



Royalties and Fees for technical services

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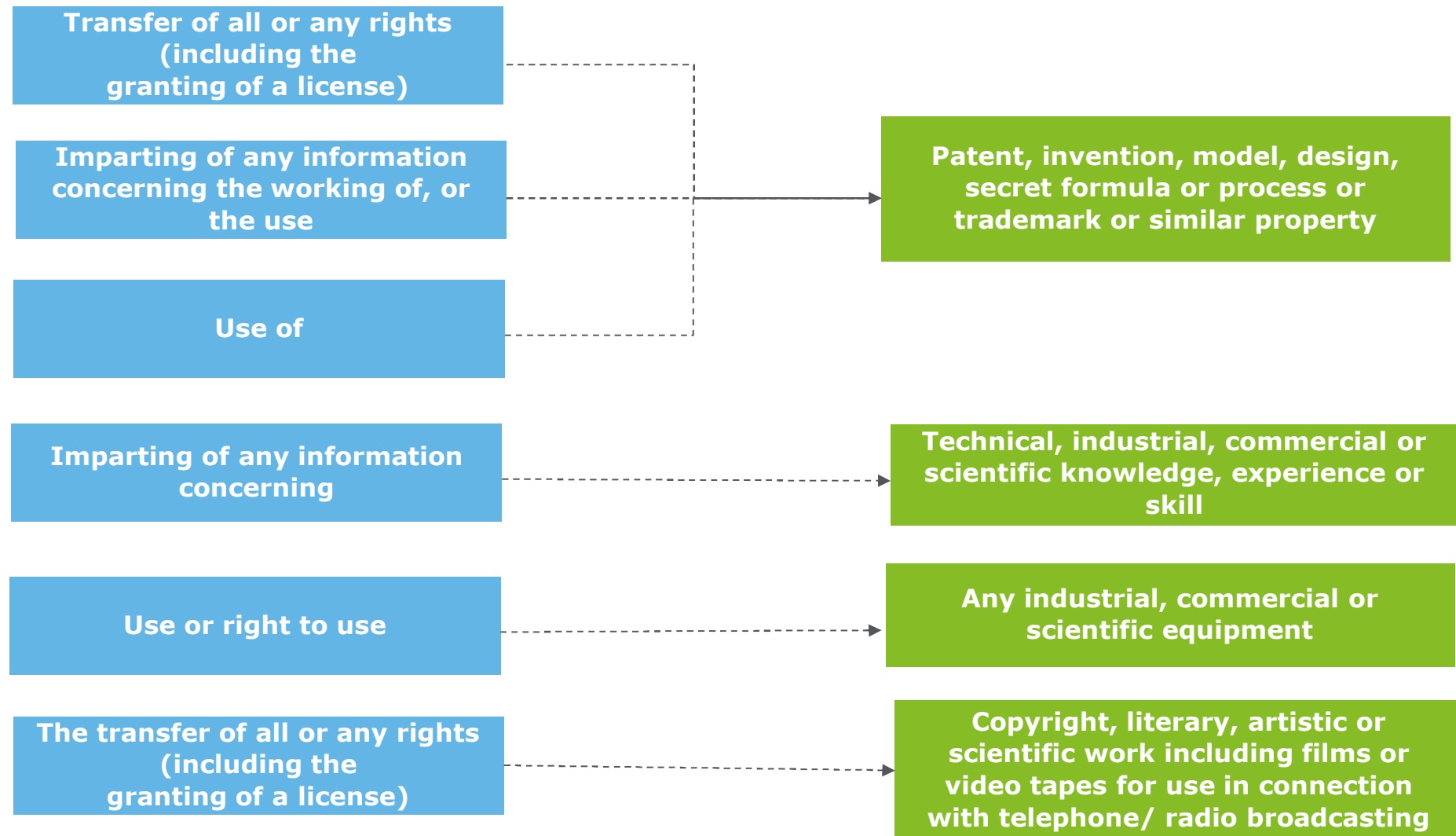
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Royalty

Definitions

Royalty – Definition under the ITA

Consideration (including lumpsum consideration) for:



- Rendering of any services in connection with above

Capital Gains, amounts referred to in section 44BB and consideration for sale, distribution and exhibition of cinematographic films excluded

Royalty – Definition under the ITA ...(Cont'd)

Finance Act 2012 inserted following explanations with retrospective from 1 April 1976:

Explanation 4

- The transfer of right, property or information includes transfer of all or any right for use or right to use computer software (including granting of a license) irrespective of the medium through which such right is transferred

Explanation 5

- Royalty shall include consideration in respect of any right, property or information whether or not such right, property or information (a) is under the control of the payer, (b) is used by the payer, (c) is located in India

Explanation 6

- The expression “process” includes transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret.

Court rulings on retrospective amendments

- Any amendment in the provision of the Act does not have the effect of automatically altering the analogous provisions of the Double Taxation Avoidance Agreements.

[WNS North America Inc. vs. ADIT (152 TTJ 145) Mumbai Trib and DIT v. Nokia Networks OY (212 Taxman 68) Delhi HC]

- **Contra: in Verizon Communications Singapore**
- The Madras High Court relied on the amended definition of royalty under domestic law and ruled that the definition of royalty in the India-Singapore tax treaty is the same as the definition of royalty under domestic law, and therefore denied treaty benefits.

Exempted Royalty

- Royalty payable in respect of computer software exempted if-
 - Lump sum payment is made by a resident
 - For transfer of all or any rights relating to computer software supplied along with a computer or computer-based equipment
 - By a non-resident manufacturer
 - Under any scheme approved under the Policy on Computer Software Export, Software Development and Training, 1986 of the Government of India

“Computer software” means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data

Royalty – Definition under the Model conventions

OECD Model – Article 12.2

- payments of any kind received
- as a consideration
- for the use of, or the right to use
 - any copyright of literary, artistic or scientific work
 - including cinematograph films
 - any patent, trademark, design or model, plan, secret formula or process
- for information concerning industrial, commercial or scientific experience

UN Model – Article 12.3

- payments of any kind received
- as a consideration
- for the use of, or the right to use
 - any copyright of literary, artistic or scientific work
 - including cinematograph films, **or films or tapes used for radio or television broadcasting**
 - any patent, trademark, design or model, plan, secret formula or process
- **for the use of, or the right to use, industrial, commercial or scientific equipment**
- for information concerning industrial, commercial or scientific experience

Royalty – Definition (certain notable variations under the Indian treaties)

Country	Definition
Singapore	Includes gains from alienation of IPRs
US	Includes gains derived from the alienation of IPR which are contingent on the productivity, use, etc.
Morocco, Namibia, Russia, Trinidad & Tobago, Turkmenistan, Kazakhstan and Kyrgyz Republic	Specific inclusion of software
Libya	Rental and other income from cinematograph films considered as business profits and not Royalties
Greece, Israel, Sweden, Netherlands	Does not include 'Equipment Royalty'
Belgium, France, Kazakhstan, Netherlands and Spain	Does not include 'Equipment Royalty' – MFN clause
Australia	Includes FIS

Royalty

Interpretation Issues under the ITA

Royalty – Interpretation issues under ITA

Meaning of 'imparting of information concerning technical, industrial, commercial or scientific knowledge, experience or skill' ('know-how'):

- Every information concerning the industries or commercial ventures does not qualify as royalty. Some sort of expertise or skill is required. Some sort of confidentiality/ secrecy & exclusivity is required. It should not be something readily available in the market.
(CIT vs. HEG Ltd. (263 ITR 230) (MP))
- Allowing access and downloading business information reports, which is a compilation of publicly available commercial information is not royalty.
(Dun & Bradstreet Espana SA (272 ITR 99) (AAR))
- Royalty signifies an extended or perpetual use for the payee, where as FTS are relevant for one time job and useful for which they are rendered. For example, the copyrights, designs or plans confer a time-spread advantage to the payee. Similarly information regarding an industrial 'experience', in the context, has to be interpreted as conferring similar perpetual or extended advantages, else there was no need to make a distinction between royalties and technical service fees .
(Kirloskar Oil Ltd. (83 ITD 436) (Pune))

Royalty – Interpretation issues under ITA

Definition of use

- The application or employment of something; a long-continued possession and employment of a thing for the purpose for which it is adapted (Black Law Dictionary)
- Criteria for determination of right to use or use of equipment (OECD TAG Report)
 - Customer has physical control / possession over the equipment;
 - Customer has significant interest in the equipment;
 - Provider does not guarantee revenues;
 - Provider does not use the property concurrent to provide services to others.
- Use or right to use depends on the relation which exists as a matter of fact between the person and the property (**Tourapark Pty Ltd v FCT [12 ATR 842]**)
- The expression 'use' (of copyright) is not used in a generic and general sense of having access to a copyrighted work. The emphasis is on the 'use of copyright or the right to use it'. In other words, if any of the exclusive rights, which the owner of copyright, is made over to the customer so that he could enjoy such rights either permanently or for a fixed duration of time and make a business out of it, then it would fall within the ambit of phrase 'use or right to use the copyright' (**Factset Research Systems Inc [182 Taxman 268]**)

Royalty

Interpretation issues under tax treaties

Royalty – Interpretation issues under tax treaties

Engineering Drawings / designs / technical documentation:

- Supply of machine design to enable buyer to operate it without transfer of license of patent/copyright, thereby not allowing buyer to manufacture machine itself, cannot be regarded as Royalty. [**Neyveli Lignite Corporation Ltd. (243 ITR 459) (Mad) & Mitsui Engg. & ship Bldg. Co. Ltd (259 ITR 248 (Del))**]
- Supply of technical documentations like designs, process, specification etc. before commencement of production is not royalty [**Nisshinbo Ind. Inc. vs. ACIT (83 ITD 748)(Chennai)**]
- Consideration for outright purchase of drawings and designs (i.e. transfer of ownership per se) is not royalty [**CIT v Davy Ashmore India Ltd. 190 ITR 626 (Cal), Leonhardt Andra Und Partner, GmbH v. CIT (2001) 249 ITR 418 (Cal), Swadesh Polytex (38 ITD 326)**]
- Engineering drawings & designs supplied to an Indian Co. for lump sum consideration for setting up plant for its own client with the right to use, sell or transfer it is not alienation of right/property contingent upon productivity/use or disposition but an 'out and out' sale of property. [**Pro-quip Corporation (AAR) (255 ITR 354)**]

Royalty – Interpretation issues under tax treaties

Software:

- Distinction between 'copyrighted articles' and 'copyright' is relevant. Payment for 'copyrighted article' is not in the nature of royalty. [**DIT v. Ericsson A.B. [2012] 204 Taxman 192 (Del HC)**].
- Software copyright supplied along with hardware as its integrated part is not Royalty. [**Lucent Technologies Hindustan Ltd (92 ITD 366)(Bang) & Motorola Inc. etc. 95 ITD 269 (Del.) (SB)**]
- Following the decision of Tribunal in the case of Motorola Inc. (supra) it was held that the amount received by the assessee under the license agreement for allowing use of the software was not 'royalty' either under the ITA or under DTAA but was in the nature of business profits, chargeable to tax in its hands under article 7 of the DTAA. It was also held that the other receipts on account of maintenance charges and training fees being incidental to the software receipts assume the same character as that of software receipts and the same are liable to be taxed accordingly. [**Infrasoft Ltd v. ADIT 125 TTJ 53 (Del)**].
- Where consideration paid by assessee to non-resident suppliers for acquiring software was actually made for 'copyrighted article' and not for 'use of copyright or transfer of right to use of copyright', payment made by assessee to vendors of software could not be taxed as royalty (**DDIT v Reliance Communication Ltd 90 taxmann.com 358**).

Royalty – Interpretation issues under tax treaties

Software continued...:

- Software embedded in hardware that enabled use of hardware sold resulted in case of sale of copyrighted article and cannot be characterized as royalty [**ZTE Corporation (392 ITR 80) and HITT Holland Institute of Traffic Technology B.V. (78 taxmann.com 101)**]
- Sale of a standardized but special purpose software and not customized software is not Royalty under Art 12 of India-Japan DTAA. [**Dassault Systems K.K. (322 ITR 125)(AAR)**]
- Ready made off the shelf computer programme acquired for business is not Royalty [**Samsung Electronics Ltd. (93 TTJ 658)**] overruled by **Karnataka High Court in the case of CIT v. Samsung Electronics Co. Ltd. [2012] 345 ITR 494**]
- Sale of canned software would tantamount to sale of goods and not royalty [**TCS vs. State of Andhra Pradesh (271 ITR 401) (SC)**]
- Downloading of software to computer or making backup copies etc. would be necessary acts for enabling use of product. The same would not be royalty as it would not amount to transfer of copyright or right therein, but only transfer of copyrighted product. [**Capgemini Business Services (India) Ltd Vs. ACIT (158 ITD 1) (Mum. Tribunal)**]

Royalty – Interpretation issues under tax treaties

Database access

- Information supplied in the nature of data. The data did not arise due to exploitation of the know-how generated by the skills or innovation. Hence, the payment for the same does not amount to royalty. [**P. T. McKinsey Indonesia (2013) (141 ITD 357) (Mum.)**]
- Payment for purchases of Business Information Reports which is a compilation of data in user friendly manner cannot be termed as 'royalties' under India-Spain Tax Treaty [**Dun & Bradstreet Information Services India (P.) Ltd. (2011) (338 ITR 95) (Bom.)**]
- Payments made for subscription fees for specialized database containing copyright material would not be regarded as royalty. The payment was for use of copyrighted material and not for use of copyright [**DCIT Vs. Welspun Corporation Ltd. (55 ITR(T) 405) (Ahmd.)**]
- The fees paid for procurement of information, which is in the nature of specialized technical knowledge about exploration of oil and gas and not general in nature would be covered under the definition of royalty [**ONGC Videsh Ltd. (2013) (155 TTJ 114) (Del.)**]

Royalty – Interpretation issues under tax treaties

Online advertisement

- Search engine advertisement payments to non-residents not in the nature of royalty – [**Pinstorm Technologies Pvt. Ltd. (45 SOT 278) (ITAT – Mumbai)**]
- Payment for advertising does not involve use or right to use by the client any industrial, commercial or scientific equipment; Uploading the advertisement was entirely the responsibility of the advertiser and client had no right to access the portal of the advertiser. [**Yahoo India (P.) Ltd. (2011) (140 TTJ 195) (Mum.)**]
- Concept of Equalisation Levy introduced in Budget 2016 to tax such payments @6% for online advertisement made to non-residents not having PE in India.

