and Mr. Matt are not its employees and therefore it is not possible for it to supply copies of their passport and the bank statement. Furthermore, Mr. Tim left the organization and Mr. Matt has returned to overseas country. Moreover the copies of the passports and the bank statements of the employees are not relevant in determining the PE of the assessee as their return of income and Form-16 issued by their employer has already been submitted. Therefore, nothing adverse can be decided against the assessee in the absence of these documents.

6. The learned DRP after considering the submission of the assessee confirmed the order of the AO in part by observing as under:

7.4 We have also examined the invoices raised by the assessee on its AE. It is clear that these two persons were working for assessee and were paid by the assessee. They were deputed to its AE and invoices were raised in relation to salaries of these employees. If we read assessee's Service Agreement for the deputation of these employees, it would be clear that these employees were visiting India for the purpose of supervision of overall working of LZAM (India) and were functioning as Managing Director of LZAM (India).

7.5 It is noted that both the agreements with LZAM India are all related to the new manufacturing facility being set up by LZAM India with the assistance of the assessee. The assessee itself has offered income from Service PE. The services provided by these two employees are also directly related to assessee's Service PE and receipts on account of salary of employees have to be considered as assessee's income from Service PE.

7.6 The AO has treated entire salary reimbursement of Rs.2.54 crores as income of assessee. However, in our opinion, only profit related to the receipt has to be taxed.

ITA no.2455/AHD/2018 A.Y. 2015-16 7.7 As per the Service Agreement, the assessee was to be paid its expenses with a mark up of 10%.The total expenditure in relation to these two employees was Rs.5,12,19,548/-, as per the details submitted by assessee on Page 494 of paper book, enclosed as Annexure- A. Therefore, the profit @ 10% comes to Rs.51,21,944/-. The AO is directed to restrict the addition to this amount i.e 51,21,955/-. The AO is directed to delete the balance addition.

7. Being aggrieved by the order of the learned DRP the assessee is in appeal before us.

8. The learned AR before us filed a paper book running from pages 1 to 100 and contended that the persons namely Mr. Tim and Mr. Matt are not the employee of the assessee. As such these are the persons who are working exclusively for the PE of the assessee in India as the managing directors. They are getting their salary after the requisite payment of tax in India. The learned AR in support of his contention drew our attention on the employment contract which are placed on pages 92 to 100 of the paper book.

8.1 The learned AR also drew our attention on the reimbursement contract between the assessee and its PE dated 1-1-2010, placed on pages 49 to 59 of the paper book.

9. On the contrary, the learned DR submitted that the persons namely Mr. Tim and Mr. Matt are the employees of the assessee who were working for the project of the AE in India. Furthermore, there is no information available on record whether these persons have filed their income tax return in India. The learned DR vehemently supported the order of the authorities below.

10. We have heard the rival contentions of both the parties and perused the materials available on record. The issue in the case on hand revolves whether the employees namely Mr. Tim and Mr. Matt are the employees of the assessee Viz a viz rendering services in connection with the supervisory PE or these are the employees of the AE namely M/s LZAM India in India. From the perusal of the order ITA no.2455/AHD/2018 A.Y. 2015-16 of the authorities below we find that during the year under consideration salary of these employees was paid by the AE M/s LZAM India on which M/s LZAM India also deducted eligible taxes and issued TDS certificate in Form-16. These employees also filed their return of income in India and copy of the same were furnished before the AO. This fact has not been disputed by the Revenue.

10.1 Likewise, on perusal of agreement for reimbursement of employee cost between assessee and M/s LZAM India dated 21st April 2010 placed on page 49-59 of paper book, we find the assessee is the ultimate parent company of the M/s LZAM India which is engaged in the business of manufacturing and selling of natural product. The assessee required personnel having high skilled and expertise in connection with its business in India. Accordingly personnel were deputed in India. It was agreed upon by the parties that the deputed personnel will be the employee of the M/s LZAM India and will work under the supervision and guidance of M/s LZAM India. The LZAM India will pay salary to those personnel and bear the cost of all the benefit provided to them. It was also agreed upon that the part of the salary will be paid in foreign currency to those personnel for the purpose of convenience but the quantum of same would be decided by the M/s LZAM India as per rules and regulation applicable in India. The relevant portion of the agreement reads as under:

(c) For the operation of its business including the various projects that LZAM India undertake in the manufacture and sale of natural products, trading of industrial products and support service for business development in India and other south Asian countries, it needs to employ personnel having the requisite skills and expertise who would be deputed to LZAM India.

(D) The depute has expressed his willingness to be deputed to LZAM India upon terms and conditions to be mutually agreed upon between LZAM India and the depute.

(E) The deputed employee shall be working for LZAM India and will be under the supervision control and management of LZAM India as an employee of LZAM India only.

