



International Tax Refresher Course - WIRC



Taxation of Royalties & Fees for technical services

A perspective

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Agenda for Discussion



Royalty

Definition as per 9(1)(vi) of the Income Tax Act, 1961

Consideration for



Royalty (a) includes lump sum consideration

(b) excludes income chargeable as capital gains

(c) includes services in relation to any of the following

Transfer of all or any rights (including the granting of a license)

Imparting of any information concerning the working of, or the use

Use of

Imparting of any information concerning

Use or right to use

The transfer of all or any rights (including the granting of a license)

Rendering of services in connection with activities referred above

Patent, invention, model, design, secret formula or process or trademark or similar property

Technical, industrial, commercial or scientific knowledge, experience or skill

Any industrial, commercial or scientific equipment

Copyright, literary, artistic or scientific work

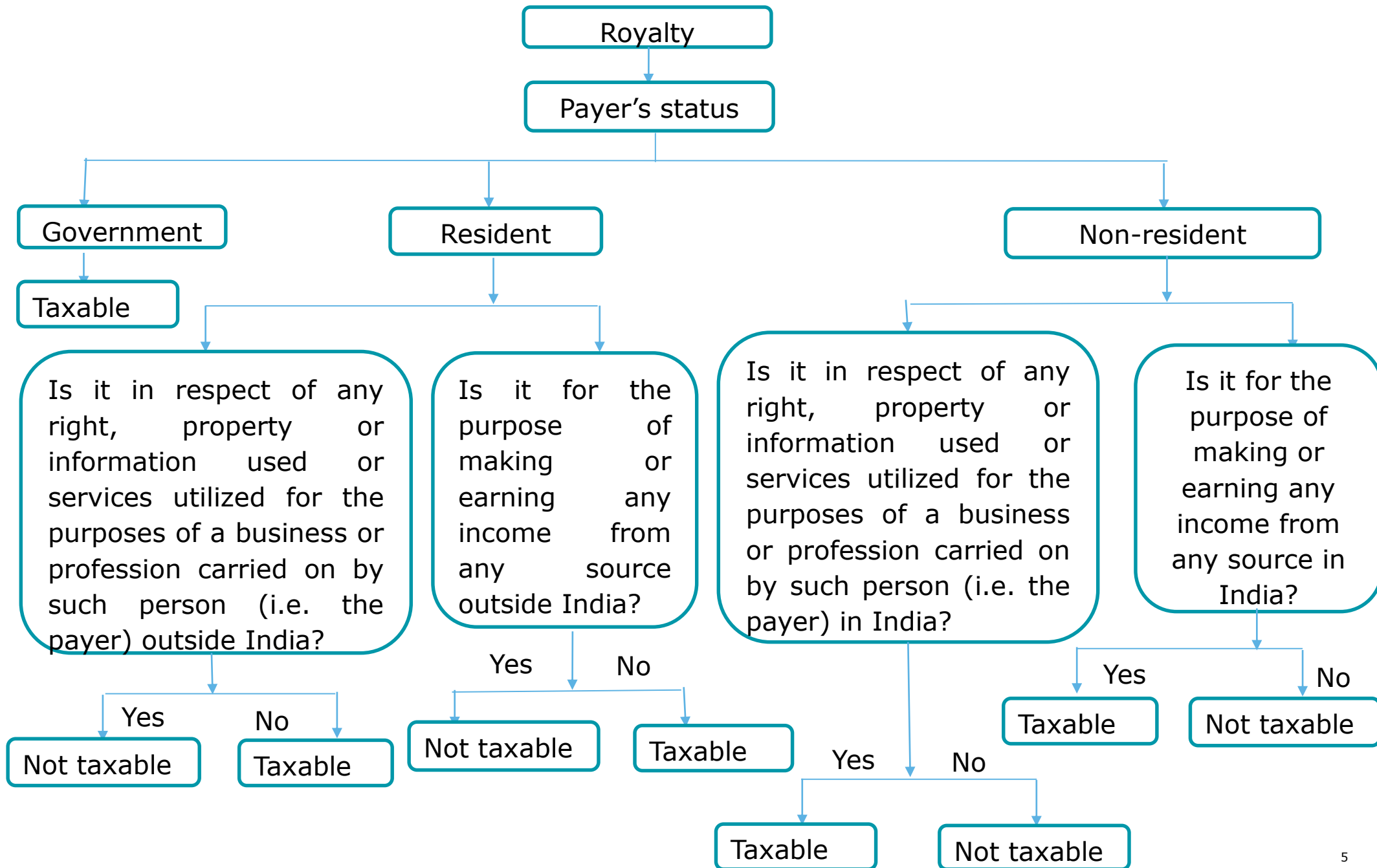
Royalty

Deemed to Accrue or Arise

Royalty income deemed to accrue or arise in India if:

- Payable by the Government
- Payable by resident to non-resident, **except**
 - where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person (i.e., the payer) outside India
 - for the purpose of making or earning any income from any source outside India
- Payable by non-resident to resident, **only if**
 - the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India
 - for the purpose of making or earning any income from any source in India

Taxability of royalty under the Act



Taxability of royalty under the Act

Explanation 2 to section 9(1)(vi)

Description	IPRs
<ul style="list-style-type: none">- The transfer of all or any rights in respect of:- The imparting of any information concerning the - working or use of:- The use of any:	Patent, invention, model, design, secret formula or process or trademark or similar property
The imparting of any information concerning	Technical, industrial, commercial or scientific knowledge, experience or skill
<ul style="list-style-type: none">- The use or right to use	Industrial, commercial or scientific equipment
<ul style="list-style-type: none">- The transfer of all or any rights in respect of	Copyright, literary, artistic or scientific work
Services in connection with the above	



Taxability of royalty under the Act

Explanation 4

- Transfer of all or any rights includes right for or to use a computer software (including granting of a license) irrespective of the medium

Explanation 5

- Includes consideration in respect of any right, property or information, whether or not—
 - the possession or control is with the payer;
 - it is used directly by the payer;
 - the location is in India

Explanation 6

- "process" includes transmission by satellite, cable, optic fibre, etc. whether or not secret

Royalty

Product v Underlying IPR

Underlying product	Embedded IPR content	What does Licensee of IPR expect?	What does Purchaser of product get?
Medicines / Drugs	Patent	Licence to manufacture	Ownership of drugs
T.V. Programme	Right to Telecast	Right to telecast	Real time entertainment
Books	Copyright	Publishing house wants right of reproduction	Ownership of book
Packaged drinking water	Trademark	Franchisee wants right to manufacture and sell under trademark	Ownership of product
Washing machine	Know-how / experience	License to manufacture and sell.	Ownership of process, skill,

Royalty

Taxation of royalties under DTAA – typical structure of royalty article

Article para	Subject matter
1	Clarification that the royalty arising in a source country may be taxed in the country of residence.
2	Taxability rights also given to source country, but with restriction on rate of tax.
3	Definition of Royalty
4	Provides that this Article would not be applicable in case royalty is effectively connected with PE / fixed base in source country
5	Source rules
6	Concessional rate applicable only to portion of royalty which satisfies the arms length test

Royalty

Definition of Royalty in UN & OECD model

Article 12(2) of OECD Model

The term "royalties" as used in this Article means 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, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience.

Royalty definition

Article 12(3) of UN Model

The term "royalties" as used in this Article means 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, trade mark, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment or for information concerning industrial, commercial or scientific experience.