Fees for Technical Services (FTS)

Provisions under ITA

FTS – Definition under the ITA

FTS - Explanation 2 to Section 9(1)(vii) of the Act

“means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel)”

Exclusion

- consideration for any construction, assembly, mining or like project undertaken by recipient; or
- consideration which would be income chargeable under the head "Salaries"

Exhaustive Definition under the Act

FTS – Definition under the ITA

Key Components of FTS

Managerial	Technical	Consultancy
<ul style="list-style-type: none">• Management functions• Management of affairs/ people	<ul style="list-style-type: none">• Expertise in technology• Knowledge/ skill related to technical field	<ul style="list-style-type: none">• Advisory services• Overlaps with technical services

Provision of services of technical or other personnel

- Providing personnel to render technical service
 - For instance, engineers, technicians, consultants, etc. to furnish services for a fee
- Deputation arrangements?

Fees for Technical Services (FTS)

Provisions under tax treaties

FTS – Definition

- No FTS clause under OECD or UN Model (Article on FTS at draft stage in UN Model)
- FTS as defined under most Indian tax treaties

FTS clause	FTS clause + Make available
<ul style="list-style-type: none">• FTS means<ul style="list-style-type: none">• payments of any amount in consideration• for the rendering of managerial, technical or consultancy services• including the provision of services of technical or other personnel• does not include payments for services mentioned in Independent/ Dependent Personal Services	<ul style="list-style-type: none">• FTS means<ul style="list-style-type: none">• payments of any amount in consideration• for the rendering of managerial, technical or consultancy services• including the provision of services of technical or other personnel• does not include payments for services mentioned in Independent / Dependent Personal Services• which make available technical knowledge, experience, skill know-how or processes• Consist of the development and transfer of a technical plan or technical design• Excluding services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment

FTS – Definition

Key Components of FTS

Managerial

- Management functions
- Management of affairs
People

Technical

- Expertise in technology
- Knowledge / skill related to technical field

Consultancy

- Advisory services
- Overlaps with technical services

Provision of services of technical or other personnel

- Providing personnel to render technical service
 - For instance, engineers, technicians, consultants, etc. to furnish services for a fee
- Deputation arrangements?

Excludes payments for services mentioned in Independent / Dependent Personal Services

- Excludes payments which are covered by Article 14/15

Fees for Included Services ('FIS')

- Deals with Technical Services - but, coverage is of FIS.
- Definition of FIS (Refer for example Indo - US Treaty, India-Canada Treaty)
- "For purposes of this article, "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services :
 - a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received ; or
 - b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design."

Managerial services excluded under the FIS definition

Concept of 'Make Available'

- Person acquiring the service is enabled to apply the technology
- Mere requirement of technical input by a person providing services does not necessarily mean that technical knowledge is "made available"
- Use of a product which embodies technology cannot be considered to make technology available
- Cases of development and transfer of technical plans or designs / making technology available may include engineering services, architectural services, computer software development, technical training, etc.

**"Make available" significantly narrows
down the scope of FTS**

Services that could make available technology

- Categories of technical and consultancy services that could make available technology are as under:
 - Bio-technical services
 - Food processing
 - Environmental and ecological services
 - Communication through satellite or otherwise
 - Energy conservation
 - Exploration or exploitation of mineral oil or natural gas
 - Geological surveys
 - Scientific services
 - Technical training
- Services that generally involve either the development and transfer of technical plans or technical designs, or making technology available:
 - Engineering services including the sub-categories of bio-engineering and aeronautical, agricultural, ceramics, chemical, civil, electrical, mechanical, metallurgical, and industrial engineering
 - Architectural services
 - Computer software development

An overview of selected India's DTAA (FTS/ FIS)

US	Singapore	China	Russia
<p>rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services are:</p> <p>(i) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment ; or</p> <p>(ii) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design</p> <p>Exclusions:</p>	<p>services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel) if such services :</p> <p>(i) are ancillary and subsidiary.....; or</p> <p>(ii) make available technical knowledge, experience, skill, know-how or processes,; or</p> <p>(iii) consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein</p>	<p>The term "fees for technical services" as used in this Article means any payment for the provision of services of managerial, technical or consultancy nature by a resident of a Contracting State in the other Contracting State, but does not include payment for activities mentioned in paragraph 2(k) of Article 5 and Article 15 of the Agreement</p>	<p>payments ...in consideration for the rendering of any managerial, technical or consultancy services including the provision of services by technical or other personnel but does not include payments for services mentioned in Articles 14 (independent personal services) and 15 (dependent personal services) ...</p>

An overview of selected India's DTAA (FTS/ FIS)

US	Singapore	China	Russia
<ul style="list-style-type: none"> • Services that are ancillary and subsidiary as well as inextricably and essentially linked, to the sale of property ... • For teaching in or by educational institution • for services for the personal use of the individual or individuals making the payments • Covered by Article relating to professional services • Services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment used in connection with the operation of ships or aircraft in international traffic 	<p>Similar exclusions as in India and US tax treaty with further 2 exclusions:</p> <ul style="list-style-type: none"> • for services rendered in connection with an installation or structure used for the exploration or exploitation of natural resources referred to in paragraph 2(j) of Article 5 • services referred to in paragraphs 4 and 5 of Article 5 		

Absence of FTS

- Conveys no special treatment envisaged for FTS
 - Eg. Mauritius, Philippines, Thailand, UAE, Bangladesh, Greece, Indonesia, Libya, Mozambique, Myanmar, Nepal
- Article 7 of DTAA may apply
 - If PE in India, then taxable in India
 - If no PE in India, then not taxable in India
- OR
- Other income Article required to be examined
- OR
- Governed by the provisions of the domestic tax law

No human intervention

- It was necessary to determine whether any human intervention was involved at any stage of rendering of services. [**CIT v Bharati Cellular Ltd (193 Taxman 97)**]
- Roaming charges paid by one telecom operator to another telecom operator cannot be characterized as fees for technical services as no human intervention was involved in roaming services [**Tata Teleservices Ltd v ITO (93 taxmann.com 22)**]
- When any technology or machinery is developed by human and put to operation automatically that operates without human interface or intervention, then usage of such technology cannot per se be held as rendering of 'technical services [**Siemens Ltd (142 ITD 1)**].
- Providing standardized facility of BSE Online Trading System to members of stock exchange by Bombay Stock Exchange did not involve any human element [**CIT v Kotak Securities Ltd (67 taxmann.com 356)**]

Impact of Most Favoured Nation clause

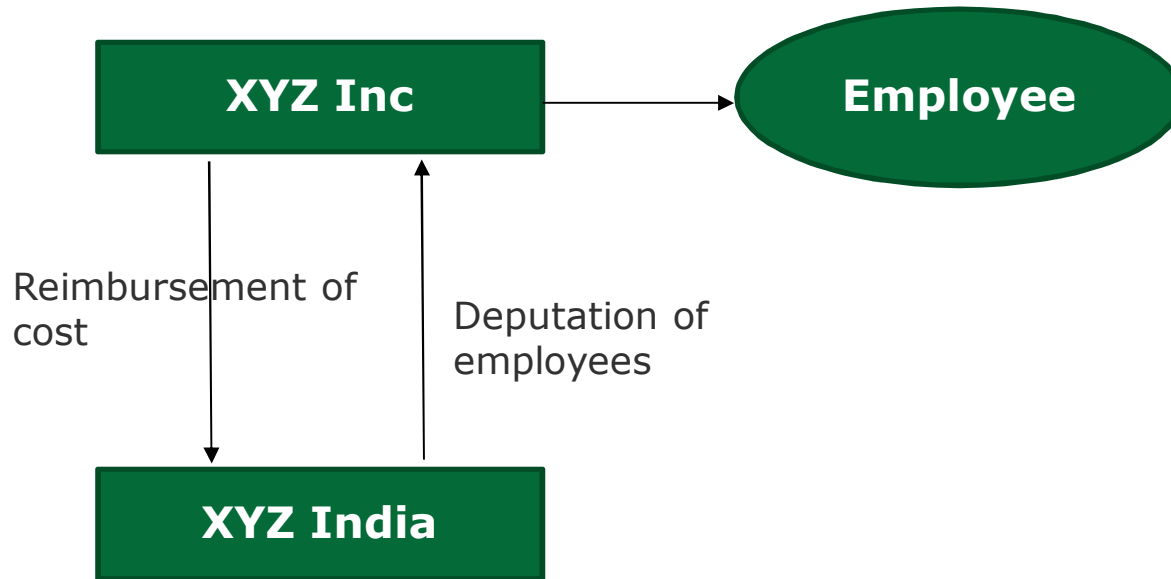
- Most favoured nation clause - an indirect amendment
 - Reduced rate of tax charged in a subsequent tax treaty; and/or
 - Narrower scope of the applicability of an Article of a subsequent DTAA
 - For eg. India-France treaty
- Generally stated in protocol
- FTS / Royalty Article has to be read with the MFN clause
 - MFN may restrict FTS to FIS
- MFN trigger may be subject to subsequent notification
- Examples of Indian tax treaties with MFN status
 - India -Netherlands tax treaty
 - India -Belgium tax treaty
 - India -France tax treaty
 - India -Sweden tax treaty
 - India -Switzerland tax treaty
 - India -Spain tax treaty

Fees for Technical Services (FTS)

Interpretation issues

FTS – Interpretation issues

Secondment of employees



- Tax implication dependent upon the terms of deputation agreement

	FTS
XYZ India to qualify as an economic employer of employee. Salary cost re-charged at actuals by XYZ Inc. to XYZ India	X
XYZ India to qualify as an economic employer of employee. Salary cost re-charged at mark up by XYZ Inc. to XYZ India	✓
XYZ Inc. deputed employee for providing services to XYZ India. Cost at actuals re-charged by XYZ Inc.	✓

FTS – Interpretation issues

Telecom services

Whether telecom / satellite related services are FTS under the Act?	FTS
Customer payments for subscribing to mobile telephone services	X
Payments made by telecom companies for interconnect / port / access / toll service for carrying calls between two different networks	X
Payments for transmission of data from India to customers location outside India using satellite, under sea cable, leased line, etc.	X
Payments for internet services agreement for bandwidth	X

Skycell Communications Limited (251 ITR 53)(Mad) / Bharti Cellular Limited (SC)

FTS – Interpretation issues

Repairs

Whether repairs and maintenance are FTS?

	FTS
Payment for engineering designs and plans in connection with repairs in India	✓
Payment for providing engineers for repair work in India	✓
Payments for repair work carried outside India.	✗

Lufthansa Cargo India (P.) Ltd. (91 ITD 133)

FTS – Interpretation issues

Credit Rating

Whether credit rating related services are FTS under India – US DTAA?

	FTS
Payment for corporate credit rating issued by credit rating agencies	X
Payment for suggestions for meeting certain standards so that credit rating can be granted and providing reports for to do for future	X

Hindalco Industries Limited (96 TTJ 1009) (TMUM)

FTS – Interpretation issues

Hotel management fees

Whether payments for typical hotel management services are FTS?

	FTS
Payment for recruiting and training staff	✓
Payment for advertising and marketing of hotel rooms	✗
Payment for provision of experts / specialists to run the hotel	✓
Payments for other common services such as loyalty schemes, Privileged customer programs, etc.	✓

FTS – Interpretation issues

Consulting services

Whether consulting services are FTS under the ITA and DTAA?

	FTS
Payment for supply of data and information which is commercial / industrial nature	✓
Payment for devising marketing / sales strategy / business strategy / portfolio strategy	✓
Payment for consulting services for registration and enforcement of IPRs	✓
Payment for service that allows customers to access and download business information reports	✗

First three services should not qualify as FTS with DTAA having make available clause

FTS – Interpretation issues

Export commission

Whether commission paid for identifying and procuring orders is FTS?

