TDS ON INTERNATIONAL REMITTANCES
Issues & Perspectives

By

V.Vikram, Advocate

SAPR Advocates

http://www.saprlaw.com

Agenda

1. TDS Sections – An overview
2. A typical scenario – disallowance u/s 40(a)(i)
3. Royalty
4. Fees for Technical Services
5. Impossibility of performance
6. Foreign Commission Agent
7. Secondment
8. Non-discrimination
9. MFN
10. Sound of one-handed clapping! (S.206AA , S.94A, Equalization Levy etc.)

1. International Taxation – TDS Sections An Overview

- **S.5(2)**: charging provision
  - *accrues* or
  - *deemed to accrue* (S.9) or
  - *received in India* or
  - *deemed to be received in India*
- **S.9:** deeming provisions
  - 11 categories
- **S.195**
- **S.40(a)(i)**

To be read along with S.90(2) i.e Act or DTAA (Article 12) S.115A or Article 12, say)

S.5

S.5(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person ; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

S.9(1)(i)

Income deemed to accrue or arise in India.

S.9. *(1) The following incomes shall be deemed to accrue or arise in India :*

(i) all income accruing or arising, whether directly or indirectly, through or from any business connection in India, or through or from any property in India, or through or from any asset or source of income in India, or through the transfer of a capital asset situate in India.

Explanation 1.—For the purposes of this clause—

(a) in the case of a business of which all the operations are not carried out in India, the income of the business deemed under this clause to accrue or arise in India shall be only such part of the income as is reasonably attributable to the operations carried out in India ;

S.9(1)(vi) - Royalty

S.9(1)(vi) income by way of royalty payable by—

(a) the Government ; or

(b) a person who is a resident, except where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the royalty is payable in respect of any right, property or information used or services utilised for the purposes of a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

S.9(1)(vii) - Fees for Technical Services

S.9(1)(vii) income by way of fees for technical services payable by—

(a) the Government ; or

(b) a person who is a resident, except where the fees are payable in respect of services utilised in a business or profession carried on by such person outside India or for the purposes of making or earning any income from any source outside India ; or

(c) a person who is a non-resident, where the fees are payable in respect of services utilised in a business or profession carried on by such person in India or for the purposes of making or earning any income from any source in India :

S.195

- Who
  - Any person responsible for paying to a non-resident or a foreign company
- What
  - Any interest or **any other sum chargeable to tax** under the provisions of the IT Act
- When
  - At time of credit or payment whichever earlier
- How
  - Deduct income-tax thereon at **rates in force**

S.195

Other sums.

195. *(1) Any person responsible for paying to a non-resident, not being a company, or to a foreign company, any interest (not being interest referred to in section 194LB or section 194LC) or section 194LD or* ***any other sum chargeable under the provisions of this Act*** *not being income chargeable under the head "Salaries") shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier,* ***deduct income-tax thereon at the rates in force***

S.195 (contd.)

- Lays down responsibility of TDS on the “person responsible for paying” to non-resident
- Payer - Application to the Assessing Officer for lower/ NIL deduction of tax by payer [S.195(2)/195(3)]
- Payee – Application to the AO for lower/NIL deduction of tax [S.197]
- Declaration to be filed + CA certificate [S. 195(6)].
- Board can specify a class of persons or cases, where payer has to make an application. *No person or classes have been specified so far.*

S.195(2) Certificate – Mandatory or not An unnecessary controversy?