Royalty

Model Comparison – Sharing of taxing rights

OECD Model

Royalties arising in a Contracting State beneficially owned by a resident of the other Contracting State shall be taxable only in that other State

**Residence
based taxation
principle**

UN model

- Royalties arising in a Contracting State paid to a resident of the other Contracting State may be taxed in that other State
- However, such royalties may also be taxed in the Contracting State in which they arise and according to the laws of that State
 - but if the beneficial owner of the royalties is a resident of the other Contracting State
- the tax so charged shall not exceed X per cent (the percentage is to be established through bilateral negotiations) of the gross amount of the royalties

**Source based
taxation
principle**



Royalty

Nexus with the Permanent establishment clause

OECD Model – Article 12.3

- 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 – Article 12.4

- 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

Fees for technical services

Fees for technical services

Definition under section 9(1)(vii) of the Income Tax Act, 1961

“Fees for technical services” means **any consideration (including any lump sum consideration)** for the rendering of any services in the nature of:

- managerial,
- technical or
- consultancy

including the provision of services of technical or other personnel

FTS does not include

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

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 services
 - For instance, engineers, technicians, consultants, etc. to furnish services for a fee

Fees for technical services

Does the term fees for technical services include professional services?

Fees for technical services [explanation 2 to section 9(1)(vii)]	Professional services [explanation (a) to section 194J]
Any lumsump consideration received for rendering services in the nature of- <ul style="list-style-type: none">- Technical- Consultancy- Managerial	Shall include - <ul style="list-style-type: none">- Legal- Medical- Engineering- Architectural- Profession of accountancy- Technical consultancy- Interior decoration- Advertising- Profession as may be notified
Exclusions – considerations received for any – <ul style="list-style-type: none">- Construction- Assembly- Mining- Like project undertaken by the recipient- Or income chargeable under the head 'Salaries'	<ul style="list-style-type: none">• Exclusion – None
	<ul style="list-style-type: none">• Hindalco Industries Ltd (152 Taxman 17) (Mum)<ul style="list-style-type: none">- payment for professional services- can only be brought to tax under article 7 of the India-Australia DTAA- could not be treated as a payment for supply of scientific, technical, industrial or commercial knowledge or information

Fees for technical services

General definition under certain Indian Tax Treaties

FTS clause

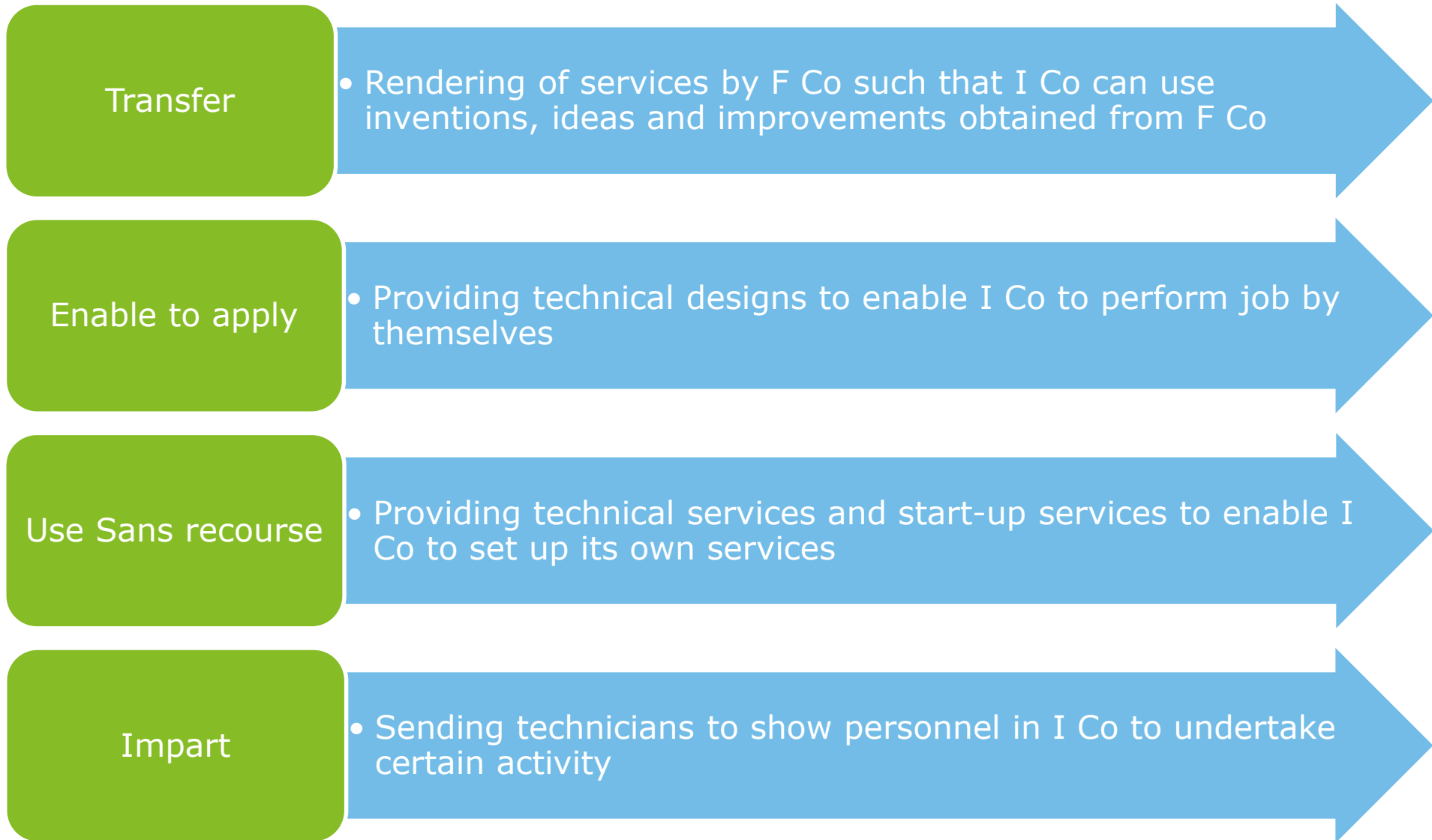
- FTS means
 - payments of any amount in consideration
 - for the rendering of managerial, technical or consultancy services
 - including the provision of services of technical or other personnel
 - does not include payments for services mentioned in Independent / Dependent Personal Services

FTS clause + Make available

- FTS means
 - 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

Fees for technical services

Concept of Make Available



Fees for technical services

Make available


“Make available” significantly narrows down the scope of FTS

**MOU to India-US
DTAA**



- 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

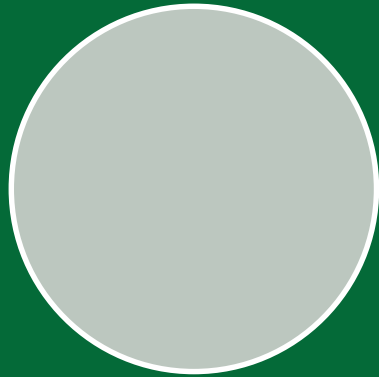
**Judicial precedence
explaining the
concept of ‘make
available’**



- De Beers India Minerals (P.) Ltd. [2012] 346 ITR 467 (Kar.)
- Intertek Testing Services India (P.) Ltd., In re [2008] 307 ITR 418 (AAR)
- Anapharm Inc., In re [2008] 305 ITR 394 (AAR)
- Endemol India (P.) Ltd., In re. [2014] 361 ITR 340 (AAR)
- Raymond Ltd. [2003] 86 ITD 791 (Mum.)