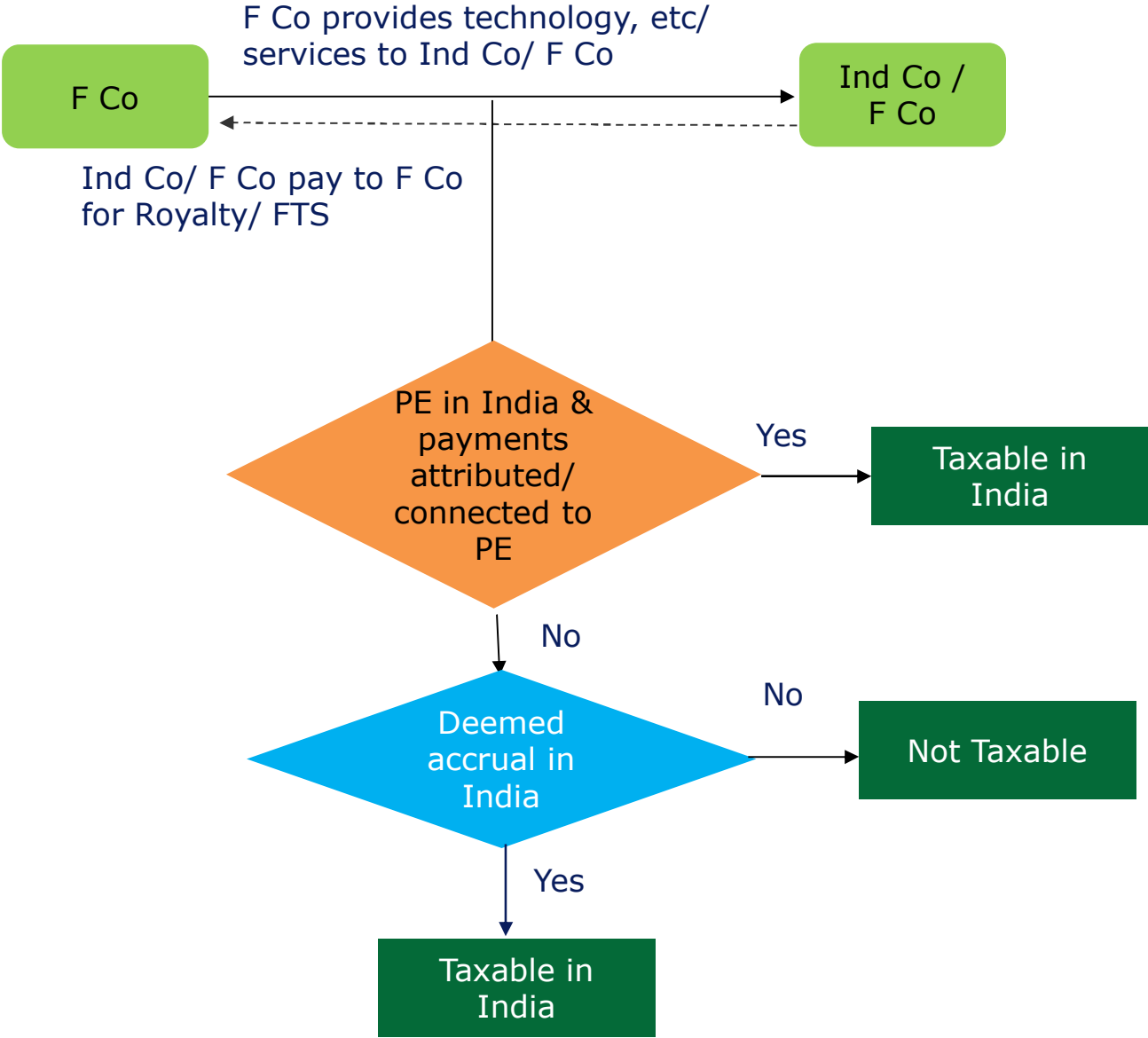
	FTS
Payment for services of agents who may actively engage in identifying and procuring orders for exporters	X

Taxation of Royalty/FTS

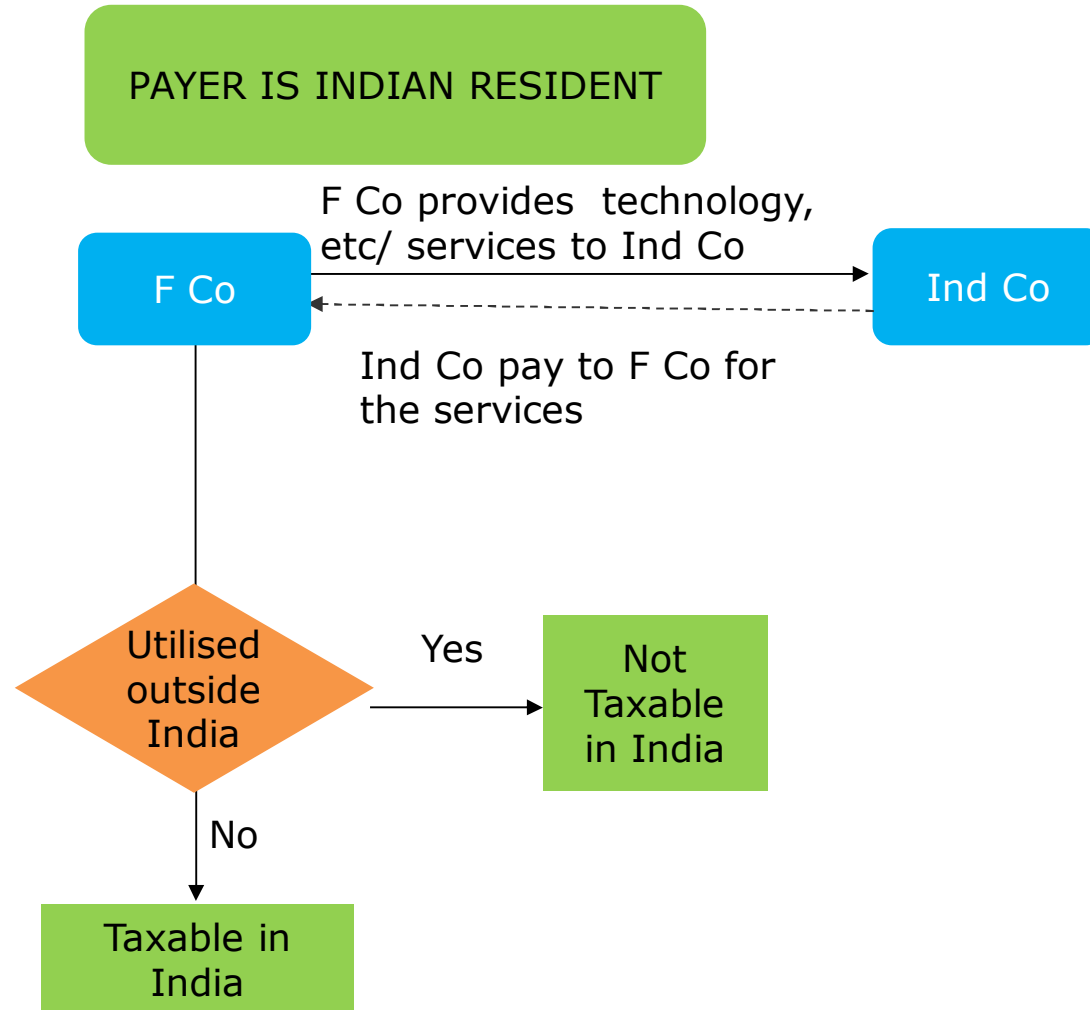
Taxability under the Act

- Scope of taxable income of a foreign company
 - Income accrues or arises in India
 - Income is deemed to accrue or arise in India
 - Income received in India

Taxability of a foreign company in India under the Act

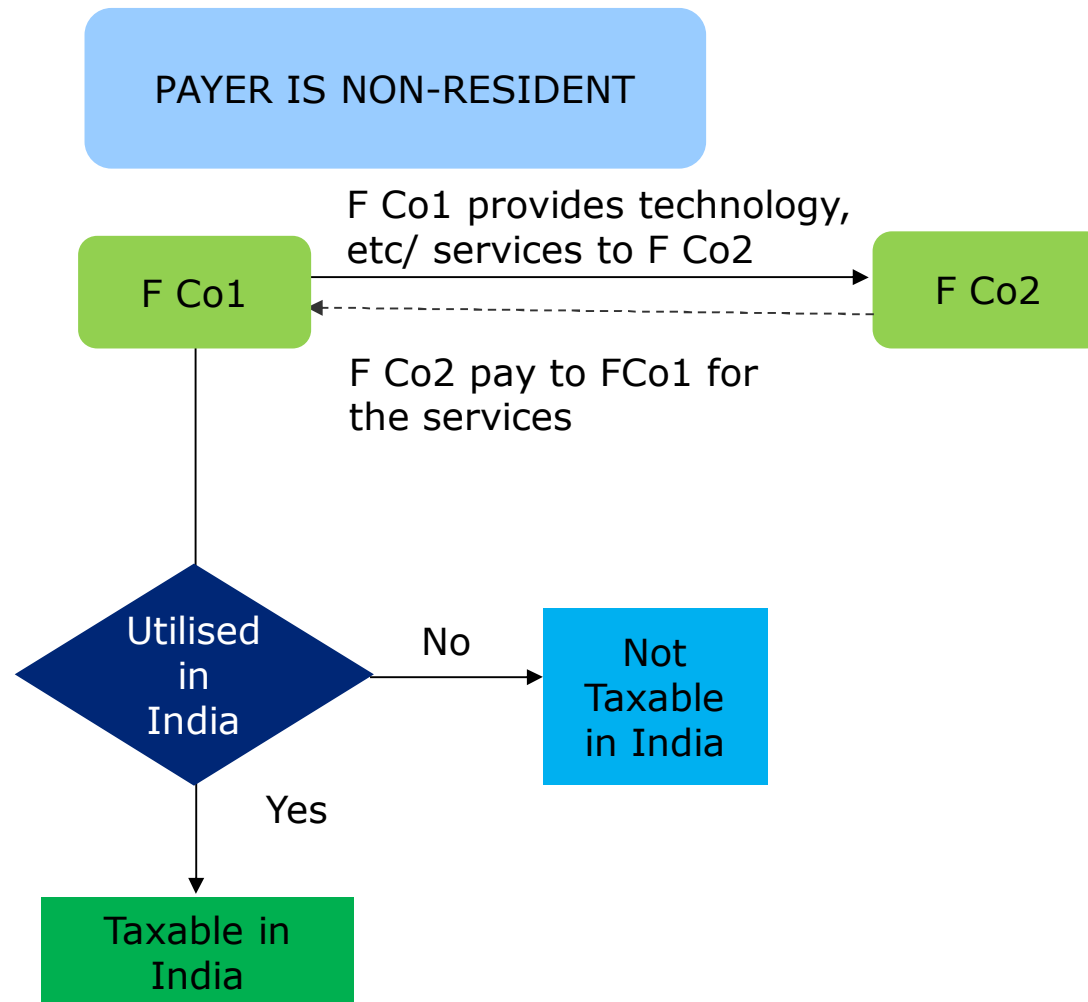


Deeming rules under the Act



Utilised in a business or profession carried on in India or for the purpose of earning income from any source in India

Deeming rules under the Act



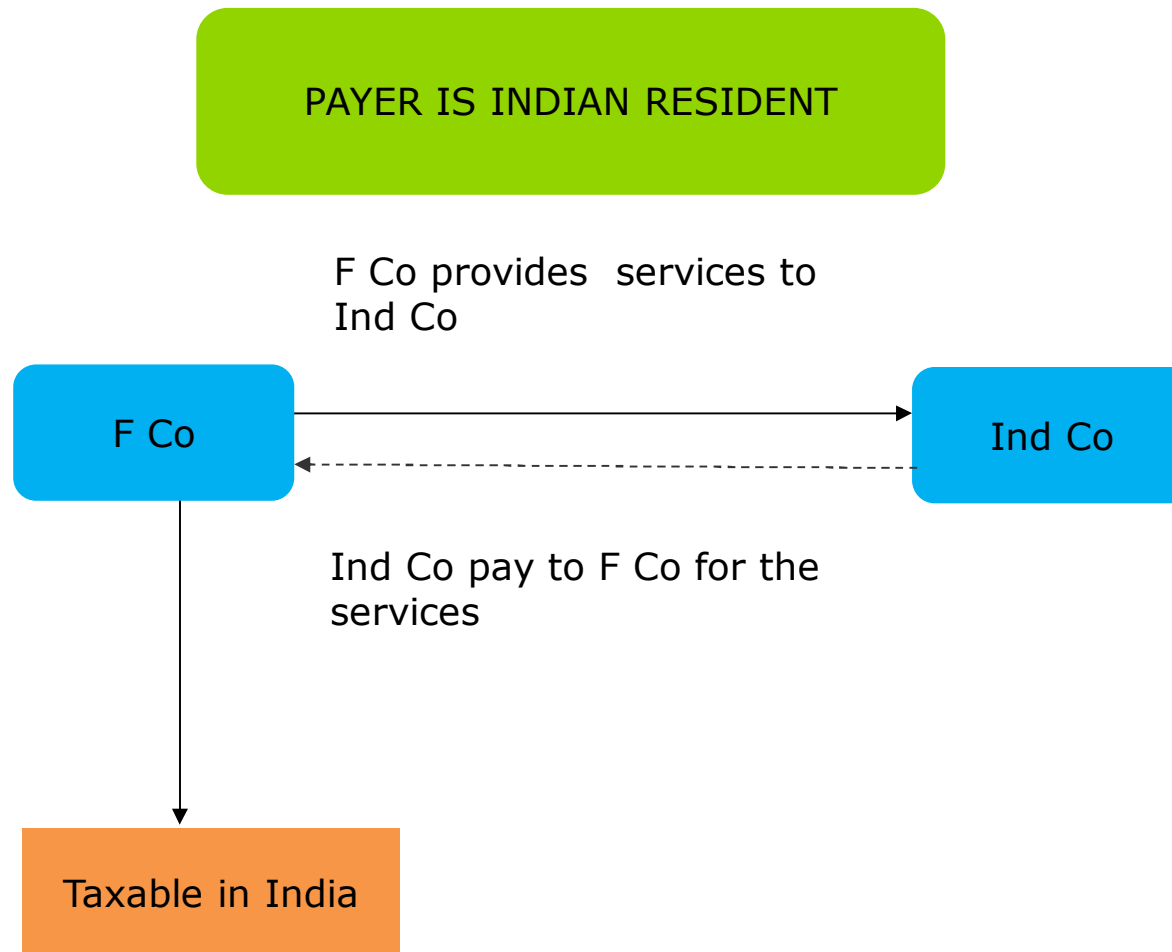
Utilised in a business or profession carried on in India or for the purpose of earning income from any source in India