- **Samsung Corporation decision (185 Taxmann 313 Karnataka HC)** held it is a statutory obligation for obtaining S.195(2) certificate
- **GE Technology decision in 234 CTR 153** clarified S.195(2) certificate non-mandatory
- **CBDT Circulars since:**
  - CBDT circular no. 02/2014 dated 26.2.2014 states that interest u/s. 201 will be on portion representing income (not the whole amount).
  - CBDT circular no. 03/2015 dated 12.2.2015 states that **disallowance u/s. 40(a)(i) will be on sums chargeable to tax (not the whole amount)**

S.40(a)(i)

S.40. *Notwithstanding anything to the contrary in sections 30 to 38, the following amounts shall not be deducted in computing the income chargeable under the head "Profits and gains of business or profession",—*

(a) in the case of any assessee—

(i) any interest (not being interest on a loan issued for public subscription before the 1st day of April, 1938), royalty, fees for technical services or other sum chargeable under this Act, which is payable,—

(A) outside India; or

(B) in India to a non-resident, not being a company or to a foreign company,

on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :

S.40(a)(i)

- *Explanation.*—For the purposes of this sub-clause,—

  (*A*) "royalty" shall have the same meaning as in *Explanation2* to clause (*vi*) of sub-section (1) of section 9;

  (*B*) "fees for technical services" shall have the same meaning as in *Explanation2* to clause (*vii*) of sub-section (1) of section 9;

- Effectively, entire expenditure is to be disallowed
  - Slowly being watered down by judiciary to make it less onerous…..

S.201(1) – assessee in default

S.201. *(1) Where any person, including the principal officer of a company,—*

(a) who is required to deduct any sum in accordance with the provisions of this Act; or

(b) referred to in sub-section (1A) of section 192, being an employer,

does not deduct, or does not pay, or after so deducting fails to pay, the whole or any part of the tax, as required by or under this Act, then, such person, shall, without prejudice to any other consequences which he may incur, ***be deemed to be an assessee in default*** *in respect of such tax:*

Provided *that any person, including the principal officer of a company, who fails to deduct the whole or any part of the tax in accordance with the provisions of this Chapter on the sum paid to a resident or on the sum credited to the account of a resident shall not be deemed to be an assessee in default in respect of such tax if such resident—*

(i) has furnished his return of income under section 139;

(ii) has taken into account such sum for computing income in such return of income; and

(iii) has paid the tax due on the income declared by him in such return of income,

and the person furnishes a certificate to this effect from an accountant in such form as may be prescribed

S.163 – Representative Assessee

C.—Representative assessees—Special cases

Who may be regarded as agent.

S.163. *(1) For the purposes of this Act, "agent", in relation to a non-resident, includes any person in India—*

(a) who is employed by or on behalf of the non-resident; or

(b) who has any business connection with the non-resident; or

(c) from or through whom the non-resident is in receipt of any income, whether directly or indirectly; or

(d) who is the trustee of the non-resident;

and includes also any other person who, whether a resident or non-resident, has acquired by means of a transfer, a capital asset in India :

2. A typical disallowance....u/S.40(a)(i)

- Step 1: **Classification of payments:**
  - Typically, as *not* being business profits (S.9(1)(i) or Article 7 r.w. Article 5), rather
  - Being Royalty or Fees for technical services (S.9(1)(vi)/S.9(1)(vii) or Article 12/13)
  - Lot of PE cases now (service PE, DAPE, supervisory PE etc.). PE tax on basis (i.e. income of PE – its expenses) , Royalty/FTS tax on gross basis
  - Note that S.9 is a *deeming* provision : Accruing or arising in India irrespective of place of rendering & utilization of services (at least from Finance Act 2010!)
- Step 2: Hold that, due to S.9 above, sums paid to NR were chargeable to tax and **tax should have been withhold as per S.195**
- Step 3: As tax was not withheld u/S. 195, **disallowance of expenditure made u/S. 40(a)(i) on said payments to NR**

FTS/Royalty in IT Act: First attack via Finance Act 2010

Path to heaven littered with broken Amendments…?

- **Ishikawajima-Harima's** (288 ITR 408 SC) twin test of "rendering" and "utilization" in India for FTS u/S 9(1)(vi)
- Explanation to S.9(1) via Finance Act 2007 amendment
  - Ill-drafted; amendment doesn't change anything as per **Clifford Chance 318 ITR 237 (Bom)** and by the Karnataka High Court in **Jindal Thermal Power Company 225 CTR 220**.
- The Finance Bill 2010 made the following amendment:

"Explanation.—For the removal of doubts, it is hereby declared that for the purposes of this section, income of a non-resident shall be deemed to accrue or arise in India under clause (v) or clause (vi) or clause (vii) of sub-section (1) and shall be included in the total income of the nonresident, whether or not,—

(i) the non-resident has a residence or place of business or business connection in India; or

(ii) the non-resident has rendered services in India."