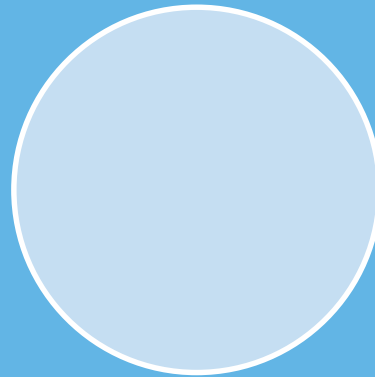
Fees for technical services

Absence of FTS clause?



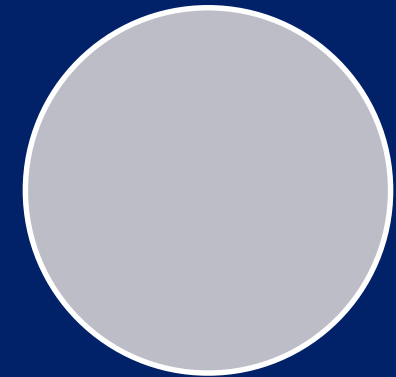
Taxable as per the provisions of the Act

1. **TVS Electronics Ltd [2012] 52 SOT 287 (Chennai)** - when DTAA is silent on an aspect, the provisions of the Act have to be considered and applied



Business income under Article 7 in case tax payer has a PE in India

1. Bangkok Glass Industry Co. Ltd. [2013] 34 taxmann.com 77 (Madras)
2. McKinsey & Company (Thailand) Co. Ltd. [2014] 144 ITD 570 (Mumbai - Trib.)
3. Tekniskil (Sendirian) Berhad [1996] 222 ITR 551 (AAR)
4. IBM India Private Limited (ITA Nos. 489 to 498/Bang/2013)



Taxable as Other Income – Article 22

1. Lanka Hydraulic Institute Ltd. (11 taxmann.com 97)(AAR)

DTAA with Philippines, Thailand, UAE, Bangladesh, Greece, Libya, Mozambique, Myanmar, Nepal does not have an FTS article

Fees for technical services

Absence of Management services & MFN

- DTAA with countries such UK, Canada, Cyprus, Malta, Netherlands, Portugal, Spain, USA does not include managerial services under the definition of fees for technical/included services. MFN clause present in DTAA, whether a benefit of the same can be taken?

Steria (India) Ltd.[2016] 72 taxmann.com 1 (Delhi HC)

Management services provided by French entity not to be treated as 'FTS' as there is MFN clause in India-France DTAA. Definition of FTS occurring in India-UK DTAA clearly excludes management services. No requirement to have a separate notification incorporating the beneficial provisions of the protocol to India-UK DTAA. **Overrules the AAR ruling of Steria and Mersen India**

Sandvik AB 52 taxmann.com 211 (Pune ITAT)

Management service fee not taxable in India as FTS as the 'make available' condition was not satisfied. MFN clause as per the protocol to the India-Sweden DTAA to import the 'make available' condition into the India-Sweden DTAA

Cummins Ltd. 381 ITR 44 (AAR)

Supply management service fees paid to a UK resident is not in the nature of FTS under India - UK DTAA because it does not meet the requirement of 'make available'. Further, the aforesaid services are in the nature of management services and India-UK DTAA does not have management services within the ambit of FTS

Fees for technical services

Technical Services – Necessity of Human intervention

Term 'Technical' sandwiched between 'managerial' & 'consultancy'

"managerial and consultancy" is a definite indicative of the involvement of a human element

Principle of 'noscitur a sociis' shall apply – which means that the meaning of the word or expression is to be gathered from the surrounding word

"Technical" has to be construed as involving direct human involvement without that, technical services cannot be held to be made available

The aforesaid principles have been upheld by various Courts:

- Bharti cellular ltd. [2009](319 ITR 139)(Delhi)
- Siemens Ltd. [2013](142 ITD 1)(Mum - Trib.)
- Skycell Communications Ltd. [2001](251 ITR 53)(Madas)
- Jaipur Vidyut Vitran Nigam Ltd (2009)(123 TTJ 888)(Jp.)

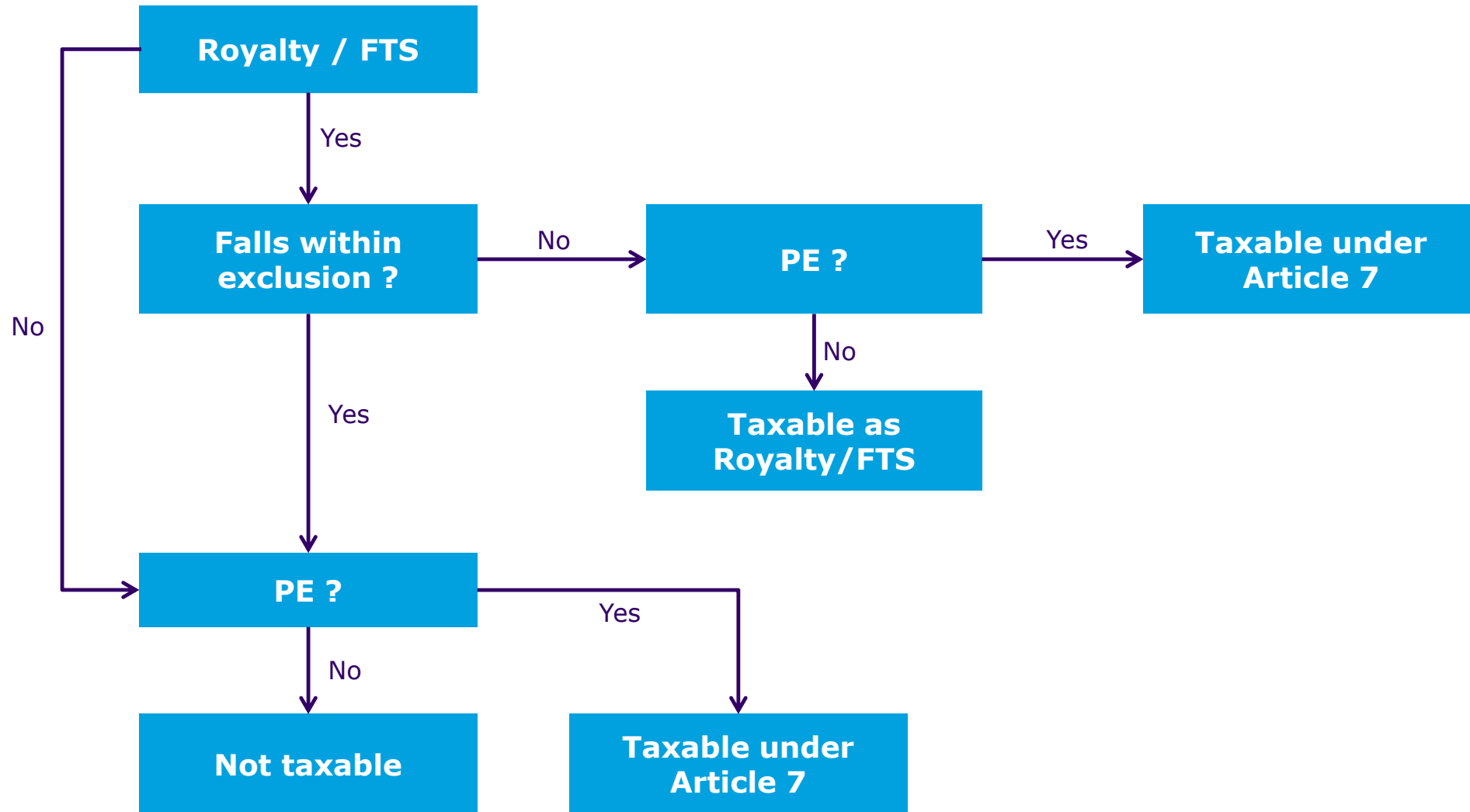
Supreme Court in its recent decision of **Kotak Securities Ltd** held that for a service to qualify as a technical service, following elements are necessary:

