Taxation of Royalty and Fees for Technical Services
## Contents – R/FTS

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- Taxation framework under the Income-tax Act 1961 (‘ITA’)
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- Selected issues
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R-FTS: Overview of Taxation Framework

• **Scope of R / FTS: Meaning and coverage**

• **Deemed accrual / arising of the R-FTS for the Non-Resident (NR) in India**
  – In which cases and when would the income be taxable in India?

• **Nature of taxation of R/ FTS**
  – Gross basis (Non Permanent Establishment ['PE'] situation) both under the Act as well as DTAA
  – Net basis (if attributable / effectively connected to NR’s PE in India) under the Act as well as DTAA

• **Compliance aspects for Non-Residents**
  – PAN and Tax Residency Certificate to be obtained by NR payee
  – Withholding tax by payer even if he is a Non-Resident and related compliances
    – Post Vodafone (SC), Section 195 amended to include NR to NR payments in all cases
  – Transfer pricing to demonstrate arm’s-length nature of the transactions with Associated Enterprises
  – Filings of returns (with TP Report) by NR payee and undergoing Assessments followed by DRPs, Appeals, etc.
  – Grossing up of TDS cases – unable to access easily position /taken by payers
• **Section 5 – Scope of Total Income for Non-Residents**
  - Income received / deemed to be received in India
  - Income accruing / arising in India or deemed to accrue or arise in India

• **Section 9 – Income deemed to accrue or arise in India**
  - R / FTS taxation provisions introduced from w.e.f. 1 June 1976 i.e. AY 1977-78
  - Royalty - Section 9(1)(vi) read with Explanations thereto
  - FTS - Section 9(1)(vii) read with Explanations thereto
  - R / FTS deemed to accrue or arise in India if payable by:
    - Government
    - Residents except when payment is for business / profession / source outside India
    - Non-residents where payment relates to business / profession / source in India

  Note: Source = Not the payer of income but where activities / business carried out by Indian Entity (Havells - Del HC) but there are contrary decisions as well

• **S. 90(2):** Provisions of the Act will prevail over provisions of DTAA to the extent they are more beneficial

• **S. 94A:** DTAA benefits denied to NR of Notified Jurisdictions (lack of effective exchange of information)
Meaning of Royalty under ITA

• Section 9(1)((vi) - Royalty payable in respect of any right, property or information used or services for business / profession as stipulated

• Explanation 2 to Section 9(1)(vi): Royalty means consideration for (includes lump sum consideration but excludes income chargeable under the head ‘Capital Gains’) for:

  a) Use of or Transfer of all or any rights in - including granting of any license:

  • patent, invention, model, design, secret formula or process or trademark or similar property

  • copyright, literary, artistic or scientific work including films or video tapes but excludes consideration for sale, distribution and exhibition of cinematographic films

b) Imparting of any Information concerning:

  • working of or use of patent, model, design, secret formula, process, trademark or similar property

  • technical, industrial, commercial or scientific knowledge, experience or skill

c) Use or right to use:

  • industrial, commercial or scientific equipment (excluding those covered under Section 44BB) [Introduced from AY 2002-03]

d) Rendering of any services in connection with activities constituting Royalty

• Explanation 3 to Section 9(1)(vi): Computer software means any computer program recorded on any disc, tape, perforated media or other information storage device and includes any such programme or customized electronic data [from AY 2001-02]
Widening ambit of Royalty - Computer Software

Explanation 4 added to s. 9(1)(vi)
- For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred.

As per Memorandum to Finance Bill
- Some judicial decisions have interpreted this definition in a manner which has raised doubts as to whether consideration for use of computer software is royalty or not. Considering the conflicting decisions of various courts in respect of income in the nature of royalty and to restate the legislative intent, it is further proposed to amend the Income-tax Act.

- India in its comment on the UN MC 2011 has recommended “The use of and right to use computer software irrespective of the medium through which such right is transferred is to be construed as ‘Royalty’ (Article 12)”

- As an observer member, India has reserved its positions on several paragraph of the OECD MC – cases of reservations which extend to software, ICS experience, undersea cables, payments for roaming calls, spectrum allocation, etc.
Widening ambit of Royalty – Use / Possession and Process

The Finance Act 2012 - Expansion of Royalty definition retrospectively w.e.f. AY 1977-78

• Explanation 5 added to s. 9(1)(vi)
  - For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not
    (a) the possession or control of such right, property or information is with the payer;
    (b) such right, property or information is used directly by the payer;
    (c) the location of such right, property or information is in India

• Use of Process : Explanation 6 added to s. 9(1)(vi)
  - For the removal of doubts, it is hereby clarified that the expression “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret

• Inserted primarily to overturn Delhi High Court’s decision in the Asia Sat case