Deeming rules under the Act

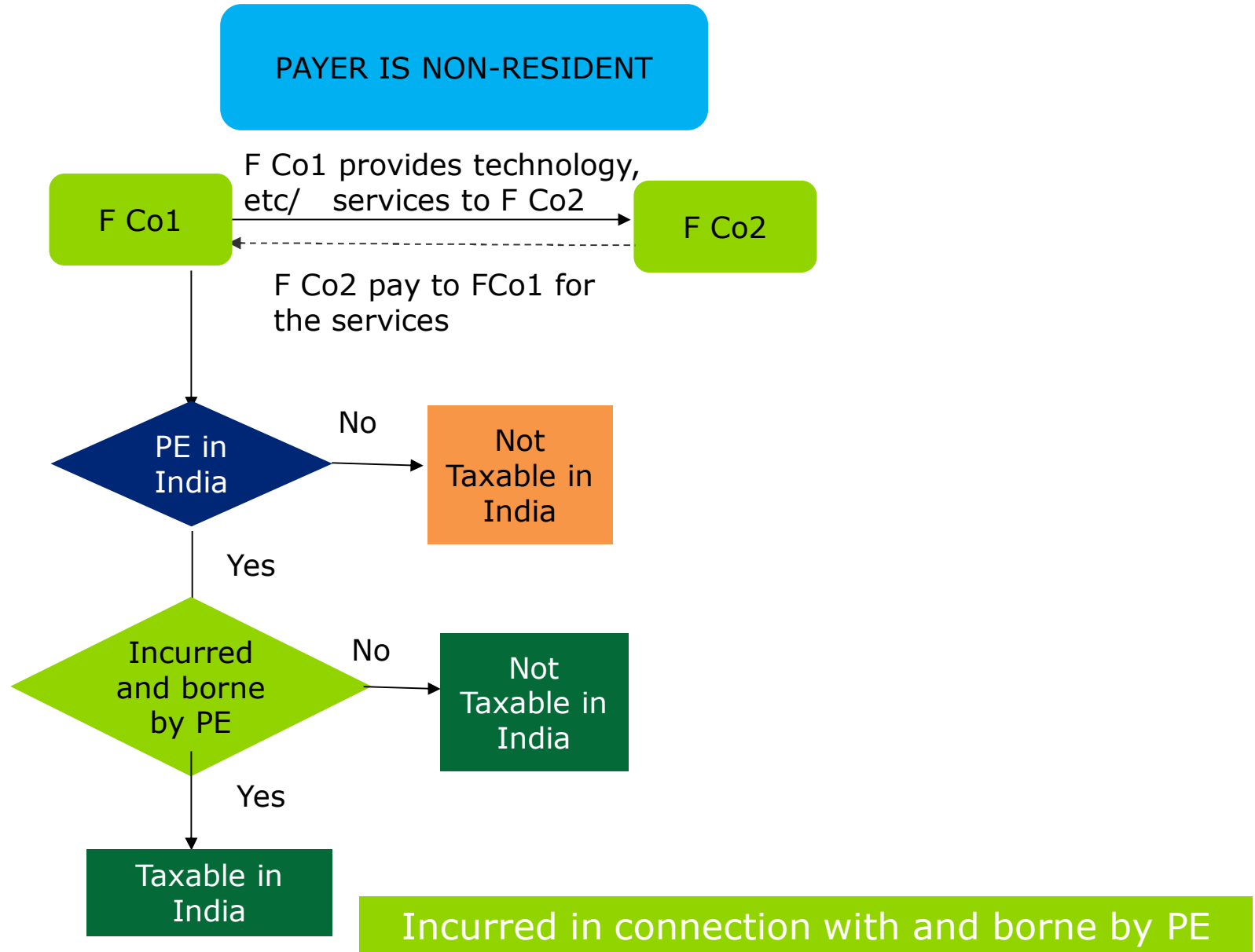
Payer of royalty/ FTS	Utilization*	Taxable in India
Indian resident	In India	Yes
	Outside India	No
Non-resident	In India	Yes
	Outside India	No

*Utilised in a business or profession carried on in India or for the purpose of earning income from any source in India

Deeming rules under the Treaties



Deeming rules under the Treaties



Deeming rules under the Treaties

Payer of royalty/ FTS	Utilization*	Taxable in India
Indian resident	Anywhere	Yes
Non-resident	India	Yes
	Outside India	No

*Incurred in connection with and borne by PE

Certain issues in taxability of Royalty/ FTS

Meaning of 'Source' in/outside India.

Asia Satellite Telecommunication Company (85 ITD 478) (Delhi Tribunal)

- 'source' does not refer to the person who makes the payment, but it refers to the activity which gives rise to the income

Aktiengesellschaft Kuhnle Kopp and Kausch (262 ITR 513) (Madras HC)

- Royalty paid by resident on export sales to a non-resident outside India
- Held that royalty was paid out of the export sales and hence, source for royalty is the sales outside India
- Since the source for royalty is from the source situate outside India, the royalty paid on export sales is not taxable

Certain issues in taxability of Royalty/ FTS

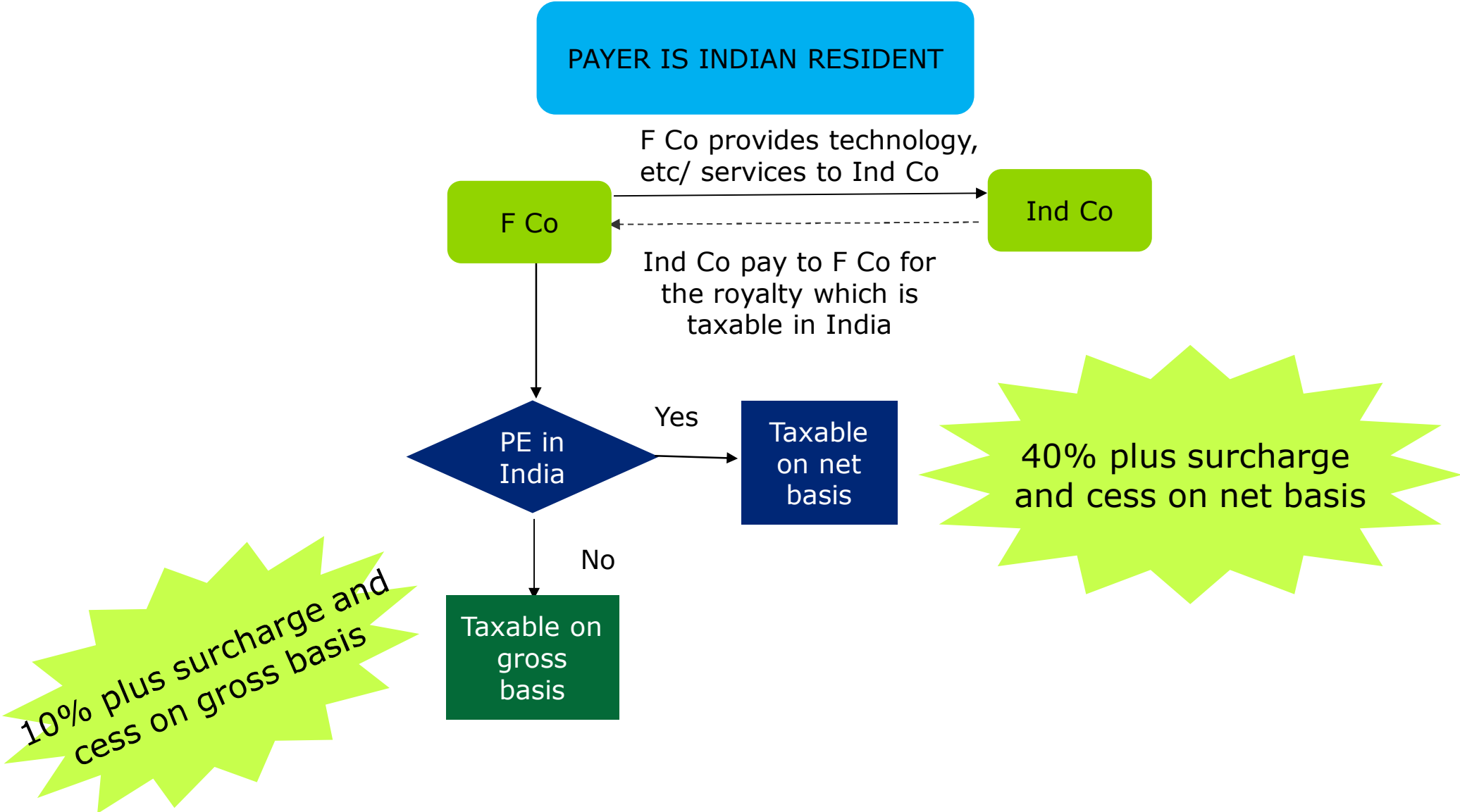
Whether Royalty/ FTS is chargeable in the year of 'accrual' or 'payment'

Article 12(1): Royalties arising in a Contracting State (CS) and 'paid' to a resident of the other CS may be taxed in the other CS:

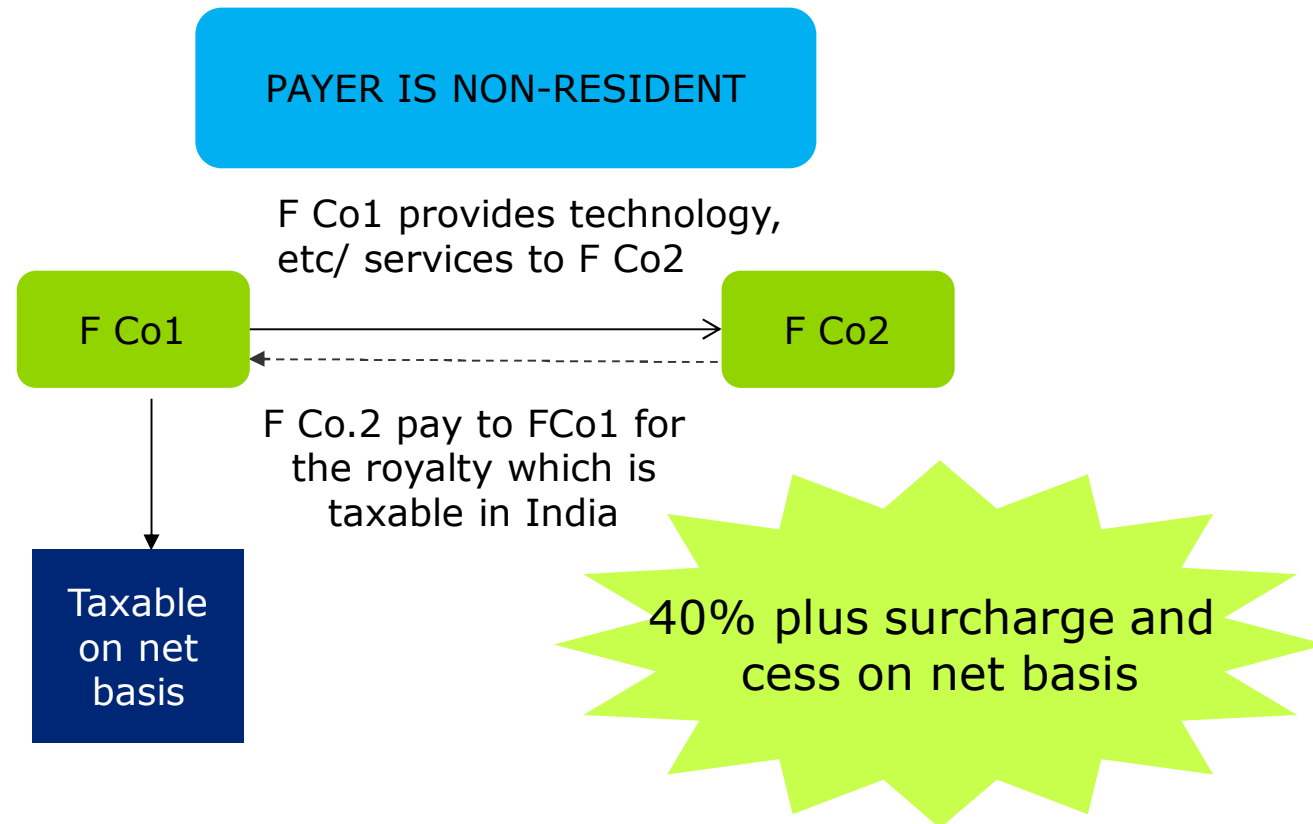
- Credit entry in the books of accounts of the payer to the account of the payee amounts to its receipts by the payee. [**CIT v. Standard Triumph Motor Co. Ltd (201 ITR 391) (1993)(SC)**].
- For taxability U/A 12 twin conditions of 'accrual' and 'payment' is required to be satisfied [**National Organic Chemicals Ltd. (96 TTJ 765) (2004)(Mum)**]
- **Flakt (India) Limited (AAR)**: For the purpose of taxing such royalties/fees in India, Para (1) is wholly irrelevant. It is also pointed out above that Para (2) thereof clearly lays down that the amount of such royalties/fees may also be taxed in India, in which they arise, and according to the laws of India. It is thus clear that the provisions of Article 12 of the treaty, discussed above, do not provide that taxability of such royalties/fees in India shall be on cash or receipt basis.