- Service must be customized to cater to specific needs of service recipient;
- Service must not be a common facility that is available for use of every customer of service provider

Interplay between Royalty, FTS & PE – under DTAA

Interplay between Royalty, FTS & PE – under DTAA

FTS & PE



* Subject to beneficial provisions under the Act

Interplay between Royalty, FTS & PE – under DTAA

Meaning of design under Royalty & PE

The payments made for designs and drawings which are for **outright sale** of designs and drawings to the Indian entity

[CIT v Davy Ashmore India Ltd. 190 ITR 626 (Cal), Leonhardt Andra Und Partner, GmbH v. CIT (2001) 249 ITR 418 (Cal), Swadesh Polytext (38 ITD 326)]

Mere passing of information concerning the design of a machine which is **tailor made** to meet the requirement of a buyer does not by itself amount to transfer of any right of exclusive user

[Neyveli Lignite Corporation Ltd. (243 ITR 459) (Mad) & Mitsui Engg. & ship Bldg. Co. Ltd (259 ITR 248 (Del))]

Price paid to the supplier is a total contract price which covers all the stages involved in the supply of machinery from the stage of design

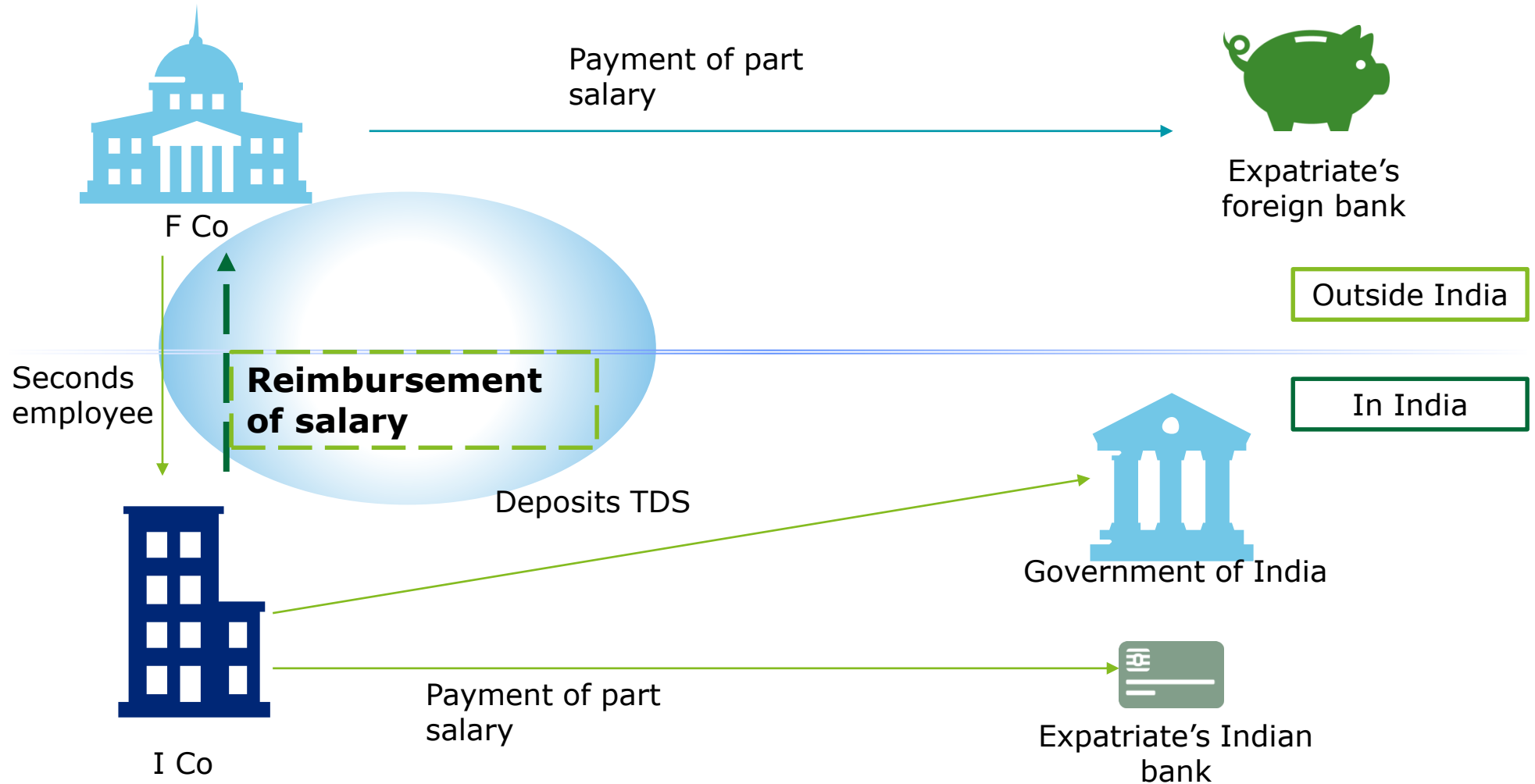
[Pro-quip Corporation (AAR) (255 ITR 354)]