• The term Transmission not defined
Meaning of FTS under ITA

- Explanation 2 to Section 9(1)(vii). FTS means any consideration (includes lump sum consideration) for rendering any:
  - Managerial
  - Technical
  - Consultancy Services
- Includes
  - Provision of services of technical / other personnel
- Excludes:
  - Construction; Assembly; Mining; Any like project; Income chargeable as ‘Salary

- The Supreme Court in Ishikawajima (2007) 288 ITR 408(SC) held that offshore services not only must be utilized in India but also be rendered in India as part of its business or have sufficient territorial nexus - live link with India to become taxable

- The FA 2007 inserted an Explanation to Section 9 w.r.e.f. 1 June 1976 to indicate that Interest, Royalty and FTS would be included in total income of NR irrespective of their place of resident or place of business or business connection in India or rendering of services in India (introduced subsequently by FA 2010)
Meaning of FTS under ITA

• **Managerial Services** - R. Dalmia v. CIT (1977) 106 ITR 895 (SC)
  - The words "person concerned in the management of the business" mean a person not only directly participates or engages in the management of the business but also one who indirectly controls its management through the managerial staff, from behind the scenes. Management includes the act of managing by direction, or regulation or administration or control or superintendence of the business.

  - Technical Services Human intervention to be involved in technical services as the term technical is between Managerial & Consultancy Services [Bharti Cellular (SC) and other decisions]

• **Consultancy Services** – GVK Industries Ltd (2015) 371 ITR 453 (SC)  read with Bharti Cellular (Del HC)
  - The term "consultancy" has been defined in the Dictionary as "the work or position of a consultant; a department of consultants." "Consultant" itself has been defined, inter alia, as "a person who gives professional advice or services in a specialized field."
  - The word "consultant" is a derivative of the word "consult" which entails deliberations, consideration, conferring with someone, conferring about or upon a matter. Consult has also been defined in the said Dictionary as "ask advice for, seek counsel or a professional opinion from; refer to (a source of information); seek permission or approval from for a proposed action".
  - It is obvious that the service of consultancy also necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant.

• **Professional Services** are also covered per judicial precedents and Technical Services need not be confined to technology relating to engineering, manufacturing or applied science
• **Taxation on Gross basis under Section 115A**
  
  - Stipulated conditions for agreements with Indian Concern (Payer)
    - Agreement with Government, or
    - Agreement to be approved by the Government; or
    - Where it relates to a matter included in the Industrial Policy – (Currently, FEMA)
  
  - Cases of NR to NR not fully covered as payer envisaged as the Government or an Indian Concern
    - Indian Branch of Foreign Company – Indian Concern (CBDT Circular 740 dated 17.4.96 / Bank of Credit & Commerce – Mum AT)
  
  - Prior to AY 2004-05, Gross basis of taxation applied only to R/ FTS income of Foreign Companies

• **Position till AY 2013-14**
  
  - For agreements made on or after 1 June 1997 till 31 May 2005
    - Taxation on gross basis under Section 115A read with Section 44D at 20% (+SC and EC)
  
  - For agreements entered on or after 1 June 2005 - Basic rate of 10% on gross basis (+SC and EC)
Position from AY 2014-15

- Taxation on gross basis under Section 115A and net basis under Section 44DA as above
- Basic rate of tax increased to 25% on gross basis (+SC and EC) irrespective of the date of the agreement
- Provisions of Section 206AA at 20% on gross basis not relevant unless DTAA stipulates lower rate, TRC available but no PAN of the payee available
  - Deduction under Section 206AA is initial withholding of tax and not a charging Section
  - Thus, excess withholding tax over DTAA rate can be claimed refund in tax return post PAN and TRC
  - If grossing up applies then the grossed up rate is to be compared with 20%
    - This view is now supported by judicial precedents
  - No Surcharge or cess to be applied and 20% is the absolute gross withholding tax rate
- Section 94A: Cyprus – highest rate of withholding at 30% on gross basis from 1 November 2013 till (now de-notified and renegotiated)
Taxation on net basis - Section 44DA – position from AY 2004-05

- For R/ FTS effectively connected with PE of business / fixed place of profession of NR in India

- **PE**
  - As per Section 92F(iii) of the Act
  - The Supreme Court in Morgan Stanley (292 ITR 416) has held that PE definition in the Act is inclusive and would cover all types of PEs as per DTAA as well

- **Prior to AY 2004-05 / Section 44DA:**
  - R/ FTS were held to be taxable on gross basis even when attributable to PE
  - This was due to gross basis taxation only under the ITA; and
  - Where DTAA obliged computation of income in accordance with and subject to limitations of the ITA
  - Several old Advance Rulings have upheld this position
Position of R / FTS under Model Convention (MC)