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2.0 DISBURSEMENT OF PAY AND REMUNERATION TO EMPLOYEES 2.1 It is expressly provided and agreed between the Parties that for administrative convenience and to meet employee requirements, LZAM India has requested and LZAM has agreed to disburse on behalf of LZAM India, the pay and remuneration of the employee deputed by LZAM to the employment of LZAM India.

2.2 The delivery of the pay and remuneration by LZAM will be made from outside India only.

ITA no.2455/AHD/2018 A.Y. 2015-16 2.3 LZAM India shall from time to time provide the details of remuneration paid in India and need to pay outside India of the employee to LZAM.

2.4 LZAM shall from time to time raise debit notes on LZAM India with the details of remuneration disbursed on behalf of LZAM India to the employee of LZAM India outside India.

2.5 LZAM India shall reimburse LZAM the actual amount disbursed to LZAM India employee on its behalf.

2.6 All benefits to be provided to the employee in India shall be provided by LZAM India only.

3.0 RIGHT AND OBLIGATIONS OF THE PARTIES 3.1 The sole obligation of LZAM under this agreement is to disburse the employee to LZAM India, which would cease upon actual deputation of the employee to LZAM India. For the removal of doubt, it is clarified that LZAM is not providing any Services to LZAM India by deputing the employee to LZAM India or through the deputed employee.

10.2 Subsequently, the employment agreement dated 30th April 2010 was entered between the AE M/s. LZAM India and the employees namely Mr. TIM which are placed on pages 92 to 95 of the paper book. Similarly employment agreement dated 1st July 2014 was made between AE M/s LZAM India and Mr. Matt, which is placed on pages 98 to 100 of paper book. On perusal of the employment agreement it is revealed that the employees are working exclusively for the AE M/s LZAM India. The relevant clause of the employment agreement reads as under:

In the case of Mr. TIM This Agreement serves to confirm your employment in Lubrizol Advanced Materials India Private Limited (hereinafter referred to as "the Company" in accordance with the following term and conditions:

1. EMPLOYMENT Effective as of January 1, 2010, you will be employed by the Company in the position of Managing Director (for Lubrizol Advanced Materials activities in India) for a period of five years (each such year being herein after referred to as a "contract year" at our Mumbai office. Your employment shall be subject to your transfer to another location within India if required by the Company.

You will work solely under the control, direction and supervision of the Company and in accordance with the policies, rules and guidelines of the Company. You will perform the duties and exercise the powers that the Company may assign to you from time to time.

2. REMUNERATION 2.1 Salary ITA no.2455/AHD/2018 A.Y. 2015-16 Your basic salary is set forth in Annexure A attached hereto and incorporated herein by reference. The gross remuneration is subject to statutory withholdings and Indian income taxes, as applicable.

In the case of Mr. MATT This Agreement serves to confirm your employment in Lubrizol Advanced Materials India Private Limited (hereinafter referred to as "the Company" in accordance with following terms and conditions:

1. EMPLOYMENT Effective as of July 15,2014, you will be employed by the Company in the position of Managing Director (for Lubrizol Advanced Materials activities in India) for a period of three years ( each such each being hereinafter referred to as a "contract year" at our Mumbai office. Your employment shall be subject to your transfer to another location within India if required by the company.

You will work solely under the control, direction and supervision of the Company and in accordance with the policies, rules and guidelines of the Company. You will perform the duties and exercise the powers that the Company may assign to you from time to time.

10.3 The above facts which represent the primary evidences have not been disputed by the authorities below. Thus, no adverse inference can be drawn against the assessee merely on the informations displayed on the website. Furthermore, the informations displayed on the website cannot precede the documents which are available on record for deciding the issue on hand. Likewise, the documents in the form of passport and bank statement which were not filed by the assessee, cannot help the Revenue. In view of the above, we are not convinced with the finding of the learned DRP. Accordingly, we direct the AO to delete the addition made by him. Hence the ground of appeal of the assessee is allowed.

11. The next issue raised by the assessee vide ground Nos. 6 to 8 is that learned DRP erred in treating Mr. Tim and Mr. Matt as agent of the assessee as per clause 4 of Article 5 of India-US DTTA and accordingly treating the offshore sale as part of the income taxable in India.

12. The assessee in the year under consideration has sold certain goods to its AE M/s LZAM India in pursuance of purchase agreement which was signed by Mr. Tim and Matt on behalf of AE M/s LZAM being managing directors. As per the AO these 2 employees were working for the assessee



and accordingly he was of the view that ITA no.2455/AHD/2018 A.Y. 2015-16 there exists a dependent agency PE with respect to such transaction as per the article 5 of the DTAA. Accordingly, the AO was of the opinion that such transaction should be brought to tax under the agency PE and sought clarification from the assessee.