Taxable as business profits under article 7 and not as Royalty

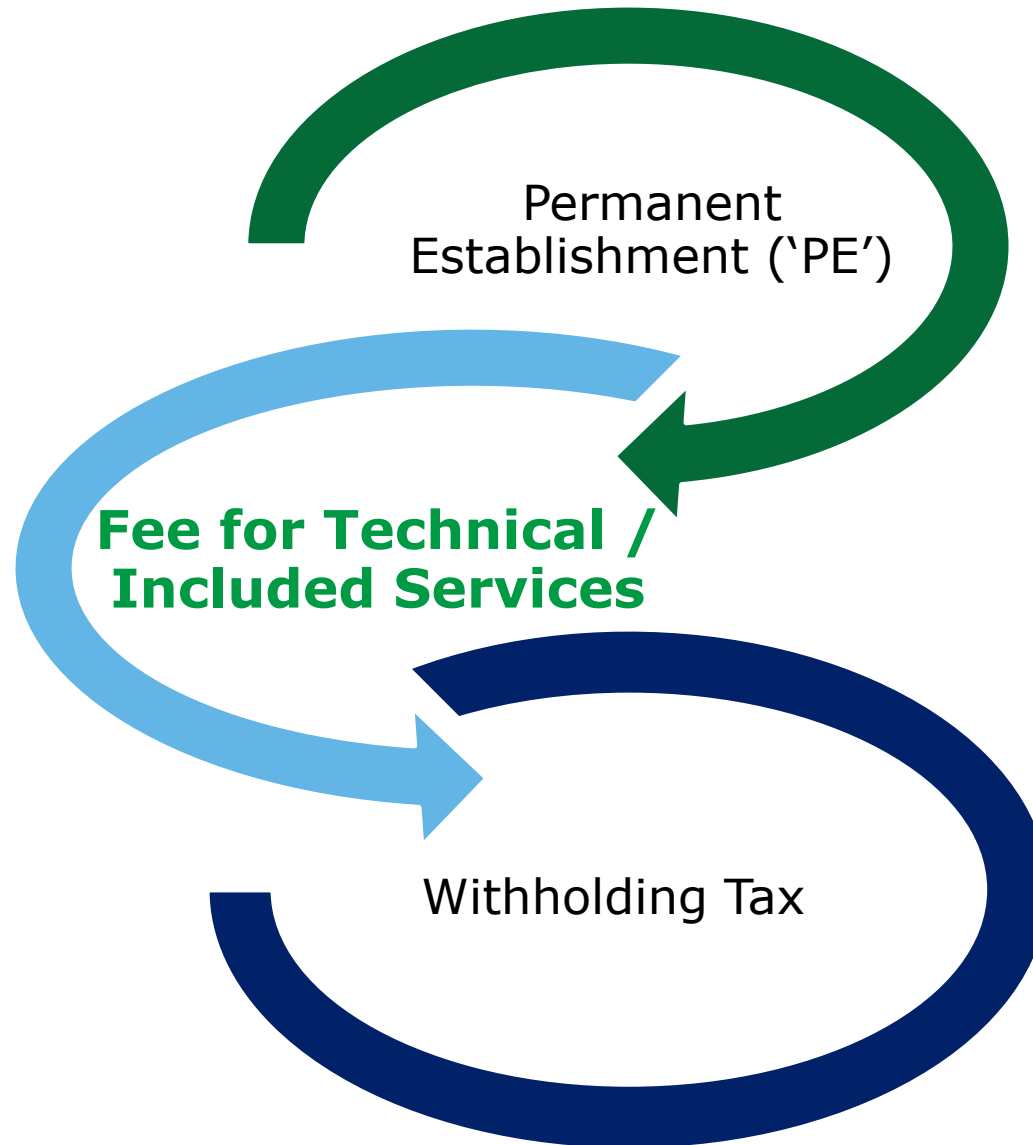
Implications due to global mobility of manpower

Implications due to global mobility of manpower

Typical Secondment Arrangement



Tax issues arising from global mobility



FTS in the context of Foreign entity due to secondment of manpower

– As the “make available” condition may not be satisfied, it merits a view whether the payment will qualify as FTS

Make available

- If the cross recharge payment does not qualify to be FTS under the tax treaty, the analysis with respect to Services PE may apply

Service PE

–If the cross recharge payment qualifies to be FTS under the tax treaty, the services not to be classified as 'Service PE' in terms of the specific exclusion under the tax treaty. I Co would have to withhold taxes on such payments made to F Co
–F Co could seek to claim credit of such India taxes in US, under the India US DTAA read with US domestic tax laws

FTS

The Delhi HC in the case of **Centrica** has held that the absence of a mark-up did not negate the transaction and reimbursement of salary was taxable as FTS, as the deputed employees made available skills to the Indian company to which they were seconded

FTS in the context of Foreign entity

Morgan Stanley International

Employees deputed to India created service PE of Foreign entity in India and once a Service PE is created the provisions of FTS shall not apply

Centrica Offshore

Absence of a mark-up did not negate the transaction and reimbursement of salary was taxable as FTS, as the deputed employees made available skills to the Indian company to which they were seconded

JC Bamford Excavators Ltd.

Technical assistance which was rendered to the Indian subsidiary by employees of the US entity resulted in a Service PE & FTS being effectively connected with the Service PE shall be taxable as business profits

Secondment Arrangements – Judicial Precedence

Withholding tax considerations

Payment to foreign entity seconding employees to India – Obligation under section 195

Provisions of the Act

The **FTS income** will be taxable **at the rate of 10 percent (plus surcharge and education cess) on gross basis** as per the provisions of section 115A of the Act (in case a PE is not constituted)

However, **in case a PE** is constituted such income will be taxable at **40 percent on net income basis**

Provisions of India US DTAA

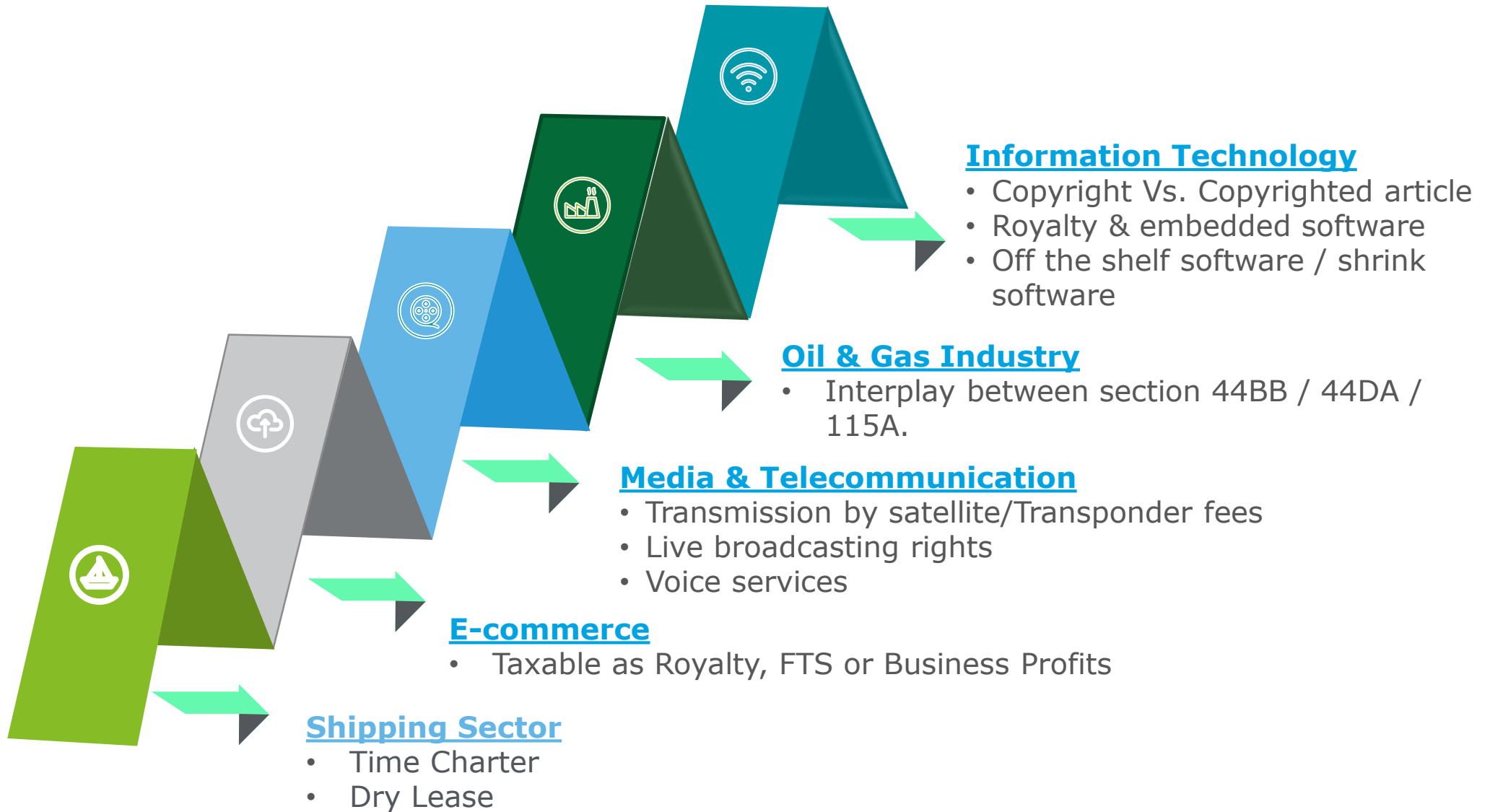
If the payments do not qualify as FTS, then there would be no withholding tax requirement – *The income embedded in such a payment must also be taxable in nature, and unless that is established, the tax deduction at source requirements do not come into play. Here is a case in which the payment is in the nature of reimbursement to a US resident, but by the virtue of article 12(4)(b) of India US tax treaty, the income embedded in the payment was not taxable in India under the treaty provisions, and since treaty provisions override the provisions of the Income Tax Act- unless the latter was beneficial to the assessee, the tax withholding requirements of section 195 were not triggered..... - Stanley Consultants vs DCIT - [2016] 72 taxmann.com 257 (Delhi - Trib.)*