3. Royalty

Explanation 2.—For the purposes of this clause, **"royalty" means consideration** (including any lump sum consideration but excluding any consideration which would be the income of the recipient chargeable under the head "Capital gains") for—

(*i*) the **transfer of all or any rights** (including the granting of a licence) **in respect of a patent, invention, model, design, secret formula or process** or trade mark or similar property ;

(*ii*) 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 ;

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

(*iv*) the imparting of any information concerning technical, industrial, commercial or scientific knowledge, experience or skill ;

(*iva*) the use or **right to use any industrial, commercial or scientific equipment** but not including the amounts referred to in section 44BB;

(*v*) the **transfer of all or any rights (including the granting of a licence) 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 ;

(*vi*) the rendering of any services in connection with the activities referred to in sub-clauses (*i*) to (*iv*), (*iva*) and (*v*)

Royalty – Explanation 2
Interpretation by Judiciary

- **Satellite transponder lease: Asia Satellite Telecommn. Co Ltd. vs DIT (332 ITR 340 Del. HC)**
  - No income is deemed to accrue in India from use of satellite outside India to beam TV signals into India even if bulk of revenue arises due to viewers in India **(not "use of equipment", not use of "process")**
- **Software license:** Not transfer of "copyright" but transfer of "copyrighted article"
  - **Motorola Inc. vs. DCIT (95 ITD 269 SB)**
  - **TII Team Telecom 140 TTJ (Mum) 649**
  - **DIT vs. Ericsson Radio Systems AB (TS-769-HC-2011 (DEL))**
  - **(Dissenting voices in *Microsoft Delhi Tribunal, Karnataka High Court in Samsung 203 TM 477*)**
- **Bottomline:** A very wide interpretation of the English used in Explanation 2 by Dept. typically read down by the Courts

Royalty –overturning judicial decisions Finance Act 2012!

Explanation 3.—For the purposes of this clause, "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.

Explanation 4.—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 licence) irrespective of the medium through which such right is transferred.

Explanation 5.—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.

Explanation 6.—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;

Royalty - Finance Act 2012 Amendments rendered useless?!

- **DIT vs. New Skies Satellite BV (Delhi HC)** 9(1)(vi) vs. Article 12 of DTAA: The retrospective amendment to s. 9(1)(vi) so as to supersede the law laid down in **Asia Satellite 332 ITR 340 (Del)** and assess transmission fees as "royalty" has no impact on assessees covered by DTAA because a corresponding amendment has not been made to the definition of "royalty" therein. Amendments to domestic law do not affect the DTAA
- **WNS North America Inc. vs. ADIT (152 TTJ 145) Mumbai Trib** and
- **DIT v. Nokia Networks OY (212 Taxman 68) Delhi HC** and
- **B4U International Holdings Limited [18 ITR(Trib.) 62] (Mum.)**
  - Amendment in Act does not have the effect of automatically altering the analogous provisions of the Double Taxation Avoidance Agreements

Royalty - Finance Act 2012 Amendments ....successful in Madras?!

- **Verizon Communications Singapore Pte Ltd. Vs. ITO (361 ITR 475 Madras HC)**
  - Provision of bandwidth / telecom services is Royalty for the **'use, or the right to use equipment'** under S.9(1)(vi) and under Article 12(3)(b) of the India-Singapore DTAA
  - It is also **"use of process"** u/S.9(1)(vi) and Article 12(3) of the DTAA
  - It is FTS u/S.12(4) of the DTAA!!
  - Earlier Decisions disregarded due to Finance Act 2012 amendments
  - Amendments in 2012 were clarificatory
  - **Distinguishes Asia Satellite** saying it related to clauses (I), (vi) and (vii) and it refers to decisions
  - Amendment in Explanation 5 gives very expansive meaning to word Royalty
  - DTAA "pari materia" to Act; to be assessed as Royalty under even the DTAA