Computation rules and rates

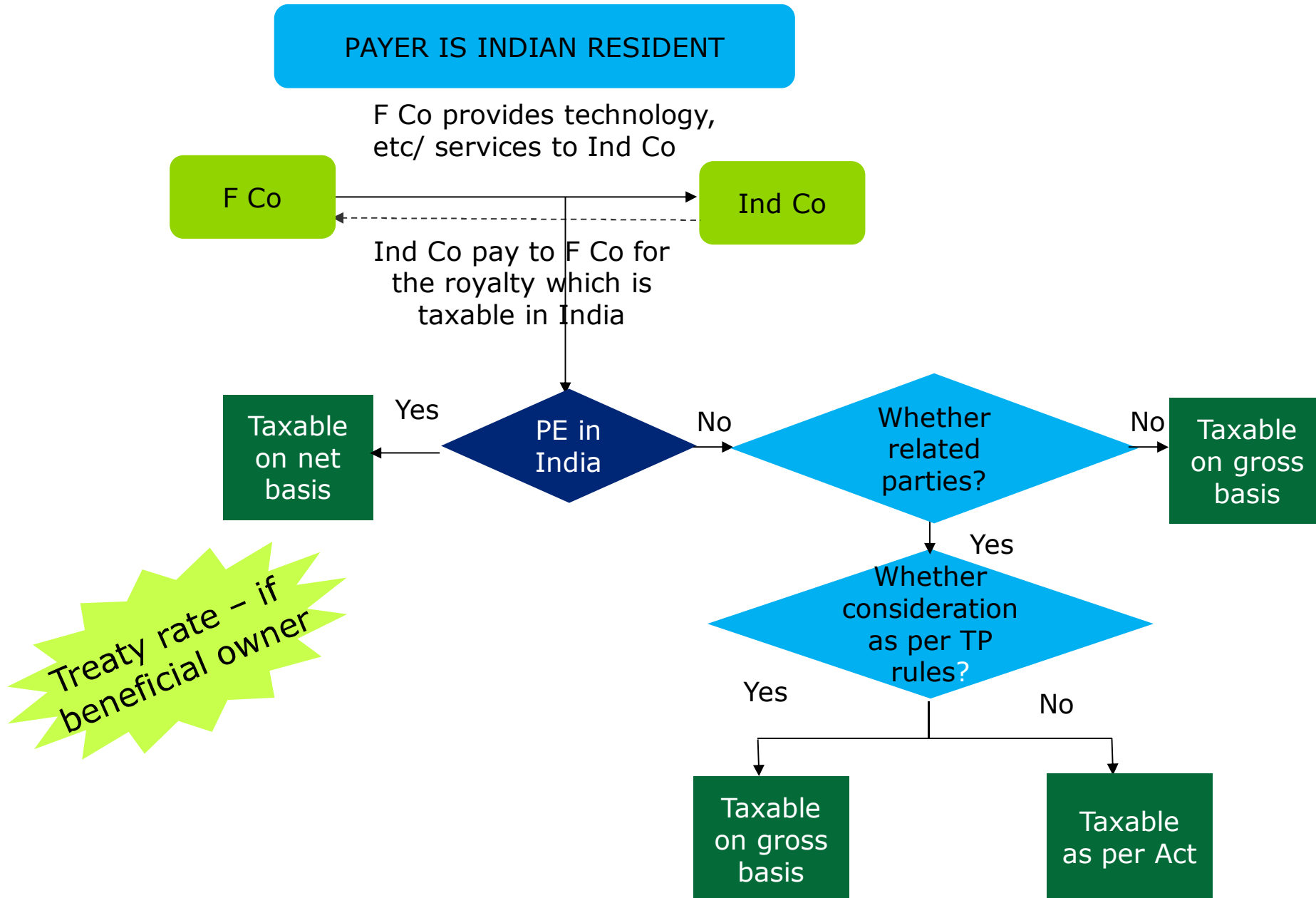
Computation and rates under the Act



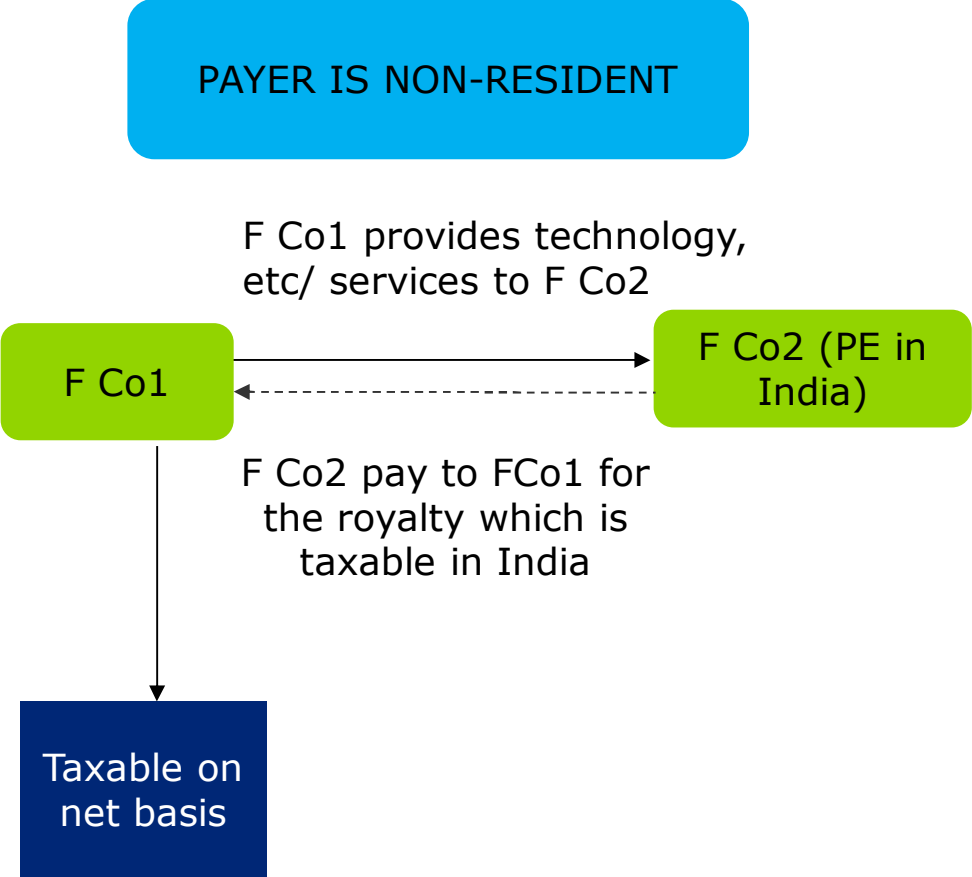
Computation and rates under the Act



Computation and rates under the Treaties



Computation and rates under the Treaties



PE clause

PE clause

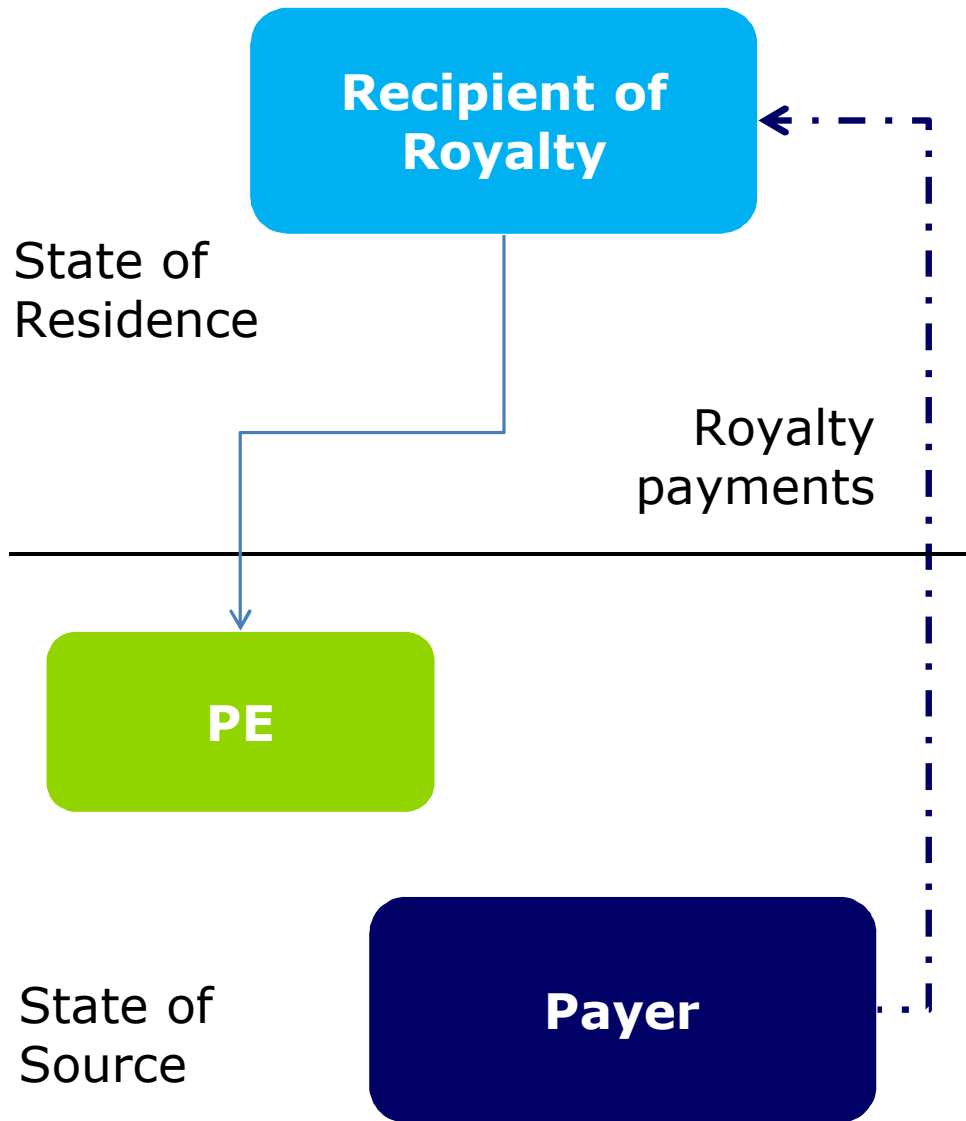
OECD Model

- The provisions of Article 12.1 shall not apply
 - if the beneficial owner of the royalties, being a resident of a Contracting State
 - carries on business in the other Contracting State in which the royalties arise through a PE situated therein
 - right or property in respect of which the royalties are paid is effectively connected with such PE
- In such case the provisions of Article 7 shall apply

UN Model

- The provisions of Article 12.1 and 12.2 shall not apply
 - if the beneficial owner of the royalties, being a resident of a Contracting State
 - carries on business in the other Contracting State in which the royalties arise through a PE situated therein
 - performs in that other State independent personal services from a fixed base situated therein
 - right or property in respect of which the royalties are paid is effectively connected with such PE or fixed base, or with business activities referred to in Article 7.1 (c)
- In such cases the provisions of article 7 or article 14, as the case may be, shall apply

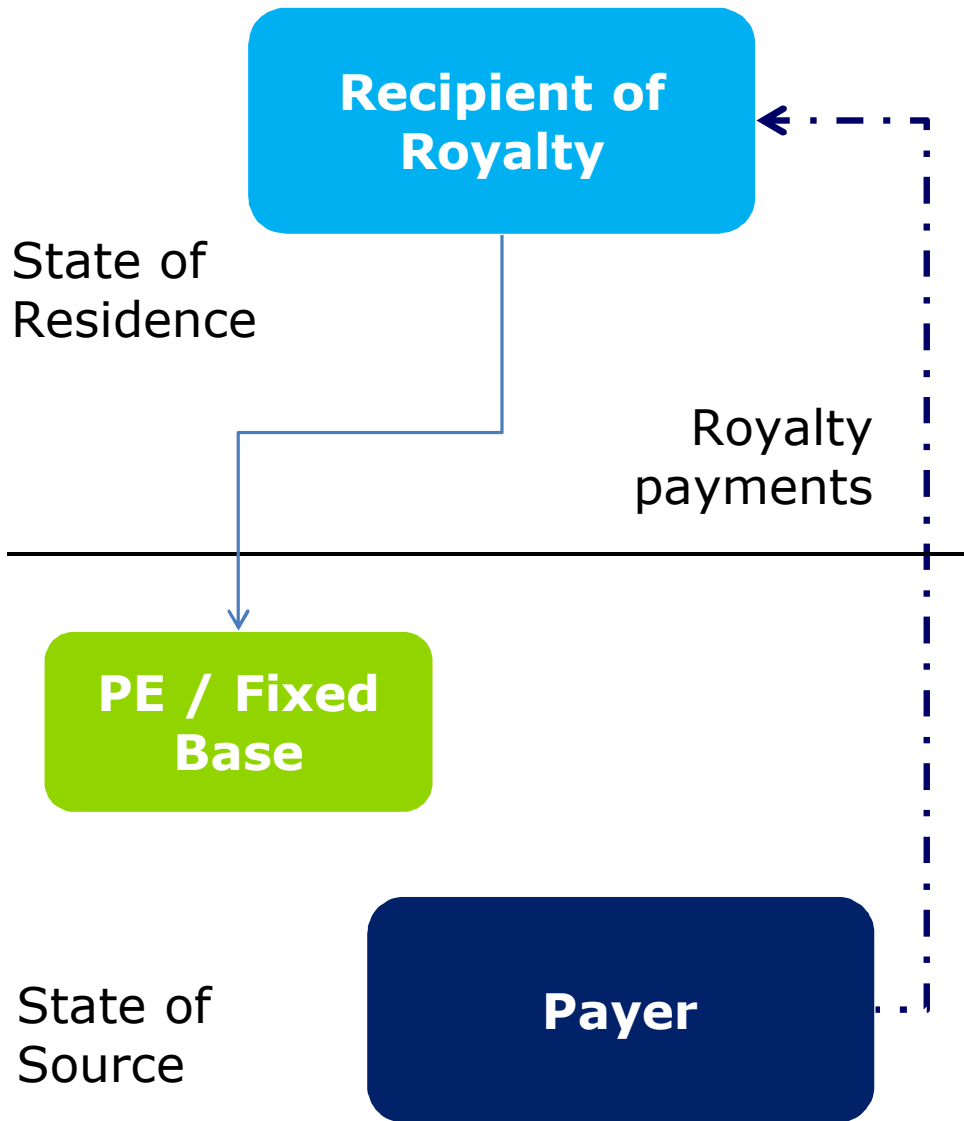
PE clause



OECD Model

- If royalty is “**effectively connected**” with such PE
 - **Article 7** (Business Profits) will apply to payments
 - Else, **Article 12** (Royalty) will apply to payments