Under Article 12 of the India US DTAA – 15% of the gross amount of such payments

Certain Industry specific Issues

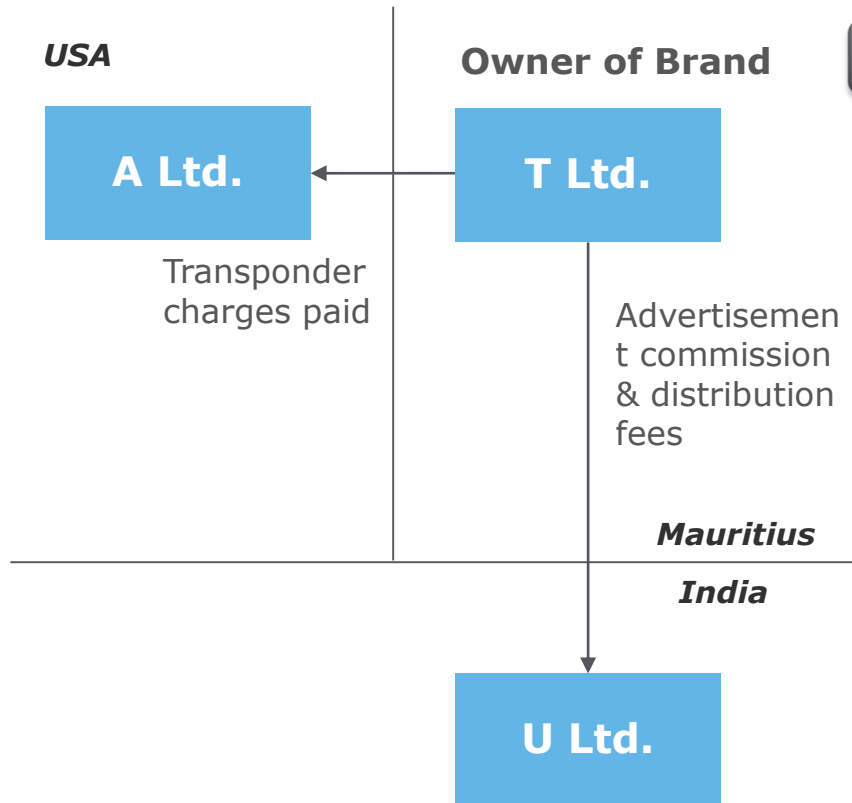
Industry issues

Summary



Case Studies

Case Study 1



Facts

- T Ltd., a tax resident of Mauritius, is engaged in the business of broadcasting of sports channel all across the globe including India
- It has a subsidiary in India, U Ltd., as its advertising sales agent to sell commercial advertisement slot to prospective advertisers and other parties in India, in connection with the business of programming and telecasting sports events and programs
- T Ltd. entered into an agreement with U Ltd. for collection of advertising revenue in India for which a commission of 10% of the total advertisement revenue secured for T Ltd. was paid to U Ltd.
- A "distribution agreement" was also entered into by both the companies for the distribution of the pay channel to the various cable operators & ultimately to the consumers in India
- Distribution revenue collected by T Ltd. is to be shared between by T Ltd. & U Ltd. in the ratio of 60:40 respectively
- T Ltd. had filed its return of income in India as "Nil" on the basis that advertising and distribution revenue earned by it is not taxable in India
- It had paid certain transponder charges to A Ltd., a company based in the USA, for telecasting the sports channel. T Ltd. did not withhold any taxes on the said amount

Issue:

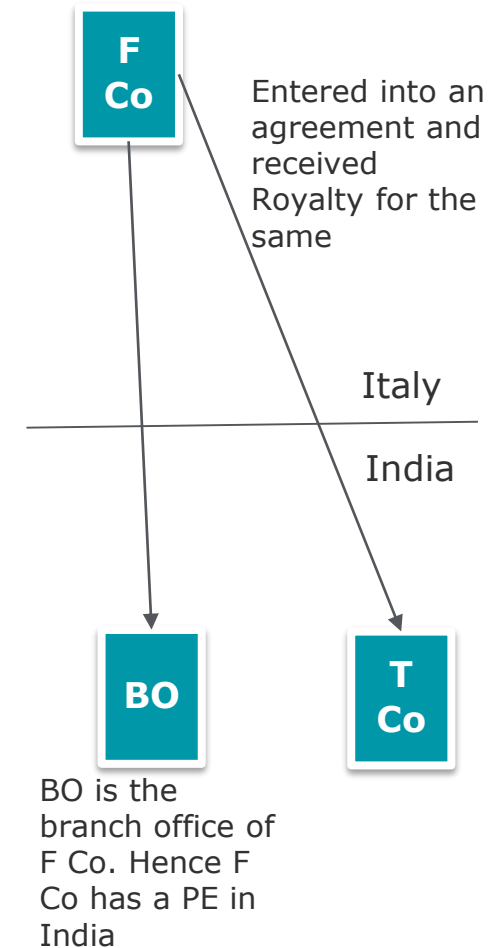
Whether distribution income is royalty in nature under section 9(1)(vi)?

Whether T Ltd. should withhold taxes on transponder charges paid to A Ltd.?

Case Study 2

Facts

- F Co company (Head Office) has set up an Indian Branch Office [BO], which is engaged in following activities in India.
- BO is engaged in undertaking business development and liasoning activities for F Co, assistance in obtaining necessary approvals from various regulator, etc.
- F Co has entered in to an agreement with T Co for technical collaboration and license agreement for providing right to assemble diesel engines and its parts in India. Under that agreement, it has received royalty income in India.
- BO had 25 employees equipped to render services which are mandated under the contract with F Co. and further they are providing business development services to F Co.
- 3 of the employees of F Co visited India from Italy and provided the needed support and training to the T Co. All these three employees of F Co were in India for execution of agreement for technical services and none of them stayed in India for more than 90 days.



Issue:

Whether the income received by FCo is taxable @41.82% in India?