**Royalty**

- **OECD MC**
  - Exclusive taxation in State of Residence unless attributable to PE of NR in the Source State
  - Royalty = consideration for use / right to use of any copy right of literary, artistic or scientific work including cinematograph films, any patent, trademark, design or model, plan secret formula or process or for information concerning industrial, commercial or scientific experience

- **UN MC**
  - Right to State of Source to tax on gross basis as well as net basis when attributable to PE / Fixed Base of Non-Resident
  - Notable inclusions of Films / Tapes used for radio / TV broadcasting
  - Notable inclusions of industrial / commercial / scientific equipment

- **US MC**
  - Similar to OECD MC but no exclusive right to tax for State of Residence
  - Notable exclusion of cinematographic films
  - Notable inclusion for gains derived from alienation which is contingent on the productivity or use or disposition of the property

- **FTS**
  - There is no specific article on FTS in either OECD / UN / US MC
  - On par with Business Income i.e. Taxable in State of Source only if attributable to PE of NR therein
Brief Overview of Article 12 – Royalty in DTAA / UN MC

- **Article 12(1)** – Distribution of rights of the Contracting States
- **Article 12(2)** – Ceiling of Gross taxation by the State of Source subject to Beneficial Ownership
- **Article 12(3)** – Meaning of the term ‘Royalty’
- **Article 12(4)** - Taxation of Royalty if effectively connected with PE / Fixed Base of Non-Residents in the State of Source
- **Article 12(5)** - Arising of Royalty in the State of Source
  - Where payer is Resident; and / or
  - If the Payer has a PE / Fixed Base in the State of Source and the Royalty is connected and borne by such PE / Fixed Base
- **Article 12(6)** – Adjustments for related party transactions
  - Excess over Arm’s-length price to be taxable as per domestic provisions

The FTS Article in most Indian DTAA is structured on above lines

Under DTAA, limited accrual of R/FTS for NR to NR cases except in few tax treaties e.g. India-USA

Concept of Beneficial Ownership and Most Favored Nation Clause also relevant
Concept of Beneficial Ownership

- **OECD MC (Articles 1, 10, 11 and 12)**
  - Improper use of conventions (Article 1)
  - Articles - BO Term not to be used in a narrow or technical sense but object and purpose of tax conventions
  - Agent, nominee and conduits, etc not BOs
  - OECD MC 2014 incorporates several past documents / proposals for BO

- **IBFD International Tax Glossary**
  - Beneficial owner is a common law term whose meaning has been developed by the Courts
  - The term is distinct from the term ‘Legal Owner’

- **Professor Klaus Vogel**
  - Beneficial owner is a person who is free to decide: Whether or not the capital / assets should be used / made available for use by others & How the yields from them should be used

- **US Model Convention**
  - Regards beneficial owner as a person if the income is attributable to him for tax purposes as a resident

- **Article 3(2) of Model Convention**
  - Whether meaning as per domestic tax law to be adopted? [India – Section 2(22), Section 79, etc.]

- **Test presence in DTAAAs in diverse form**

- **CBDT Circular 789 dt .3 April 2000** under India–Mauritius DTAA issued in the context of FIIs, etc.: Tax Residency Certificates (‘TRCs’) issued by Mauritius Tax Authorities sufficient evidence of residence status as well as BO

Most Favored Nation Clause

- **Most Favored Nation Clause**
  - More favorable DTAA terms granted to other countries extended to existing treaty countries by Source Country
    - Lower tax rate or narrowing the scope of income liable to tax
  - Generally MFN status is contained in the protocol/exchange of notes
  - MFN Clause is generally only prospective
  - Application is automatically or by negotiation and then notification

- **Examples of key Indian tax treaties with MFN status in the context of R/FTS**
  - India - Netherlands DTAA - India – Finland DTAA - India-UK DTAA
  - India - Belgium DTAA - India – Hungary DTAA
  - India - France DTAA - India – Israel DTAA
  - India - Sweden DTAA - India – Kazakstan DTAA
  - India - Switzerland DTAA - India – Saudi Arabia DTAA
  - India - Spain DTAA - India – Philippines DTAA
Royalty – Situations under India DTAAs (Illustrative)

• **Situation 1** - Presence of Article on Royalty akin to ITA
  - Taxation on gross basis and so taxation / implications very similar to that under ITA
  - Simpler method of taxation for non-residents

• **Situation 2** - Scope and accrual of Royalty Article restrictive as compared to ITA
  - Scope is narrower especially for ICS Royalties, etc.
  - NR to NR payments accrual in India is generally more restrictive except in some cases e.g. India-USA DTAA

• **Situation 3** – Scope of Royalty Article more exhaustive as compared to ITA
  - Especially for cinematographic films, gains on alienation, etc
  - Non-Resident governed by beneficial provisions of the Act