Royalty – Current Issues

- Adwords program (Referrals/SEM)
- Website registration
- Subscription to database
- Software
- Shipping

Royalty – Adwords program:
Google ITAT Bengaluru – Facts of the case

- **Google India Pvt. Ltd. vs. ACIT (IT (TP)A 1511 to 1518/Bang/2013 dated 23th Oct. 217)**
- The assessee is a wholly owned subsidiary of Google International LLC, U.S.
- The assessee is appointed as a non-exclusive authorized distributor of Adword programs to the advertisers in India by Google Ireland Ltd (GIL) Google is specialized in internet search engines and related advertising services.
- The assessee entered into a **Google Adword Program Distribution** agreement (the agreement) on 12 December 2005 with GIL for resale of online advertising space under advertisers program to advertisers in India
- The assessee held that it was a reseller of the ad space and nothing more; it was akin to placing an ad in a newspaper/billboard etc.

Royalty – Adwords program:
Google ITAT Bengaluru – Facts of the cae

- Prior to said agreement, the ITES agreement dated 01.04.2004, provided limited rights to use intellectual property of GIL
  - Assesee pointed out that ITES was mainly for checking the ad content of users across the world
- Main agreement of assessee was related to marketing and distribution rights of “Adword” program to the advertisers in India
  - Included assistance & training to Indian advertisers to understand the features of the “Adword” product
- During AYs 2008-09 to 2011-12, the assessee had paid Rs. 119 crores to GIL without TDS on premise that:
  - **No rights in Google’s IP were transferred to taxpayer from GIL**

Royalty – Adwords program
Google Bengaluru case

- The assessee is mere reseller of advertising space made available under the Adword distribution program.
- The assessee being a distributor of ad space **does not have control over the process involved in picking ads for display (or) control of the servers, which are outside India.**
- However, the AO disagreed with asessee's contention and treated the assessee as an assessee in default (S.201) for not withholding tax at source on payments made to GIL
- **The CIT(A) upheld the order of the AO**

Royalty – Adwords program
Google ITAT Bengaluru ruling

- The agreement between the assessee and GIL was **NOT in the nature of providing space for ad and display of ad** to the consumers.
  - Reference to “Adword” program in the agreement, it can be observed that it is an agreement for facilitating the display and publishing of an advertisement to the targeted customer.
- The advertiser selects some key words and on the basis of key words, the advertisement is displayed on the website or along with the search result as and when the customer selects the key words relatable to the advertisement
- Module does not merely work by providing the space in Google search engine, but it works only with the help of various patented tools and software

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)

- Google is able to target consumers/users as per the requirement of the advertiser by using the search tool/software
  - ITAT observed If only service rendered by the taxpayer was for providing the space then there was no need of directing the targeted consumers to the advertisement of the advertiser
- Truncated search results are displayed keeping in mind the commercial needs of the advertisers.
- The assessee has access to various data with respect to the age, gender, region, language, taste habits, food habits, cloth preference, the behavior on the website, etc.

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)

- Assessee uses this information for maximising impression and conversion of the customers to the ads of advertisers.
  - Hence activities of the assessee are not merely restricting to display of advertisement
- By using patented algorithm, assessee decides which advertisement is to be shown to which consumer visiting millions of website/search engine.
- Therefore it is not advertisement of the space; it is focused targeted marketing by assessee/Google with the help of technology

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)

- Assessee providing before/after sale services, after having access to user data, IPRs, secret formula, process, software and confidential information of GIL, in its own capacity under the agreement
- The assessee has not sold the storage space on the server outside India nor has it sold the identified/demarcated ad on the web site/search engine
- It is a continuous targeted advertisement campaign to the focused consumer

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)
Whether there is use of patent of trademark?