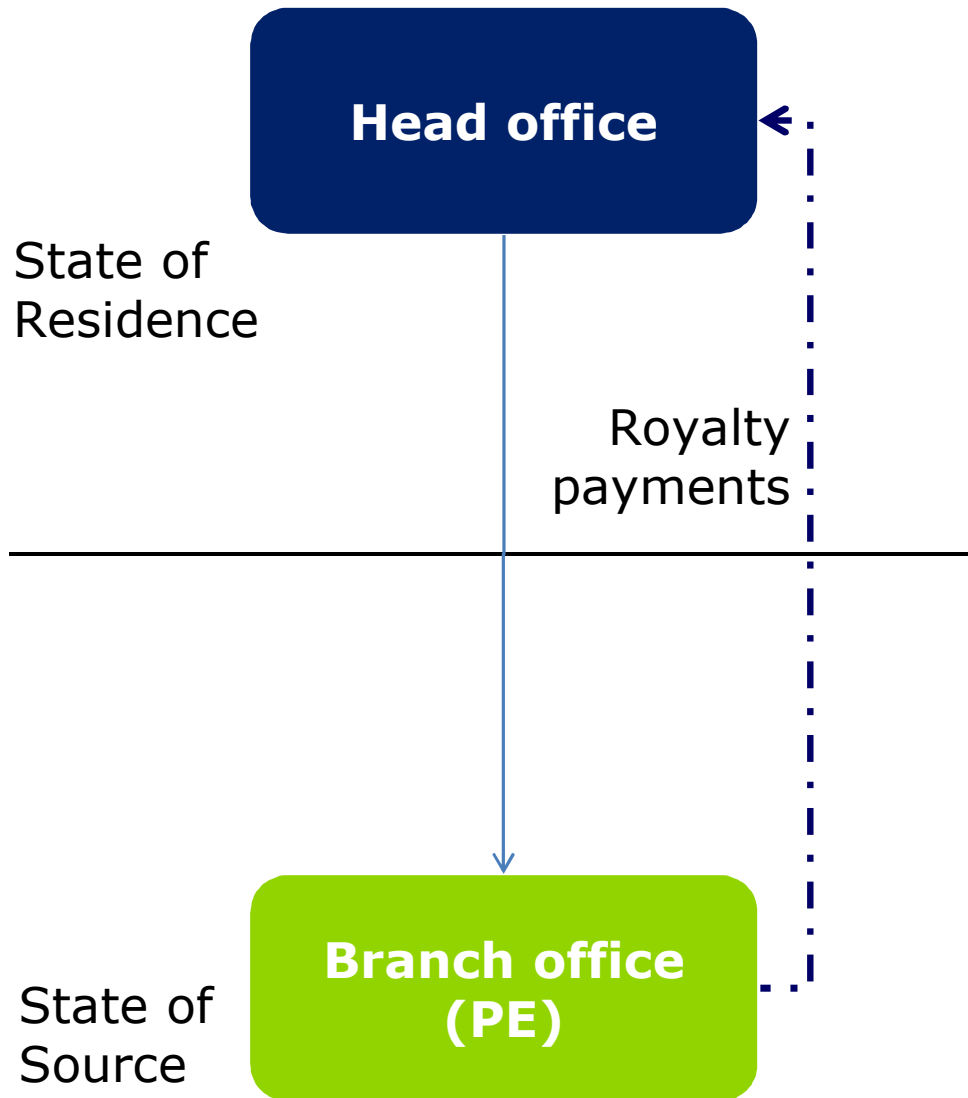
PE clause



UN Model – "Limited force of attraction"

- If royalty is "effectively connected" with such
 - PE
 - fixed base
 - business activities of the same or similar kind as those of a PE
 - Article 7 (Business profits) will apply to payments
 - Else, Article 12 (Royalty) will apply to payments

PE clause

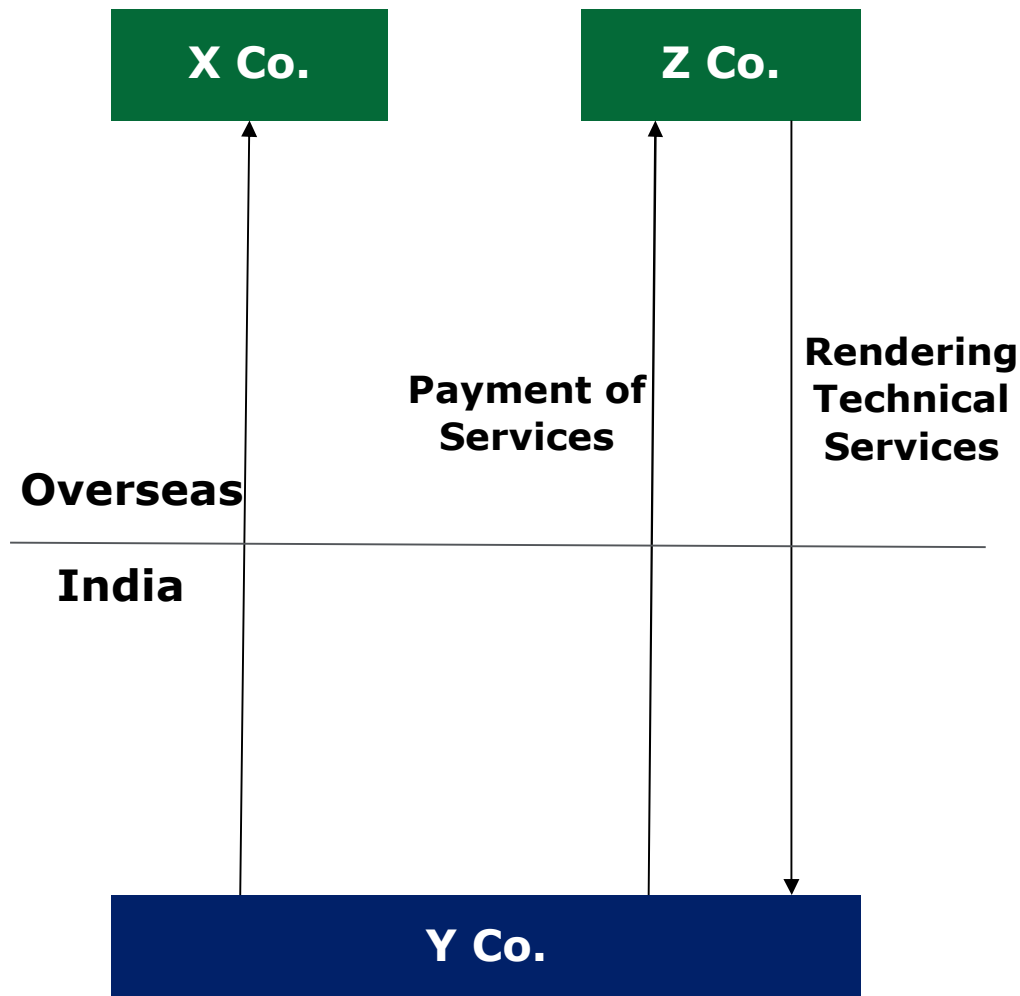


Branch office paying royalty to Head office

- Whether it is payment to self?

Case Studies

Case Study 1



Facts

- X Co. enters into a contract with Y Co. for preparation of technical report
- Y Co. outsourced the contract to Z Co. a group Co. of Y Co.
- Z Co. perform the study and prepares the report overseas
- The report is then forwarded by Z Co. to Y Co. who in turns forwards the report to X Co.
- Z Co. does not have a PE in India

Issue

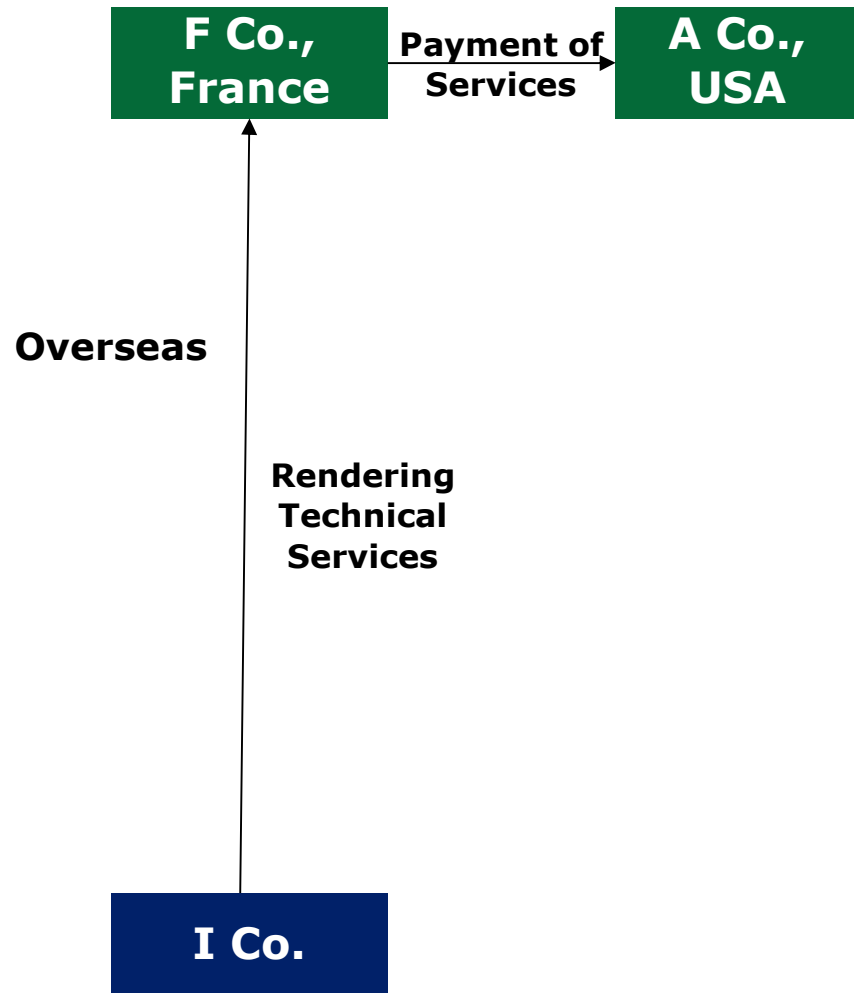
- Taxability of payment by Y Co. to Z Co. under the ITA?

Case Study 1

- **Section 9(1)(vii) of the Act**

- Services provided by Z Co. in the nature of FTS and would get covered under the definition of 'FTS' under Explanation 2 to section 9(1)(vii) of the Act
- Z Co. have performed the services outside India and the services are rendered pursuant to contract with X Co. which is located overseas
- Payments to Z Co. is for earning income from a source outside India ~not taxable in India under section 9(1)(vii)(b) of the Act (exclusion)

Case Study 2



Facts

- F Co. France engaged in the business of providing engineering & construction services, which has created PE for F Co. in India
- F Co. entered into an agreement with I Co. to provide technical/engineering services for a project in India
- In order to review and monitor the work done by the employees of F Co. in India, F Co. entered into another agreement with A Co. US
- The work done by A Co. included provision of execution plans, review of working in respect of plans and execution, provision of time schedules with emphasis on key milestones, etc.

Issues

- Payment by F Co. to A Co.
- Taxability under the Act and Article 12 of the DTAA

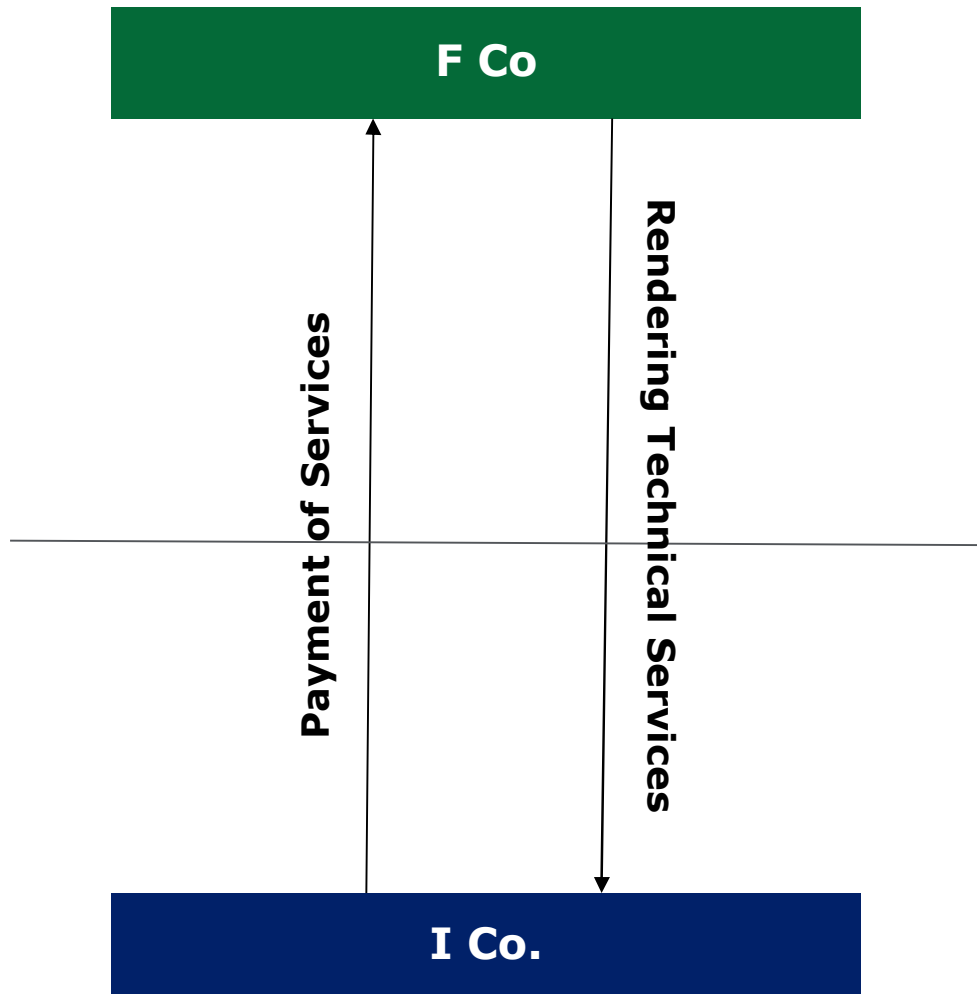
Case Study 2

Decision of Chennai Tribunal

- Payment to A Co. liable to tax in India in terms of Explanation 2 to section 9(1)(vii) and 9(1) of the Act since services were utilized for earning source of income in India
- Services provided by A Co. were made available to F Co. and is taxable as FTS in India under India-US DTAA
 - F Co. was not a layman and was an expert in providing technical and engineering services
 - F Co. was capable of observing the opinion/advice given by A Co. and implementing the same in their future projects
 - Technical knowledge, expertise and know-how provided by A Co. was made available to the F Co.

