

## AAR rules that the reimbursement of R&D expenses under Cost Contribution Agreement is not liable to tax in India

The Authority for Advance Rulings (“AAR”) has delivered an important ruling holding that the reimbursement of research and development (“R&D”) expenses under Cost Contribution Agreement (“CCA”) is not liable to tax in India.

### Facts of the case

The Applicant, ABB Limited (“ABB India”) is a company incorporated in India. As per ABB Group’s Research & Development (“R&D”) policy, all basic R&D activities were coordinated and directed through ABB Research Limited, Zurich (“ABB Zurich”). The group entities could avail the benefit of the R&D activities by entering into a CCA with ABB Zurich, whereby the participating entities (“ABB entities”) agree to contribute towards the R&D expenses incurred by ABB Zurich based on an allocation key. ABB entities are allowed a royalty-free unlimited access to the results of the research undertaken including any Intellectual Property Rights (“IPRs”) generated from the R&D. The IPRs generated are legally owned by ABB Zurich. A fee is paid by ABB entities to ABB Zurich for acting as a coordinating agency under the CCA.

### Main issue before the AAR

- Whether the Applicant’s contribution to the R&D expenses incurred by ABB Zurich would constitute income under the provisions of the Income-tax Act, 1961 (“Act”)?
- In absence of any permanent establishment of ABB Zurich in India, whether the proposed cost contribution could be taxable in India?

### Applicant’s contentions

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- [Transfer Pricing Documentation and Dispute Resolution: Making or Breaking the Corporate Tax](#)
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### Contributors

- [Sriram Seshadri](#)
- [Ashka Dave](#)

### Contacts

- The payment under the CCA was merely reimbursement of R&D cost and cannot be treated as income of ABB Zurich.
- Even if the payment was regarded as income of ABB Zurich, it is not liable to tax in India in absence of PE for ABB Zurich in India.

### Revenue's contentions

- The payment should be regarded as 'fees for technical service' in the hands of ABB Zurich and should be liable to tax in India.

### Ruling of the AAR

- The payment cannot be regarded as fees for technical services. Sharing the results of the R&D activities with ABB entities cannot be regarded as managerial, technical or consultancy services.
- ABB Zurich did not have any right to withhold the research information or results from the ABB entities. The CCA did not even contemplate granting of license by ABB Zurich to the ABB entities, which were entitled to avail the fruits of research without any restriction.
- While legal ownership of IPRs generated through the R&D activities rests with ABB Zurich, the ABB entities were the beneficial owners thereof. The contribution under the CCA cannot be regarded as consideration for transferring or conferring any rights or benefits of R&D activities.
- The R&D Board of ABB group and ABB Zurich devised cost allocation keys. Further, the CCA provided that the income derived from the commercial exploitation of IPRs would be reduced from the R&D expenses. These clauses in the CCA indicated that it was merely a joint group initiative to derive the benefits of R&D activities.
- Thus, ABB Zurich did not transfer any rights in the nature of intellectual property to the ABB entities which could be covered within the definition of royalty either under India Switzerland Tax Treaty or section 9(1)(vi) of the Act.
- Further, the cost reimbursement, even if regarded as business income, will not be liable to tax in India in absence of PE for ABB Zurich in India and the Applicant was not obliged to withhold tax from the reimbursement of R&D expenses.

- Bobby Parikh, Mumbai  
Phone: +91 22 3021 7010  
Email ID:  
[bobby.parikh@bmr advisors.com](mailto:bobby.parikh@bmr advisors.com)

- Mukesh Butani, New Delhi  
Phone: +91 11 3081 5010  
Email ID:  
[mukesh.butani@bmr advisors.com](mailto:mukesh.butani@bmr advisors.com)

- Rajeev Dimri, New Delhi  
Phone: +91 11 3081 5050  
Email ID:  
[rajeev.dimri@bmr advisors.com](mailto:rajeev.dimri@bmr advisors.com)

- Abhishek Goenka, Bangalore  
Phone: +91 80 4032 0100  
Email ID:  
[abhishek.goenka@bmr advisors.com](mailto:abhishek.goenka@bmr advisors.com)

- Sriram Seshadri, Chennai  
Phone: +91 44 4298 7000  
Email ID:  
[sriram.seshadri@bmr advisors.com](mailto:sriram.seshadri@bmr advisors.com)

- Gagan Malik, Singapore  
Phone: +65 6408 8004  
Email ID:  
[gagan.malik@bmr advisors.com](mailto:gagan.malik@bmr advisors.com)

## BMR comments and analysis

This is an important ruling upholding that the contributions under the CCA are not liable to tax in India. Several multinational companies implement the CCA as a part of their IP development strategy. While such arrangements are more prevalent in R&D activities, it is also witnessed in developing other intangible assets. This ruling clarifies the withholding tax aspects of such contributions. The ruling also reiterates the principle that tax is to be withheld at source only if the underlying payment is liable to tax in India.

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