Questions



Certain important case laws

Use of business information reports

- Dun & Bradstreet Espana S A [2004] (272 ITR 99) (AAR)
- Abc Ltd. (Xyz Ltd).[2005] (284 ITR 001) (AAR)
- Credit Agricole Indosuez v DDIT(IT) [2013] ITA NO 4295 and 4965 OF 2005 (Mumbai ITAT)
- CIT v Wipro (2011) (355 ITR 284) (Karnataka HC)

Use of trademark

- DIT v/s Sheraton International Inc. [2009] (313 ITR 267) (Delhi HC)
- DDIT v. Marriott International Licensing Company BV [2013] 144 ITD 333 (Mumbai ITAT)

Use of equipment

- Poompuhar Shipping Corporation Ltd. v. ITO (IT) [2013] ITA Nos. 2206 to 2208, 2629 & 2630 of 2006 AND 56 to 64 & 598 to 601 of 2013 (Madras HC)



Information concerning industrial, commercial or scientific experience

- ThoughtBuzz (P.) Ltd., In re [2012] 21 taxmann.com 129 (AAR)
- ONGC Videsh Ltd. v. ITO [2013] 31 taxmann.com 119 (Delhi ITAT)
- ADIT (IT) v. Globus Stores (P.) Ltd [2012] 28 taxmann.com 117 (Mum ITAT)
- ONGC Videsh Ltd. v. ITO [2013] (141 ITD 556) (Delhi ITAT)
- Ceat International SA v/s CIT [1998] (237 ITR 859) (Bombay HC)
- CIT v/s HEG Ltd [2003] (263 ITR 230) (Madhya Pradesh HC)
- Hughes Escort Communications Ltd vs. DCIT [2012] 21 taxmann.com 171 (Delhi ITAT)
- Standard Chartered Bank v. Deputy Director of Income-tax* , (International Taxation)- 2(1) [2011] 11 taxmann.com 105 (Mum ITAT)
- ITO v. Kendle India (P.) Ltd [2013] 145 ITD 83 (Delhi -ITAT.)
- Thirumalai Chemicals Ltd. v DCIT [2013] 58 SOT 375 (Mumbai - ITAT.)
- Diamond Services International (P.) Ltd. v/s Union Of India[2007] (304 ITR 201) (Bombay HC)
- P.T. McKinsey Indonesia v. DDIT [2013] (141 ITD 357) (Mumbai ITAT)



Royalty

Comparison under Income Tax Act and Model Convention (1/2)

Model convention	Income tax Act
Payment of any kind received as a consideration for the use of or the right to use any patent, trade mark, design or model, plan, secret formula or process	The transfer of all or any rights (including granting of a license) in respect of a patent, invention, model, design, secret formula or process or trade mark or similar property The use of any patent, invention model, design, secret formula or process or trade mark or similar property
None	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
Payment of any kind received as consideration for the use or the right to use information concerning industrial, commercial or scientific experience	The imparting of any information concerning technical , industrial, commercial or scientific knowledge, experience or skill The use or right to use , any industrial, commercial or scientific equipment but not including the amounts referred to in section 44BB

Royalty

Comparison under Income Tax Act and Model Convention (2/2)

Model convention	Income tax Act
<p>Payment of any kind received as a consideration for the use or right to use, any copyright of literary, artistic or scientific work including cinematograph films</p> <p>UN – or films or tapes used for radio or television broadcasting</p> <p>US – (including computer software, cinematographic films, audio or video tapes or disks and other means of image or sound reproduction</p>	<p>The transfer of all or any rights (including granting of a license) in respect of any rights 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 not including consideration for the sale, distribution or exhibition of cinematographic films</p>

Definition as per the Income Tax Act is **wider** as compared to the model convention. The term consideration used in tax treaties in this context, specifies “payments” as a mode, thereby other modes of consideration may not qualify as Royalties



Fees for technical services

Make available clause and relevant case laws

Facts	Whether 'Make Available'?	Decision
Service of the grading and certification reports for diamonds and other articles India –Singapore DTAA	N	Diamond Services International P Limited – [2008] 304 ITR 201 (Bom.)
Technical assistance to enable service recipient to design, construct and operate a plant to manufacture aluminum. Training for application of technical know how India – US DTAA	Y	Hindalco Industries Ltd. v. ACIT [(2005) 94 TTJ 944 (Mum)]
Payment for services to make available executive personnel for development of general management, finance and purchasing, marketing and assemble/ manufacturing activities under the management provision agreement India –US DTAA	N	P No. 28 of 1999 AAR –242 ITR 0208
Air borne geophysical survey using specialized equipments	N	De Beers India Minerals (P.) Ltd. [2012] 346 ITR 467 (Karnataka)
Reimbursement of recruitment fees by Indian company to overseas parent company not FTS as the activity does not satisfy the make-available criteria in the India-USA DTAA	N	Stanley Consultants P Ltd. vs DCIT [2016] 72 taxmann.com 257 (Delhi - Trib.)
Payment for providing training to crew members India –UK DTAA	N	Sahara Airlines Ltd v. DyCIT – 83 ITD 11

Fees for technical services

Make available clause and relevant case laws

Facts	Whether 'Make Available'?	Decision
Amount received by international reinsurance intermediary (broker) for services rendered to insurance company in India in process of re-insurance of risk placed by Indian Insurance company with international re-insurance companies	N	Guy Carpenter & Co. Ltd. [2012] 346 ITR 504 (Delhi)
Payment for operational and support services India – Netherland DTAA	Y	PerfettiVan Melle Holding B.V. - AAR No. 869 of 2010)
Data processing services agreement India –UK DTAA	N	R. R. Donnelley India Outsource (P) Ltd.–335 ITR 122
Publicity, advertisement and sales services India –USA DTAA	N	DIT vs Sheraton Ltd. –313 ITR 267
Supervisory services for erection and commissioning of plant of Indian entity in India - India Finland DTAA	N	Outotec India (P.) Ltd. v. ACIT (59 taxmann.com 108)
Payments made for architectural design and drawings of business park could not be held as 'Fee for Technical Services' as mere passing of project specific architectural design and drawings did not make available technical knowledge, know-how or process	N	Gera Developments P Ltd. vs DCIT [2016] 72 taxmann.com 238 (Pune - Trib.)



Information Technology

Copyright Vs. Copyrighted article

HALLIBURTON EXPORT INC [2016](ITA 363/2016)(Delhi HC)

INFRA SOFT LTD. [2014] (220 Taxman 273)(Delhi HC)

SAIC INDIA (P.) LTD. [2016](71 taxmann.com 237)(Delhi - Trib.)