• **Situation 4** - Royalty attributable / effectively connected with PE in India
  - Taxation on net basis for income attributable to the PE
  - Onerous compliances / obligations / costs
Scope of Royalty – Selected Indian DTAA (Illustrative)

- **Scope exclusions**
  - USA
    - Ships & Aircraft, etc used in International Traffic
  - Ireland DTAA
    - Aircraft
  - France / Netherlands
    - Industrial / commercial / scientific equipments

- **Royalty v. Capital Gains (Net?)**
  - USA DTAA – gains contingent upon productivity, disposition or use
  - Singapore DTAA – includes gains derived from alienation right / property / information
  - Alienation v. Transfer
  - Gain is Net income taxed on gross basis v. Gross income basis for other items

- **Specific inclusion for software / computer software program**
  - Malaysia, Morocco, Kazakstan, etc
• **Situation 1 - Absence of Article on FTS**
  - Business profits i.e. taxation of Non-Resident in India only in their PE situation
  - Most beneficial situation for Non-Residents
  - E.g. Mauritius, UAE, etc
• **Situation 2 - Presence of Article on FTS akin to ITA (e.g. DTAA with Japan, Germany, etc)**
  - Taxation on gross basis - Taxation / implications very similar to that under ITA
  - Simpler method of taxation for non-residents
• **Situation 3 - Scope and accrual of FTS more restrictive as compared to ITA**
  - Scope of FTS Article more restrictive then ITA (India-USA DTAA- See next few slides)
  - NR to NR payments & accrual in India more restrictive except some cases –India-USA DTAA
  - Work to be done in source country (e.g. India-China DTAA)
• **Situation 4 - FTS effectively connected with PE in India**
  - Taxation on net basis for income attributable to the PE with Onerous compliances
Situation 3 - Scope of FTS Article restrictive as compared to ITA

• Provisions of the India-USA DTAA most relevant (Article 12 / Fees for Included Services)
  – Includes only Technical (expertise in Technology) or Consultancy Services (Advisory services but in the technical field)
    • Managerial Services absent!
    • Illustrations of technical fields / sector given in protocol E.g. Engineering, etc.
  – Include services ancillary /subsidiary qua Royalty (various factors specified)
    • E.g. Consultancy services to improve manufacturing process post grant of rights
    • No for cleaning services of machinery
  – Exclude services ancillary / subsidiary and inextricably / essentially linked to the sale of goods other than those constituting Royalty
  – Encompass ‘Make Available concept (Fees for Included Services [FIS]) (See Next Slide)
  – Encompass development / transfer of technical plan or technical design
  – Specific exclusions for personal use, educational institutions, etc.
**FTS – Situations under India DTAAAs (Illustrative) (3 of 3)**

<table>
<thead>
<tr>
<th>Situation 3 - Scope of FTS Article restrictive as compared to ITA (Cont’d)</th>
<th>• Concept of make available exists in more than a dozen treaties</th>
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</thead>
<tbody>
<tr>
<td>• Concept of ‘Make Available’ under India-USA DTAA - Making available any technical knowledge, experience, skill, know-how or process</td>
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<tr>
<td>– Person acquiring the services enabled to apply the technology</td>
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<td>– Mere Technology input / use of product technology by itself not sufficient</td>
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<td>• E.g. Engineers helping Indian Manufacturer on how to produce the products and provides information / advice</td>
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<td>• E.g. Modifying product formulas and training employees to apply the same</td>
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<td>– Condition not satisfied for periodic repairs, inspections, etc of machines</td>
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<tr>
<td>• Concept of make available exists in more than a dozen treaties</td>
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<td>– Directly – Australia, Canada, Cyprus, Malta, Netherlands, Portugal, Finland, Singapore, USA, UK, etc</td>
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<tr>
<td>– In some DTAA the term ‘managerial’ is included additionally with technical and consultancy! (e.g. Singapore)</td>
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<tr>
<td>– Due to MFN Clause – Belgium, France, Israel, Kazakhstan, Spain, Sweden</td>
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<tr>
<td>– Australia – Concept of FIS included in definition of Royalty</td>
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<tr>
<td>– Examples and principles of India-USA DTAA can be applied to other DTAAAs as well – several judicial precedents support this view – but do with careful analysis and reasoning !!</td>
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R / FTS – meaning of ‘paid’ and impact on deemed accrual

- **OECD MC on Article 12**
  - Paid has a very wide meaning i.e. fulfillment of the obligation to put funds at the disposal of the creditor in the manner required by the contract or by custom

- **R/ FTS held to be taxable only when ‘paid’ to Non-Residents**
  - Siemens Aktiengesellschaft (2012) Bom HC: India-Germany DTAA
  - Pizza Hut International (2012) – Del AT: India- USA DTAA
  - CSC Technology (2012) – Del AT: India-Singapore DTAA
  - Booz, Allen & Hamilton – (2013) Mum AT (In absence of RBI approval, no accrual of income)
  - Johnson and Johnson v ADIT (2013) Mum AT

- **Paid – defined under Section 43(2) of the Income-tax Act 1961**
  - ‘Paid’ means actually paid or incurred according to the method of accounting
  - Whether above definition relevant for Article 3(2) and can be imported for DTAAAs?