12.1 The assessee in response to the notice submitted that Mr. Tim and Mr. Matt are not its employees. As such these persons are the employees of the AE based in India. The purchase agreement was signed by them on behalf of the AE as their authorized signatory being managing directors. Thus these 2 employees of AE based in India cannot be construed as business connection in India under explanation 1 to section 9(1) (1) of the Act.

12.2 The assessee further submitted that the provisions of article 5 can be attracted if there is a person working only on behalf of the foreign entity and the transaction entered by that person are not at the arm length price and such person should also maintain the inventory. But there is no person on its behalf working in India which can be termed as dependent agency PE. As such the entire sale of goods was carried out by the assessee itself from outside India. Mr. Tim and Matt have not provided any services to it in this transaction of sale of the goods for the reason that they are the employees of AE and their salary was paid by the AE. Further the transaction of sale were made at arm length price. Hence there was not any dependent agency PE formed in India.

12.3 Furthermore, it was submitted by the assessee that sale of the goods represents offshore transaction meaning thereby the sale was executed and completed outside India, the risk and title of the goods were transferred outside India and payment was also made outside India. As such the offshore sale is not taxable in India as per the provision of section 5 and 9 of the Act. The assessee in this regard also relied on judgment of Hon'ble SC in case of Ishikawajima-Harima Heavy Industries Limited vs. DIT reported in 288 ITR 408.

ITA no.2455/AHD/2018 A.Y. 2015-16 12.4 However, the AO disregarded the contention of the assessee by holding that these 2 employees namely Mr. Tim and Mr. Matt are working on your behalf with the AE (assessee) in India which establishes the agency PE in India. Therefore, such transaction should be brought to tax in India. Further assessee failed to substantiate its claim based on documentary evidence that the sale of goods was not part of the project operation in India in connection with the intercompany service agreement. Accordingly the AO worked the amount of profit attributable to India as per the provision of rule 10 of the Income tax rule to the tune of Rs. 7,74,861/- and added the same to the total income of the assessee.

13. Aggrieved assessee preferred an appeal to the learned DRP who confirmed the order of the AO in part by observing as under:

10.1 We have gone through the assessee's submission and AO's finding. The AO has discussed this issue in detail in his order and for the sake of brevity, we are not reproducing the same.

10.2 On going through the details, it is clear that the Intercompany Service Agreement and the Agreement for reimbursement of employee cost were related to setting up of manufacturing plant including its commissioning, etc. One of them was working as MD of LZAM India, ostensibly on secondment. The facts of the case clearly indicate that the employees of the assessee were acting in India wholly or almost wholly, on behalf of the assessee and the employees had the opportunity to exercise authority to conclude contracts of purchase of goods. Thus the assessee satisfies the Dependent Agent PE conditions. Therefore, we are of the opinion that an Agency PE is formed. The DRP holds that the action of the AO in treating 50% of the turnover of the sales is not based on any material. The same can be calculated on the basis of the global profitability of the assessee or 10% whichever is higher.

In view of the above, the objection of assessee is rejected.

14. Being aggrieved by the order of the learned DRP, the assessee is in appeal before us.

15. The learned AR before us submitted that the purchase agreements was signed by the persons namely Mr. Tim and Mr. Matt in the capacity of directors on ITA no.2455/AHD/2018 A.Y. 2015-16 behalf of the AE in India. Therefore, there is no question of treating the supply of the goods as attributable to the service PE in India.

16. On the contrary, the learned DR before us vehemently supported the order of the authorities below.

17. We have heard the rival contentions of both the parties and perused the materials available on record. At the threshold, we note that we have already given a finding that the individuals namely Mr. Tim and Mr. Matt are not the employees of the assessee. Rather these are the employees of the AE of the assessee namely M/s LZAM India. Therefore, the purchase agreement signed by them was entered on behalf of the AE in the capacity of authorized signatory being the directors. Accordingly, it can be concluded that there was no connection in the employees and the assessee which can establish the agency PE in India. Thus the whole basis for treating the transaction of impugned sale and purchase as attributable to the agency PE is not sustainable. Furthermore, the agency PE can be attracted as per the relevant provisions of article 5 and 7 but we note that the conditions as specified therein have not been complied with. Accordingly, we are not convinced with the finding of the learned DRP and direct the AO to delete the addition made by him. Hence the ground of appeal of the assessee is allowed.

18. In the result, the appeal of the assessee is allowed.

Order pronounced in the Court on 31/05/2021 at Ahmedabad.

Sd/-  
(RAJPAL YADAV)  
VICE PRESIDENT

Sd/-  
(WASEEM AHMED)  
ACCOUNTANT MEMBER

(True Copy)

Ahmedabad; Dated  
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31/05/2021