- The right to use a copyright in a programme is totally different from the right to use a programme embedded in a cassette or a CD which may be a software
- The payment made for using a programme cannot be said to be received as consideration for the use of or right to use of any copyright in the programme to bring it within the definition of royalty as given in the DTAA.
- Tax payer paid consideration for transfer of copyrighted article in form of software. As such, exclusive right had not been transferred in favour of the tax payer qua software purchased by it
- Tax payer's rights were restricted to use of copyrighted product for internal business purpose
- Such consideration cannot be in the nature of royalty

Information Technology

Royalty & embedded software

- Embedded software involves supply of software along with hardware or right to use software and provision of services.
- OECD 2014 under Article 12 'Royalties'
 - consideration payable under a contract should be broken down on the basis of the information contained in the contract or by means of a reasonable apportionment with the appropriate tax treatment being applied to each apportioned part
 - Treatment applicable to the principal part should generally be applied to the whole amount of the consideration (including the ancillary parts)
- The Commentary to the UN Model Convention on taxability of bundled software is on similar lines as the view expressed in the Commentary to the OECD Model Convention
- The India Court rulings on the issue of bundled software can be broadly classified as under:
 - Supply of software embedded/ bundled with hardware by the vendor
 - Supply of software separately from hardware

Royalty & embedded software

Supply of software embedded/ bundled with hardware

- Motorola Inc. [2005](95 ITD 269)(Del ITAT)(SB),
 - Ericsson A.B. [2012](343 ITR 470)(Del),
 - Nokia Networks OY [2013](358 ITR 259)(Del)
 - Huawei Technologies Co. Ltd. [2014](149 ITD 323)(Del ITAT)
 - Alcatel Lucent Canada [2015](56 taxmann.com 413)(Del),
- Aforesaid rulings are in favour of the taxpayer**

Supply of software separately from hardware & subsequently bundled together by the buyer

- Sunray Computers (P) Ltd. [2012] 348 ITR 196 (Kar)
- Reliance Infocom Ltd. [2013] 39 taxmann.com 140

Aforesaid rulings are not in favour of the taxpayer

Software imported & subsequently bundled with distributor's software & sold

- Infotech Enterprises Ltd. [2014] 63 SOT 23 (Hyd. ITAT)

Aforesaid ruling is in favour of the taxpayer

Royalty

Off the shelf software / shrink wrapped software

- Off the shelf software / Shrink software is generally for internal business use or for the purpose of distribution to end user.
- **Judicial view emerging-**
 - For a payment to be considered as Royalty, a mere right to use or the use of a copyright would be sufficient.
 - It is not necessary that there should be a transfer of any exclusive right
 - As per the language of section 9(i)(vi) of the Act specifies that the rights being granted should be **'in respect of'** any copyright and there is **no requirement of it being a right in copyright.**
- **Judicial precedents-**

+ Hewlett Packard (India) P. Ltd (5 SOT 660)
[Bang ITAT]

+ Infracore Limited (1 ITR(TRIB) 390) [Del
ITAT]

+ Solid Works Corporation (51 SOT 34)
[ITAT](Bombay)

+ Baan Global BV* [2016] 71 taxmann.com
213 (Mumbai - Trib.)

+ ZTE Corporation[2016] 70 taxmann.com 1
(Delhi - Trib.)

- Synopsis International Old Ltd (ITA No.
11 to 15 of 2008 and 17 of 2008)
(Karnataka High Court)

- Samsung Electronics Co. Ltd (345 ITR
494)(Karnataka High Court)

E-commerce

Taxable as Royalty, FTS or Business Profits

Royalty

- Electronically ordering / downloading of digital products for the purpose of commercial exploration.
 - TAG report
- Subscription fees for providing online social media monitoring services are in the nature for use or right to use process or information concerning industrial, commercial or scientific experience
 - Thoughtbuzz P. Ltd (2012)(346 ITR 345)(AAR)
- Payment made for obtaining license to use database maintained is to be regarded as royalty
 - Wipro Ltd. [2013] 355 ITR 284 (Karnataka),
 - Infosys Technologies Ltd. [2014] 51 taxmann.com 417 (Karnataka),
 - Gartner Ireland Ltd. [2013] 60 SOT 43 (Mumbai - Trib.)
- Use of airline portal by agent is not possible without the use of server. Portal and server together constitute integrated scientific cum commercial equipment & subscription fee paid for the use of said portal is taxable as royalty
 - Cargo Community Network (P.) Ltd., In re [2007] 289 ITR 355 (AAR)

E-commerce

Taxable as Royalty, FTS or Business Profits

Fees for Technical Services

- Mere use of technology in providing a service would not qualify as fees for technical services. Special skills or knowledge related to a technical field is required for provision of services –
 - TAG report
 - Fino Fintech Foundation [2016] 71 taxmann.com 224 (Mumbai - Trib.)
- Technology used in developing / bringing out standard facility and allowing to use the same does not constitute services in the nature of FTS
 - Skycell Communications Ltd. [2001](251 ITR53)(Mad),
 - eBay International AG (ITA No. 6784/M/2010)
 - Primenet Global Ltd. [2016] 70 taxmann.com 179 (Delhi - Trib.)

Business income

- Fees for display of banner advertisements on websites would be in the nature of business profits.
 - TAG report
 - The High Powered Committee (HPC) on Electronic Commerce and Taxation constituted by CBDT
 - Yahoo India P Ltd. (2011)(140 TTJ 195)(Mum Tribunal)
 - Right Florists P. Ltd (2013)(154 TTJ 142)(Kol)
- Website Hosting - payment received for providing web hosting services though involve use of certain scientific equipment cannot be treated as consideration for use of, or right to use of, scientific equipment
 - TAG report
 - Savvis Communication Corporation [2016](69 taxmann.com 106)(Mum ITAT)
 - However, as per HPC it is royalty income



Media & Telecommunication

Payments pertaining to transmission by satellite/Transponder fees

- Based on the AAR ruling of **Dell International Systems** (305 ITR 37), Finance Act was amended to expand the scope of royalty and also include payments made towards '**process**' (Explanation 6 to section 9)
- Whether it is mandatory for a process to be a secret to qualify for royalty payments?
- The term process is not defined under the tax treaties.
- Judicial precedents-
 - **B4U International Holdings Ltd** (18 ITR (Trib) 62 MUM) - after considering the impact of the proposed amendment by the Finance Bill 2012 to section 9(1)(vi) of the Act, ruled that the payment will not fall within the ambit of royalty under the tax treaties as **the tax treaty provisions will remain unchanged**
 - **Viacom 18 Media Pvt. Ltd.** [2014] (44 taxmann.com 1)(Mumbai Trib.) - payment of fees for use of satellite transponder service by assessee to US company taxable as 'royalty', under article 12 of India-US DTAA. It states that **since term 'process' is not defined in India-US DTAA, hence, its definition as per the Act is to apply**
 - **Asia Satellite Telecommunication** (332 ITR 340)(2011)(Del HC) - there was no grant of right to use the process of transponder capacity nor was satellite the equipment leased and hence no 'royalty'



Oil & Gas Industry

- Mutually exclusionary clauses inserted in section 44BB & section 44DA w.e.f. 1 April 2011 are not retrospective
 - Schlumberger Asia Services Ltd. [2012] 22 taxmann.com 165 (Delhi)
 - CGG Veritas Services, SA [2012] 18 taxmann.com 13 (Delhi)
 - PGS Geophysical AS [2014] 369 ITR 27 (Delhi)

Amendment to section 44DA / 44BB

- Payment for providing various services in connection with prospecting, extraction or production of mineral oil, would be assessed under section 44BB, and not under section 44D -
 - Oil & Natural Gas Corporation Ltd. [2015] 376 ITR 306 (SC)

44BB v. 44D

- Geophysical services taxable under section 44BB and not as FTS under section 44DA since section 44BB provisions are more specific.
- If section 44DA covers all types of services rendered by the non-resident, that would reduce section 44BB to useless and such a result would be opposed to the very essence of the rule of harmonious construction
 - OHM Ltd. [2013] 352 ITR 406 (Delhi)

44BB v. 44DA