- **Paid is thus arguably different from cash basis of accounting - Flakt AAR is against cash basis of accounting for R/FTS**

R-FTS - Retrospective amendments

**Whether impacts DTAA?**

- MC / DTAA Article 3(2) - Terms not defined to have meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State
- OECD / UN MC - Recommends Ambulatory approach of interpretation over static approach
- B4U International (2012) - Mum AT
  - Payments for hiring of Transponder not Royalty
  - Amendments have no affect as there is no change in DTAA
- WNS (Mum AT), Nokia (Del HC) and other judicial precedents support the above principles
- Recent decisions – Baan Global (Mum AT) [Software] & New Skies Satellite (Del HC)

**Whether create retrospective withholding tax obligations or Disallowance under Section 40(a)(i)?**

- No - *Lex non Cogit ad impossibia*: Law cannot compel a person to do something which is impossible – a principle upheld by several decisions of the Supreme Court
- Several direct judicial precedents now available on this issue
R-FTS – selected key issues controversies

<table>
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<tr>
<th>Royalty</th>
<th>FTS</th>
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<tr>
<td>• Computer Software / use of other copyrighted products</td>
<td>• Back Office Support / IT-ITes services</td>
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<tr>
<td>• Payments for use of Satellite / Transponder</td>
<td>• Cost Sharing / R&amp;D Arrangements</td>
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<td>• Payments for Leased Line / Bandwidth / Circuits / Inter-connectivity</td>
<td>• Routine repairs / standard facility</td>
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<td>• Payments for Live Telecast</td>
<td>• Payments for Specialized Services e.g. Feasibility Studies / Clinical Trials (v. payments as Industrial, Commercial and Scientific Experience = Royalty)</td>
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<td>• Payments for online database access / subscription</td>
<td>• Payment for production of live TV Signals</td>
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<td>• Accreditation arrangements (Hospitals, etc)</td>
<td>• Database storage and / or processing charges</td>
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<td>• Website use / hosting, advertising portal, etc</td>
<td>• Secondment arrangements</td>
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<tr>
<td>• Payments for ships – dry lease v. wet lease</td>
<td>• Reimbursement of expenses</td>
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<tr>
<td>• Payments for services whether include use of Brand and can be re-characterized or split?</td>
<td>• Marketing and Export Commission</td>
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<tr>
<td>• Know-How and Industrial, commercial and scientific experience</td>
<td>• Supervisory services</td>
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<td></td>
<td>• Services inextricably connected / part of sale</td>
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Domestic controversies or decisions under Section 194J of the Act are also relevant but with care because only Explanation 2 of Section 9(1)(vi)/(vii) covered......
Software Taxability

**Income Tax Authorities**
- Supply of software involves use / right to use of following:
  - copyright,
  - patent,
  - Invention,
  - process, or scientiﬁc work
- Taxable in India as royalty on gross basis

**Taxpayers**
- Supply of software does not involve any use / right to use of copyright, patent, invention or process
- It is for use of a copyrighted product / article and thus, business income, not taxable in India in the absence of any PE in India
- Reliance placed on OECD and International commentaries

**Characterisation of receipts from software supply by foreign companies / entities / persons**

- **Whether Royalty?**
- **Software of supply**
- **Whether Business Income?**

**Issue under litigation in a number of cases pre and post introduction of Explanation 4 to Section 9(1)(vi)**

Question currently pending before the Supreme Court primarily from series of negative decisions of Karnataka HC and controversy extends to online database access and similar other items as well
Recent Computer Software decisions (favorable) - Copyright vs. Copyrighted Article

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<tr>
<th>Decision</th>
<th>Authority</th>
<th>DTAA</th>
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<tr>
<td>Halliburton Export (2016) – Del HC: India-USA DTAA</td>
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<td>Del HC followed its earlier decision in Infrasoft (2014) and upheld distinction between copyrighted article payment for which is not Royalty and payment for copyright which constitute Royalty</td>
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<tr>
<td>Domestic provisions not to be considered as DTAA is more beneficial</td>
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<td>Baan Global (2016) – Mum AT: India-Netherlands DTAA</td>
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<tr>
<td>Limited right to operated copyrighted article is not Royalty</td>
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<td>Right to modify source code is for own internal computing operations</td>
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<tr>
<td>Domestic amendments not relevant for DTAA applicability</td>
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<tr>
<td>Capgemini Business (2016) – Mum AT: India-Singapore DTAA</td>
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<tr>
<td>Making copy for protection of damage or loss cannot be said to be transfer of copyright</td>
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Computer Software decisions - Purchase for redistribution / sale