**Foster Wheeler France SA. (157 ITD 793) –
Chennai Tribunal**

Case Study 3



Facts:

F Co., was engaged by I Co. to undertake technical services including technical drawings, detailed designs and reports

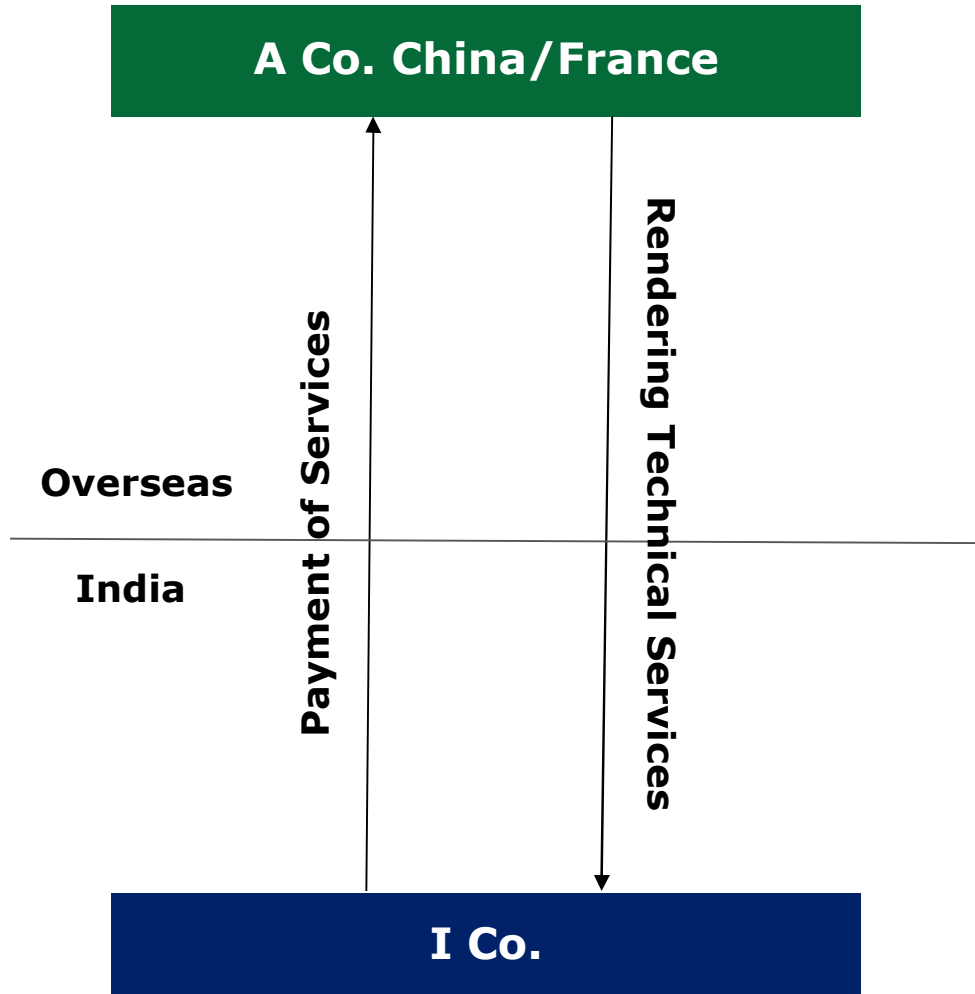
Issue:

Whether the payments to F Co. by I Co. constitute FTS under India-Canada DTAA and India-Singapore DTAA?

Case Study 3

- **India-Canada DTAA (Snc-lavalin International Inc.–Delhi High Court)**
 - Condition of making available technical knowledge is not an essential condition for considering the question as to whether the amount is FTS or not particularly when the payment is only where the technical or consultancy services consists of development and transfer of a technical plan or technical design only
 - The term 'transfer' as used in article 12(4) does not refer to absolute transfer of right of ownership; it refers to transfer of technical drawings or designs by the resident of one State to the resident of the other State, which is to be used by or for the benefit of the resident of the other State.
 - Even where the technical design or plan is transferred for the purpose of mere use of such design or plan by the person of the other Contracting State and for which the payment is to be made, article 12(4)(b) would be attracted
 - Accordingly, payment to F Co. was held to be in the nature of FTS
- **India-Singapore DTAA**
 - Services rendered by F Co. consist of development and transfer of a technical plan or design but it doesn't to enable I Co. to apply the technology contained therein
 - Payment to F Co. may not be taxable as FTS in India
 - Similar exclusion in India-US DTAA and India-Portugal DTAA

Case Study 4



Facts

- I Co. enters into a contact with ACo. for inspection of material/equipment overseas
- Services are rendered outside India

Issues

- Taxability of payment by I Co. to A Co. under India-China DTAA and India-France DTAA

Case Study 4

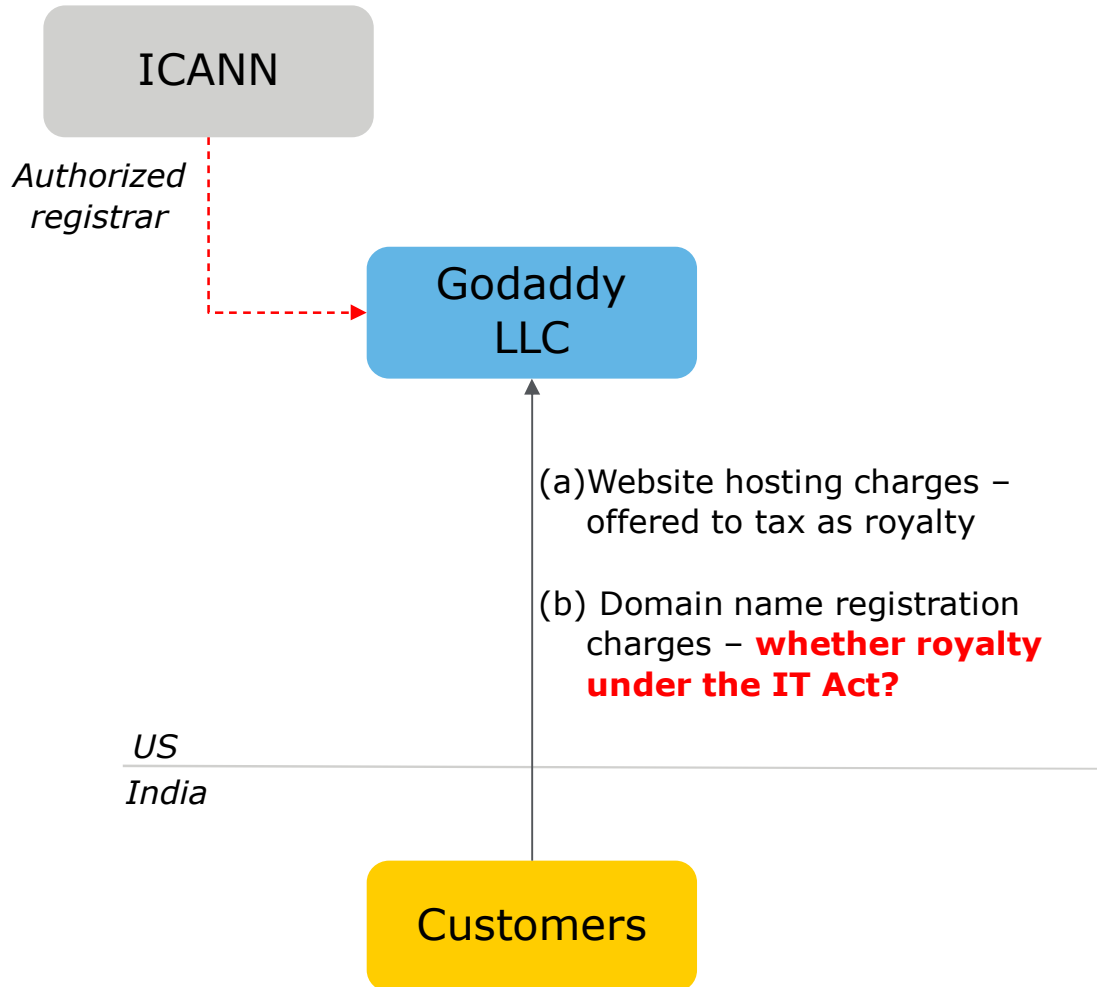
Under India-China DTAA

- Taxable in India only if underlying services are provided in India
- Payments to A Co. may not be taxable as FTS under India-China tax treaty as the services are rendered outside India
- The Mumbai Tribunal in case of Ashapura MinichemLtd. held that even services performed outside India will be taxable in India

Under India-France DTAA

- Payment to A Co. may not be taxable as FTS under Article 13 read with clause 7 of Protocol of India-France DTAA in view of MFN clause
- Narrower definition of FTS under the India-Portugal DTAA can be applied
- Performance rule under India-Finland DTAA can be applied

Case Study 5



Facts:

Services provided by Godaddy LLC to customers in India under domain name registration services:

- Checking the availability of desired domain name
- Facilitating registration of the domain name of the users
- Assigning unique IP address for the domain name
- Maintaining a record of all the domain names and their IP address

Case Study 5

Contentions before the Tribunal

By AR:

- The AO / DRP have incorrectly linked web hosting services with domain registration services and both of these services have independent existence
- Further, the taxpayer merely facilitates in getting domain registered in the name of the customer and hence, the receipt in respect of domain name registration is not in the nature of 'royalty'
- Reliance was placed on Asia Satellite Telecommunications (Delhi HC) and Dell International Services (AAR)

By DR:

- The transaction of domain name registration and web hosting services are interrelated processes, and are not independent processes of each other but are inextricably linked / connected to each other
- Domain name is an intangible asset similar to trademark. Godaddy has the right to register, assign, transfer and manage specific domain names. It enjoys absolute and exclusive right to assign domain names under specific domain extensions. The domain name registration charges were paid in India
- Reliance was placed on Satyam Infoway (SC), Tata Sons Limited (Delhi HC), Makemytrip (India) Pvt. Ltd (Delhi ITAT)

Case Study 5

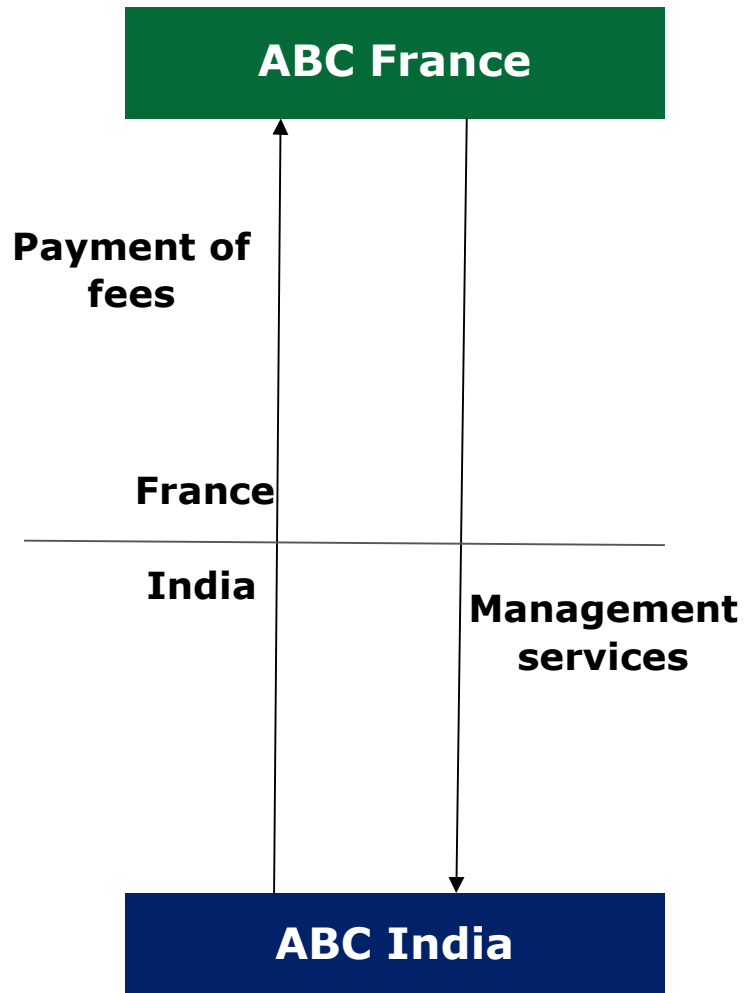
Tribunal ruling

- **Domain name is a “trademark”**
 - Placed reliance on rulings discussing trademark protection
- **Rendering of services for domain name registration is rendering of services in connection with use of an intangible property which is similar to trademark**
- **Hence royalty within clause (vi) read with clause (iii) of section 9(1)(vi) of the IT Act**

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

(vi) **The rendering of any services in connection with the activities** referred to in clause (i) to (iv), (iva) and (v).”