- The Tribunal distinguished the decisions of *Sheraton International Inc v. DDIT [2009] 313 ITR 267 (Del), Formula One World Championship Ltd. v. CIT [2016] 76 taxmann.com 6 (Del)* by holding that
  - Use of trademark for advertising marketing and booking in the cases were incidental activities of the taxpayer
- Therefore, payments made by the assessee was not only for marketing and promoting Adword programmes **but was also for the use of Google brand features and trademarks (!!)**

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)
Whether adwords program is a secret process?

- The Tribunal held that though Adwords programme along with associated videos are available in public domain but how this programme functions for focused marketing campaign, promoting advertisements are only possible with the use of secret formula, confidential customer data only
- Since this secret process of targeting the customers, is not in public domain, **assessee was using secret process for marketing /promoting displaying of the advertisement** (!!)

Royalty – Adwords program
Google ITAT Bengaluru ruling (contd.)
Distinguishing precedents

- The Tribunal distinguished the decisions in the case of **Pinstorm Technologies (P.) Ltd v. ITO [2013] 154 TTJ 173 (Mum)** and **Yahoo India (P.) Ltd. v. CIT [2011] 46 SOT 105 (Mum), ITO v. Right Florists (P.) Ltd [2013] 143 ITD 445 (Kol) :**
  - Payments have been made for use of patented technology, secret process and use of trade mark. The assessee's case is not merely a case of displaying or exhibiting of advertisement by the advertiser on the website.
  - In those cases, payments were made directly by user to foreign advertising platform
- **Accordingly, since the payments made by the assessee to GIL falls within the ambit of royalty, the assessee was required to withhold tax at source on such payments (!!)**

Royalty – Website Registration

- **Godaddy.com LLC vs. ACIT (ITA No.1878/Del/2017, AY 2013-14 dated 3.4.2018)**
- Domain name is an intangible asset which is similar to trademark. Consequently, income from services rendered in connection with such domain name registration is assessable as "royalty" u/s 9(1)(vi) of the Income-tax Act
- Relied on Hon'ble Apex Court in the case of **Satyam Infoway Ltd. Vs. Siffynet Solutions Pvt.Ltd. – [2004] Supp (2) SCR 465 (SC)** stating that in that case SC held that the **domain name is a valuable commercial right and it has all the characteristics of a trademark** and accordingly, it was held that the domain names are subject to legal norms applicable to trademark.

Royalty – Website Registration

- Relied on Hon'ble Bombay High Court in the case of **Rediff Communications Ltd. Vs. Cybertooth AIR 2000 Bombay 27** which held that domain names are of importance and can be a valuable corporate asset and such domain name is more than an internet address and is entitled to protection equal to a trademark.
- Relied on Hon'ble Jurisdictional High Court in the case of **Tata Sons Ltd. v. Manu Kosuri, (2001) PTC 432 (Del.),** which held that domain names are entitled to protection as a trademark because they are more than an address.
- **Distinguished Asia Satellite Delhi HC** case on grounds it had no relevance to present facts of the case
- ITAT Delhi thus concluded that , the charges received by the assessee for services rendered in respect of domain name is royalty within the meaning of **Clause (vi) read with Clause (iii) of Explanation 2 to Section 9(1) of Income-tax Act.**
- **Note:** Completely different from payment for website hosting which was held to be not royalty in **People Interactive India Pvt. Ltd. (TS-129-ITAT-2012(Mum.))**

Royalty - Software

- Checkered history for taxation of Royalty as software! Initially the tide was tilted towards the assessee:
- 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)**],
  - Followed by **Infrasoft Ltd v. ADIT 125 TTJ 53 (Del)**
- Sale of a standardized but special purpose software and not customized software is not Royalty under Art12 of India-Japan DTAA. **(Dassault Systems K.K. (322 ITR 125)(AAR))**

Royalty – Software
Samsung (Kar. HC) upsets the applecart!