I. In favor of Assessee

- **M. Tech India (2016) – Del HC: India-Australia**
  - Value Added Reseller with right to use source code for purposes of End user – Payment is for acquiring a product and not Royalty following – Infrasoft (Del HC) and Dynamic Vertical (Del HC)

- **Financial Software & Systems P Limited (2014) - Chennai AT**
  - Payments made to non-residents for procuring standard and copyrighted software products for distribution or re-sale purpose is not in the nature of Royalty as it is a Trading Transactions and role of Indian company was only to install and running of the software

- **Infotech Enterprises Limited (2014) – Hyderabad AT**
  - Purchase of software from Dutch company and bundling with its own software for onward sale to customers. Perpetual license given directly to end customers by Dutch Company
  - Transaction in the nature of purchase of trading items / goods – not Royalty

- **Locuz Enterprise (2015) – Hyderabad AT**
  - NR was a reseller of software products and therefore transaction was in the nature of trade. Payments did not fall within the ambit of Royalty

II. Against the Assessee – Several: Skillsoft AAR and several decisions of Bangalore AT / Karnataka HC
Recent Computer Software decisions - Software embedded in Hardware

In favor of Assessee

- **Galatea (2016) – Mum AT: India-Israel DTAA**
  - Dominant character and essence of transaction was sale of machine and software had no independent value for customers.
  - There was transfer of copyrights or any rights therein.
  - Operating software accompany sale of machine – no Royalty

- **ZTE Corporation (2016) – Del AT: India-China DTAA**
  - Telecom equipments supplied to Indian Telecom operations with embedded software
  - Software integrally connected to supply of hardware
  - The supply of software cannot be treated as Royalty
Recent Transponder decisions

- **In favor of the Assessee**
  - **New Skies Satellite BV (2016) – Del HC: India-Thailand DTAA**
    - Lease of Satellite Transponder not taxable as Royalty
    - Domestic amendments not relevant for DTAA applicability
  - **Taj TV (2016) – Mum AT**
    - Transponder payments are for use of facility and not for use of any equipment
    - Domestic amendments not relevant for DTAA applicability
    - Transponder payments not Royalty
Recent Telecom & Connectivity decisions

• In favor of the Assessee
  
  • Interroute Communications (2016) - Mum AT: India-UK DTAA
    – Payments for international telecommunication network connectivity facility neither taxable as Royalty or FTS as there is no transfer or technology or make available
    – India-USA DTAA applied
    – Domestic amendments not relevant for DTAA applicability
  
  • Nava Bharat Ventures (2016) – Mum AT: Section 194J
    – Payment of open access charges for use of transmission lines are not Royalty since there is no use or right to use of any patent, invention, model, design, secret formula, process or trademark.
    – No reference to Retrospective Explanations as not relevant for S. 194J
  
  • Qualcomm India (2016) – Hyd AT: India-USA DTAA
    – Payment for internet and Bandwidth Services including equipment installations at customers premises for accessing network are not Royalty as there is no personalized / sophisticated modified equipment for specific and exclusive use of the Assessee
Recent Telecom & Connectivity decisions

- In favor of the Assessee

  **Bharti Airtel (2016) - Mum AT: India-UK DTAA**

  - Inter-connect usage charges paid in connection with international Long Distance Telecom Services Business (calls originating / terminating outside India)
  - No FTS as there is no manual or human intervention during the transportation process
  - No Royalty as
    - Royalty connotes exclusivity and exclusive right in relation to the thing for which Royalty is to be paid
    - The above is generally associated with some discovery, invention or specialized knowledge not available to the public
    - The payer must use IP on its own and bear the risk of exploitation or liabilities of the use.
    - The above is applicable to ‘process’ and amendments have not done away with the requirement of exclusivity.
    - In telecom sector, all telecom operators have similar infrastructure and network and also the process is in public domain
    - None of the services providers have exclusive process rights
    - The payment is for Standard facility and not Royalty
    - Domestic amendments not relevant for DTAA applicability
Recent Live Telecast decisions

In favor of Assessee

- **Delhi Race Club (1940) Limited (2014) – Delhi HC**
  - Section 194J - In clause (v) of Explanation 2 to Section 9(1)(vi) – Royalty
    - “The transfer of all or any rights (including the granting of a license) in respect of any copyright, literary, artistic or scientific work including films... “
    - The word ‘in’ inserted by the Court “The transfer of all or any rights (including the granting of a license) in respect of any copyright in literary, artistic or scientific work including films... “
    - Reasons: copyright does not synchronize with the word literary, artistic or scientific work as they are the work in which copyright exists. Plain reading is meaningless. Court has power to add a word in the Statute in required cases.
    - Live telecast is in nature of broadcast under the Copyright Act and no copyright in it subsists under Section 13 of the said Act – thus, payments for live telecast not in the nature of Royalty