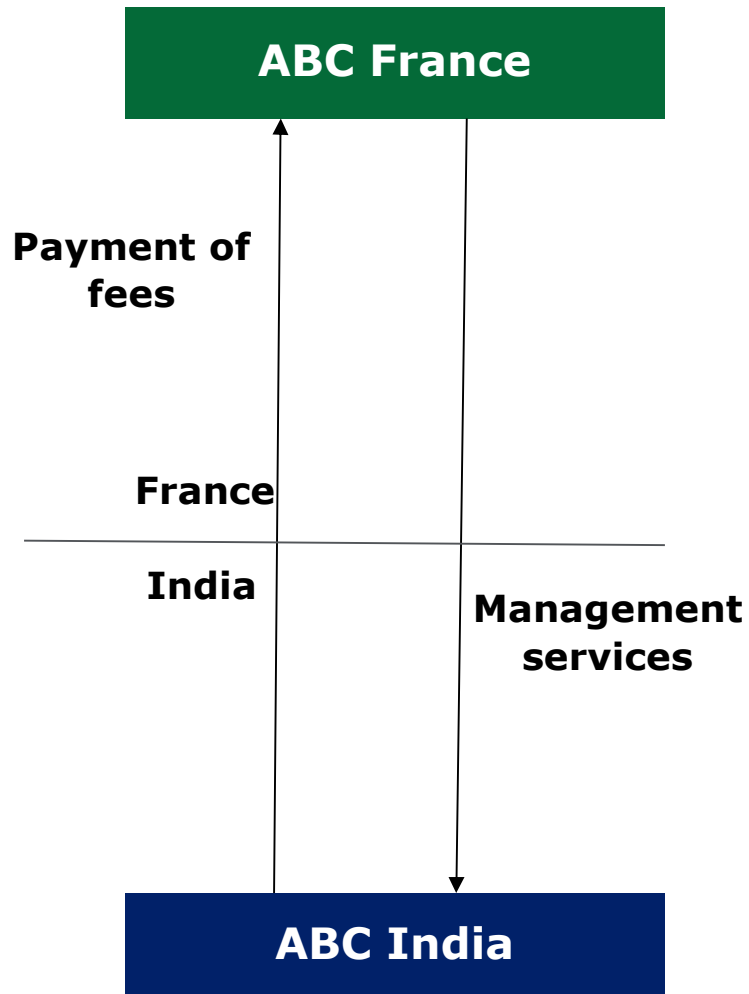
Case Study 6



Facts:

- ABC India (the assessee) is a public limited company incorporated in India. ABC France is a limited liability partnership incorporated in France and a tax resident of France
- ABC India entered into a Management Services Agreement with ABC France
- ABC France provided management services to the ABC India with a view to rationalize and standardize the business conducted by ABC India in India
- ABC India has not deducted any tax at source in respect of payments to ABC France on the basis of the protocol to India-France tax treaty and taking benefit of Article 13 of India-UK tax treaty
- The AO is not in agreement with the above and has argued that the protocol cannot apply as there is no separate notification regarding the incorporation of the beneficial provisions of India-UK tax treaty as forming part of India-France tax treaty
- AO has also argued that without prejudice to the above, as the FTS article under India-UK tax treaty does not cover "managerial services", he has to examine if any of the services satisfy "make available" criteria.

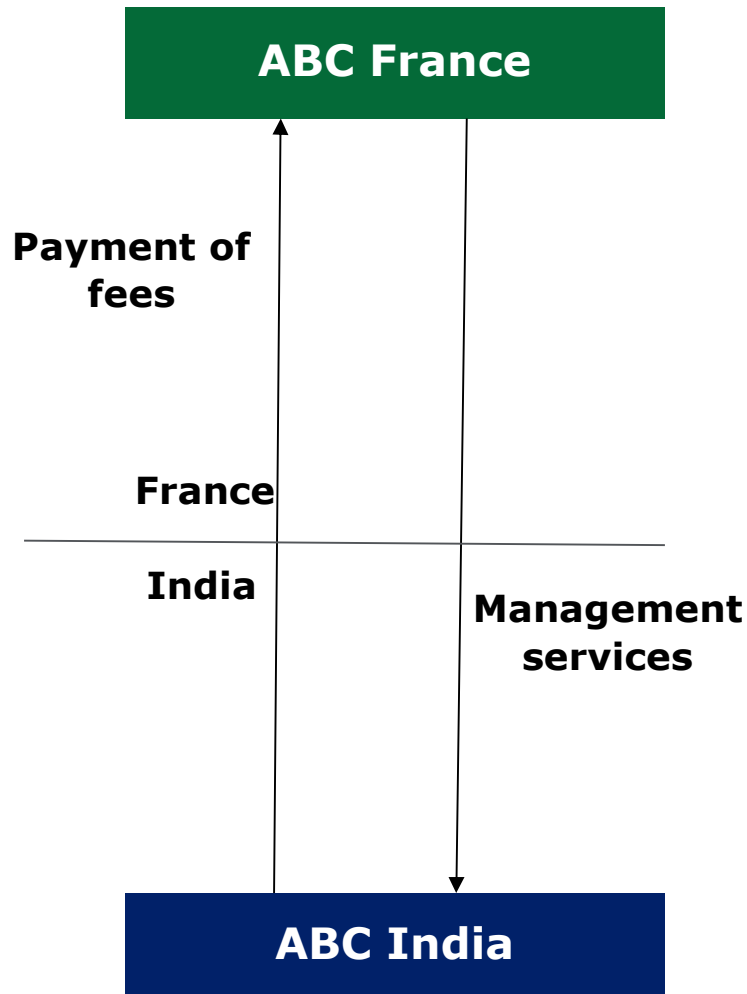
Case Study 6



Issues:

- Whether ABC India is liable to withhold tax at source in respect of payments to ABC France?
- Whether the view taken by AO is correct
- whether protocol to India-France tax treaty needs to be notified in order to be operational?
- whether it is necessary to examine the make available criteria since the FTS article under India-UK tax treaty does not cover "managerial services"?

Case Study 6

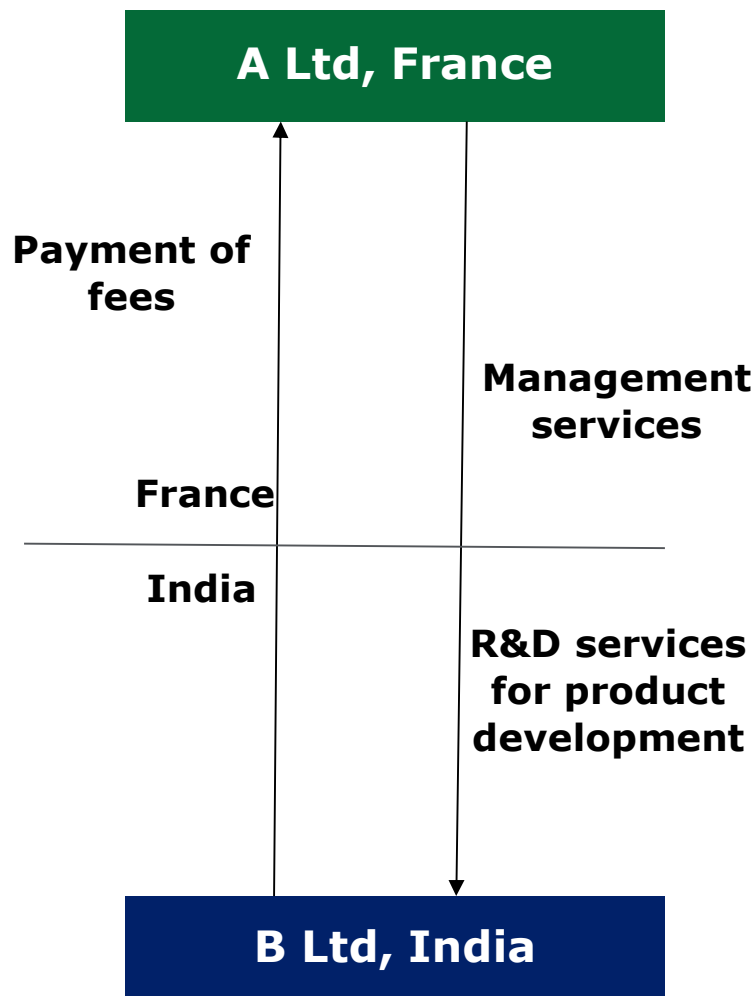


Ruling:

- Protocol forms an integral part of a DTAA
- Accordingly, the MFN clause (Clause 7) in the Protocol to the India-France DTAA is self-operational and does not require a separate notification from Central Government to be effective
- Overruling the AAR's decision, the High Court, held that the amount paid to offshore service provider for provision of managerial services does not constitute FTS by virtue of restricted scope/definition of FTS under the India-UK DTAA which must be read as forming part of India-France DTAA
- Once the expression 'managerial services' is outside the ambit of 'fee for technical services', it not necessary to examine the second part of the definition i.e. make available criteria

Steria (India) Ltd. (386 ITR 390)(Delhi HC)

Case Study 7



Facts (1):

- A Ltd, France renders various services to B Ltd, India (associated entity) as under:

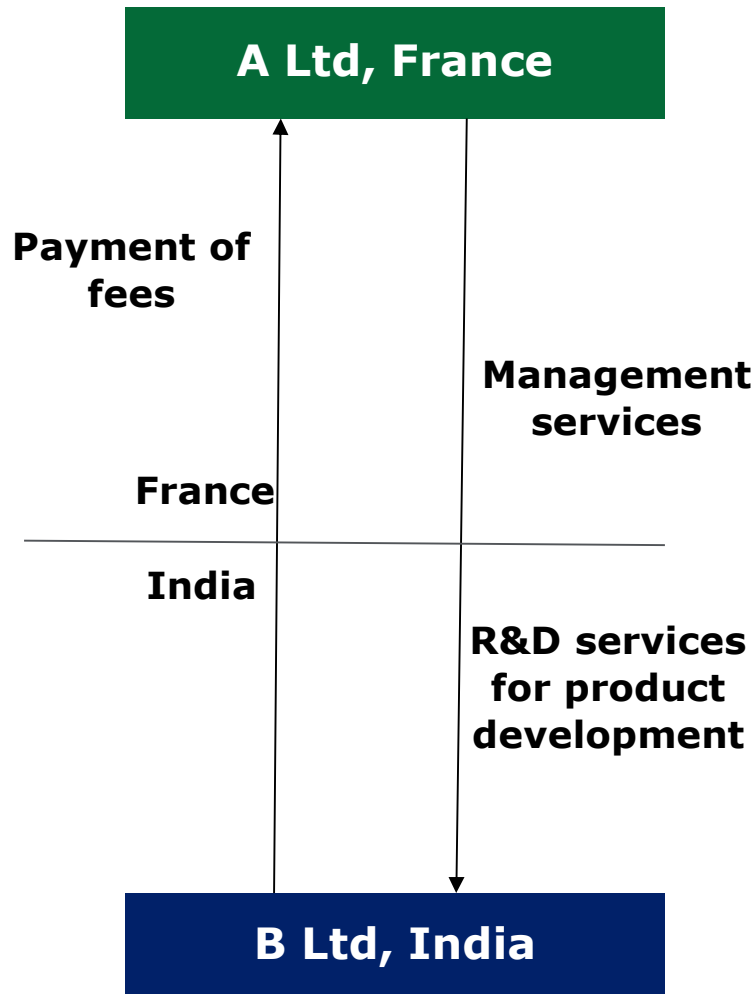
• Category I services

Particulars	Description of services
Support in relation to purchasing activities	Providing guidance on sourcing, negotiating, nominating suppliers, follow-up, co-ordination and communicating for purchase of components to project team
Purchase management overview	Conducting assessment of suppliers to ensure quality, technology and delivery requirements
Sales management overview	Aid in negotiating most advantageous selling prices and business terms, coordinating sales-related activities with customers etc.

• Category II services.

Particulars	Description of services
Research and Development	Assisting in development of the product as and when requested by B Ltd

Case Study 7



Facts (2):

- A Ltd is a tax resident of France and is eligible for treaty benefits under India France DTAA
- A Ltd does not have any presence in India in the form of branch, office or any other form of place of business in India
- Office premises or facilities of B Ltd are not at disposal of A Ltd or its employees
- Except services which require physical presence by personnel of A Ltd in India, all other services are performed by A Ltd outside India
- IPR in the products would belong to B Ltd
- Payment towards services provided will be made by B Ltd outside India

Case Study 7

Analysis (2):

Taxability under India-France DTAA

- Article 13 of India France DTAA (Royalties, FTS and payments for use of equipment)
 - FTS may also be taxed in Contracting State in which they arise and according to laws of that Contracting State [Article 13(2)]
 - FTS means payments of any kind to any person in consideration for services of a managerial, technical or consultancy nature [Article 13(4)]
 - FTS shall be deemed to arise in a Contracting State when payer is a resident of that Contracting State [Article 13(7)]
- Services under both categories fall within the purview of FTS
- Para 7 of Protocol dated 29 September 1992
 - In respect of Article 13, if under any convention or agreement signed after 1 September 1989 between India and a third country (member of OECD), India limits its taxation at source on FTS to a **rate lower** or a **scope more restricted** than the rate of scope provided for in India-France DTAA, then rate or scope as provided for in that DTAA shall apply.

Case Study 7

Analysis (3):

Taxability under India-France DTAA

- **India-Portugal DTAA**

- Signed – September 1998
- Portugal – member of OECD

- Article 12(4) of India-Portugal DTAA (Royalties and Fees for included services)

- Fees for included services - payments to any person in consideration of rendering of any technical or consultancy services if such services **make available** technical knowledge, experience, skill, know-how or processes or consist of development and transfer of a technical plan or technical design which enables person acquiring services to apply technology contained therein

Case Study 7

Analysis (5):

Taxability under India-France DTAA

- **India-Finland DTAA**

- Signed – January 2010
- Finland – member of OECD

- Article 12 of India-Finland DTAA (Royalties and Fees for technical services)

- Fees for technical services – payments of any kind as consideration for managerial or technical or consultancy services [Article 12(3)(b)]
- FTS arising in Contracting State and paid to a resident of other State may be taxed in that other State [Article 12(1)]
- FTS may also be taxed in Contracting State in which they arise and according to laws of that State [Article 12(2)]
- Where FTS relate to services performed, within a Contracting State, then such FTS shall be deemed to arise in the State in which services are performed [Article 12(5)]

Case Study 7

Analysis (6):

Taxability under India-France DTAA

- **India-Portugal DTAA**

- Can consider “Make available” benefit

- **India-Finland DTAA – Article 12(5)**

- Fees for technical services shall be deemed to arise in a Contracting State when the payer is that State itself, a political subdivision, a local authority, or a resident of that State. Where, however, the fees for technical services relate to services performed, within a Contracting State, then such fees for technical services shall be deemed to arise in the State in which the services are performed.

Questions & Answers