- **Samsung Electronics Co Ltd (345 ITR 494) (Kar.)** Transfer of copyright including right to make copy of software for internal business and payment made in that regard would constitute 'royalty', both under ITA and respective DTAAs
- **Synopsis International Old Limited [2012] (212 Taxman 454) (Kar.)** Consideration paid is for rights in respect of copyright and for use of information embedded in software – falls within mischief of definition of 'royalty' under the ITA and under the DTAA

Royalty – Software
Post amendment blues

- Karanataka HC following Samsung decisions path!
  - **CIT, International Taxation v. P.S.I Data System Ltd. [2012] (208 Taxman 452)**
  - **CIT, International Taxation v. Customer Asset India (P.) Ltd. (42 taxmann.com338)**
- Post-amendment also no change and Software not taxable as Royalty under DTAA
  - **DIT v. Nokia Networks OY [2012] (253 CTR 417) Delhi High Court**
  - **Novel Inc. v. DDIT(Intl. Tax) [2014] (49 SOT 45)**

Royalty – Software
Vinzas: Madras HC gets it right?!

- **CIT vs. Vinzas Solutions Pvt. Ltd. (TCA 861/2016 dated 04.1.2017 Madras HC)**
- There is a difference between sale of a 'copyrighted article' and the 'copyright' itself. S. 9(1)(vi) applies only to the latter and not the former.
- Explanation 4 inserted by FA 2012 w.r.e.f. 01.06.1976 has to be read and understood only in that context and cannot be expanded to bring within its fold transactions beyond the realm of the proviso
- **Bottomline: Huge relief for assessee's by Jurisdictional HC in following the rationale adopted by various other Courts**

Royalty – Database access/subscription

- Karnataka High Court in the case of **ITO vs. Wipro Ltd. (TS-701-HC-2011 Kar.) and CIT vs. Infosys Technologies (17 Taxmann 115 Kar.)** held that annual subscription paid to US company for accessing its database is Royalty
  - (Incorrectly!) following **CIT vs. Samsung Electronics Co. (345 ITR 494 Kar. HC)**
- Mumbai Tribunal in the case of **Gartner Ireland Limited (60 SOT 403 Mumbai ITAT)** followed Wipro (supra) decision as it was the same payments held as Royalty
- **ONGC Videsh Ltd. vs. ITO (155 TTJ 114 Del.)** : Fee paid by ONGC to procure information in respect of exploration of oil & gas is Royalty

Royalty – Database access/subscription

- Madhya Pradesh HC in **CIT v. HEG Ltd. [2003] 263 ITR 230** had held that access to confidential data is not Royalty
- Another decision is **Factset Research Systems Inc., In re [2009] 182 Taxman 268 (AAR – New Delhi)**
- **DIT vs Dun and Bradstreet Information Services India Pvt ltd [(2011) 318 ITR 95 (Bombay High Court)] also has held in favour of assessee that payments to access reports/database is not Royalty.**
  - Indian assessee had **imported business information reports** from Dun and Bradstreet, USA, and made remittances against the same not withholding tax.
  - Following decision of AAR on identical facts in the case of Dun and Bradstreet Espana S.A. (AAR), Tribunal said payments did not attract the provisions of section 195. Upheld by Mumbai HC
- **Author's opinion: Reliance on Samsung (Karnataka HC) is incorrect; mere database access ought not be Royalty**

Royalty – Shipping
Poompuhar case - Madras HC in action again!

- Madras HC in Poompuhar Shipping Corp Ltd. Vs. ITO (360 ITR 257 Madras HC) held that
  - Equipment rental is Royalty even if payer does not have control (!!)
- Retrospective amendment in Explanation 5 is purely clarificatory
- Irrespective of transfer, consideration paid for use or right to use simpilciter is sufficient for it to fall under Royalty (!!)
- Ship is an “equipment” based on S.43(3) of Act
- Ship plying between coastal lines on Indian shores cannot fall under “international traffic” as per DTAA
- Foreign ship has PE in India when its ships are in India and berths reserved for it
- Proceedings under both S.201 and S.163 upheld