- **IMG Media UK (2016) – Mum AT: India-UK DTAA**
  - Receipts from BCCI for live TV coverage is for broadcast under the Copyright Act which does not have copyright and IMG UK had no / did not retain any ownership – No Royalty
Recent FTS – Electronic Services / Online access decision

- In favor of Assessee
  - VJM Media (2016) – Mum AT: India-UK DTAA
    - Downloading of photographs for exclusive one time usage for publication in magazine is not Royalty as payment is for copyrighted article and not copyright
    - Domestic definitions not relevant for DTAA applicability
Recent R/ FTS decisions in case of Shipping / Dredging Industry

In favor of Assessee

• **Sical Logistics (2016) – Chennai AT:**
  - Time Charter of Ship does not amount to Royalty as payment for the use of Equipment - Poompuhar (Mad HC) not followed
  - Apart from no control or possession by user, payment is not only for use of ship but also for services of moving goods using a fully manned ship.
  - Time charter means utilization of space of vessel and not to operate or exercise control

• **ONGC (2015) – SC**
  - Payments for various services in connection with prospecting, extraction and production of mineral oils – pith and substance rule – contracts inextricably linked to dominant purpose of prospecting, extraction and production of mineral oils.
  - Income was more appropriately assessable under Section 44BB as compared to Section 44D (Royalty /FTS)
Other Recent Royalty decisions

- **Formula One (2016) – Del HC: India-UK DTAA**
  - UK company transferred of right to host and promote ‘Formula F1 Race’ to Indian Company / Jaypee without any intention to license trademark
  - UK Company had full access to circuit and dictate terms like who could access circuits, prohibition of other event on circuits, etc. (Circuit held to be PE of UK Company)
  - AAR earlier concluded that Payments by Jaypee to UK Company for use of trademark is Royalty
  - Del HC held that Indian Company had no rights to use IP independently of staging and hosting of event and no other purposes - payments not in the nature of Royalty
Recent SC – Facilities v. Services

- **Kotak Securities Ltd (2016) – SC: Section 194J**
  - The Members of Bombay Stock Exchange (BSE) pay transaction charges for using BSE Online Trading (BOLT) system.
  - The Bom HC held that the BOLT services are FTS as they were managerial due to various functions performed (monitoring, surveillance, remedial actions, scrips transfer, etc.).
  - The SC held that payments are not in the nature of FTS as:
    - Modern day scientific and technological developments ten to blur the specific human element in an otherwise fully automated process.
    - The service was fully automated and available to all members in respect of every transaction that is entered into the system.
    - There is nothing special, exclusive or customized service which is rendered by BSE.
    - Bharti Cellular (SC) decision relied to hold that technical services need to be with human effort as they occur between managerial and consultancy which can be rendered only by humans.
    - The BOLT system was a standard facility provided by the stock exchange for transacting business and not a technical service.

**Note:** This decision to benefit several decisions on Royalty / FTS in the context of DTAA as well
Recent FTS – Business Support Services decisions

- **Bombardier Transportation (2016) – Ahd AT: India-Canada DTAA**
  - IT support services not Royalties as there is no right to use any equipment/secret process.
  - Management/Consultancy Services not FTS as no ‘make available’/no Transfer of technology.

- **Credit Lyonnais (2016) – Bom HC: Section 9(1)(vii)**
  - Arranges fees for mobilization of deposits in deposits scheme were not in the nature of FTS as there are not in the nature of managerial, technical or consultancy services.

- **HCL (2016) – Bom HC: India-Israel DTAA**
  - Annual Maintenance Services is not FTS under India-Israel DTAA.

- **Lufthansa Cargo (2016) – Del HC: India-Germany DTAA**
  - Overhaul and maintenance of aircraft not in the nature of FTS as No employee of the service recipient is involved and Exclusive nature of contract cannot make the services FTS.

  - Contract for work v. contract for services i.e. physical v. intellectual activities even though physical work may also involve some intellectual effort but service is where intellectual aspect is more dominant and only such contract would fall under Service under Section 194J.
Recent FTS – Business Support Services decisions

- In favor of Assessee
  - **Primenet Global (2016) – Del AT : 194J**
    - Payments by Internet Service Provider for acquiring bandwidth was in the nature of interconnection of equipments and it did not involve any technical services as there was no human intervention (Bharti Cellular –SC).
  - **Delhi Transco Ltd (2015) – Del HC: 194J**
    - Wheeling charges paid for transportation of electricity are not FTS as it did not involve any technical services as there was no human intervention (Bharti Cellular –SC).
Recent FTS Make Available decisions (1 of 2)

• **Cummins (2016) – AAR:**
  - Supply Management Services are not FTS under Article 13 of the India-UK DTAA as make available condition not satisfied. It is also not Royalty as payments are not related to any use or right to use of any specified items/intangibles.

• **Ouototec (2016) – Kol AT:**
  - Management supports and other consultancy Services – Not FTS as Make available not satisfied
  - India-Finland DTAA / Baltlivala (2016) – Kol AT: Marketing Services – Not FTS as Make available not satisfied: India-UK DTAA

• **Steria India (2016) – Del HC:**
  - Overrules previous AAR Ruling – Managerial Services are not FTS as make available condition not satisfied under India France DTAA through MFN

• **Lehman Bros (2016) – Mum AT:**
  - Recruitment & Placement Services – not FTS as make available condition not satisfied under India-USA DTAA

• **Xansa India (2016) – Del AT:**
  - Managerial services for acquisition of business – not FTS as make available condition not satisfied under India-UK DTAA
Recent FTS Make Available decisions (2 of 2)

• Gera Development (2016) – Pune AT:
  – Project specific architectural design and drawings with measurement did not amount to make available knowledge, etc. (India-US DTAA)

• Hindusthan Petroleum (2016)- Mum AT:
  – Supply of basic engineering program design to set-up plant and designing work were not in the nature of FTS – India-USA DTAA

• Gujarat Pipavav (2016) – Mum AT:
  – Engineering services for installation, commissioning, after sales, construction and audit of cranes were not in the nature of FTS – India-USA DTAA

• Rolls Royce (2016) – Del AT: India-UK:
  – Operation & maintenance of power plant not FTS under India-UK DTAA
Recent Secondment Services decisions

**Against the Assessee**

- **Centrica India Offshore Private Limited (2014) – Delhi HC and affirmed by SCN**
  - Seconded employees made available their technical expertise and know-how to regular employees. Accordingly, reimbursement of salary cost to overseas entities under secondment agreement amounts to FTS – India- UK DTAA
  - SC has dismissed the SLP simpliciter i.e. without giving any reason. Such a SC decision is not law of the land under Article 141 of the Constitution of India – SC Employee Welfare Association v UOI & Anr (1990)

**In favor of Assessee**

- **Mahanagar Gas (2016) – Mum AT: 194J**
  - One Indian Company deputed employees to another Indian Company
  - Reimbursements of emoluments made the other Indian company employer for all practical purposes
  - TDS paid by the first Indian Company
  - Salary reimbursements are not FTS
Recent FTS – Export Commission

- Favorable decision on Export/Sales commission for procuring export orders not taxable in India as FTS
  - Panalfa Autoelektrik Limited (2014) – Delhi HC
  - Kikani Exports Private Limited (2014) – Madras HC
  - Faizan Shoes Private Limited (2014) – Madras HC
  - I.M. Gears Private Limited (2014) – Chennai AT
  - Lohia Starlinger Limited (2014) – Lucknow AT
  - Pankaj A Shah (2014) – Ahmedabad AT
  - Rane Madras Limited (2014) – Chennai AT
  - Abdul Wahid Tanneries Private Limited (2014) – Chennai AT
  - Dr. Reddy Laboratories (2016) – AAR: Product Promotion Services
  - Pahilajrai Jaikishin (2016) – Mum AT
  - Farida Leather (2016) – Mad HC
  - Welspun Corporation (2016) – Ahd AT
FTS v. Independent Personal Services (Article 14)

- OECD MC has done away with a separate Article on IPS but it continues to exist under UN MC

- Most Indian DTAA's have an Article on IPS
  - Generally applies only to Individuals / Firms but can extend to other type of Entities / Companies
  - India US-UK DTAA and India-USA DTAA - special provisions for partners
  - IPS taxable in state of Residence unless fixed base in state of source or physical presence exceeding specified threshold (generally a 183 days rule)

- Nature of independent activities covered
  - Scientific, Literary, Artistic, Educational and Teaching
  - Physicians, Lawyers, Engineers, Architects, Dentists and Accountants
  - Article on FTS may contain an exclusion for items covered under IPS E.g. Japan / New Zealand
  - Even otherwise, if applicable, the Article on IPS should prevail over Article on FTS
    - IPS being a more specific Article within the Services Category
    - Tax position is generally more beneficial under IPS Article

Developments to Watch out

- UN MC proposed New Article on FTS
- Equalization Levy v. Royalty / FTS – potential overlaps
- OECD BEPS initiatives
- If PE then taxation of R/ FTS not attributable to PE
  - Earlier judicial precedents – R/FTS not attributable to PE not taxable in India
  - Recent judicial precedents – R/ FTS attributable to PE taxable in India
Q & A

Questions

Answers
THANK YOU ALL FOR YOUR ATTENTION!

CA Shabbir Motorwala

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