Royalty – Shipping

- **CIT vs. Van Oord ACZ Equipment BV [TS-695-HC-2014(Madras)]**
  - Distinguishes Poompuhar judgment
- Van Oord ACZ Equipment BV (the taxpayer) , incorporated in Netherlands, had let out dredging equipment to an Indian company, Van Oord ACZ India Private Limited. The equipment was let out on a **bareboat charter** basis, i.e., without the Master or the Crew.
- HC held that the **taxpayer was not liable to tax in India in respect of income earned from hiring of dredger on bareboat charter basis**
  - Based on amended DTAA of India-Netherlands
  - Poompuhar was time-charter; this case is bareboat charter
  - No PE as entire control of equipment not with taxpayer
- Useful for amended DTAA's like Belgium, France, Israel, Kazhakstan, Greece, Netherlands, Spain, Greece and Sweden)

4. FTS

FTS – Make available clause

- After Finance Act 2010 amendment, refuge seems to be mainly in the "make available" clause in Article 12 of the DTAA's
- Service recipient to thenceforth be able to perform service
  - Logic: Teach a person to fish instead of giving them a fish
- Main decisions are:
  - **Hon'ble Delhi High Court in the case of DIT Vs Guy Carpenter & Co Ltd ([(2012) 346 ITR 504 (Del)]** and
  - **Hon'ble Karnataka High Court in the case of CIT Vs De Beers India Pvt. Ltd [(2012) 346 ITR 467 (Kar)]**

FTS – Make available
Chennai takes unique stand….again!

- **Foster Wheeler France S.A. (taxpayer) vs Deputy Director of Income Tax (DDIT),** Chennai ITAT held that payments made by a non-resident to another non-resident for providing engineering specifications are taxable as 'fees for technical services' (FTS) under the Indian Income Tax Act, 1961 as well as Article 12(4)(b) of the India-USA DTAA
  - ITAT rejected commonly used argument of 'make available' clause present in the treaty on the basis that the taxpayer was not a layman and was capable of observing the opinion/advice given by the associate company and could implement the same in future projects (!!)
- **Brakes India Chennai ITAT** on testing flywheel…..for discussion!
- **International Management Group (UK) Ltd vs. ACIT (ITA 1613/Del/2015 dated 4.10.2016)**
  - Documentation and material provided to the BCCI by IMG and so BCCI is able to use such know-how and documentation generated from provision of the services independent of the services of the appellant in future. It is too naïve to say that in absence of IMG services BCCI on its own can't hold the IPL. Merely because BCCI has entered into a contract for conducting further 9 events does not lead to the conclusion that the information documentation, agreements, contracts etc cannot be said to be "made available" to the appellant

FTS – Standard (common) service

- **CIT vs. Kotak Securities (Civil Appeal 3141 of 2016 dated 29th March 2016)**

"The service provided by the Stock Exchange for which transaction charges are paid fails to satisfy the ***aforesaid test of specialized, exclusive and individual requirement of the user or consumer who may approach the service provider for such assistance/service****. It is only service of the above kind that, according to us, should come within the ambit of the expression "technical services" appearing in Explanation 2 of Section 9(1)(vii) of the Act. In the absence of the above distinguishing feature, service, though rendered, would be mere in the nature of a facility offered or available which would not be covered by the aforesaid provision of the Act."*

- **CIT vs. Bharti Cellular Ltd. 330 ITR 239 SC**
- **Skycell Communications Ltd. & Anr. v. Deputy Commissioner of Income Tax & Ors (2001) 251 ITR 53**

FTS – Standard (common) technical service

- **DIT vs. A.P.Moller Maersk A S (Civil Appeal No 8040 of 2015 dated 17th February, 2017)**
  - In order to constitute "technical services", services catering to the special needs of the person using them must be rendered.
  - **The provision of a common facility is not "technical services".**
  - Amount paid towards reimbursement of a common technical computer facility is not "fees for technical services".
  - Amount received by way of reimbursement of expenses does not have the character of income
- FTS definition discussed in detail by multiple SC judgments:
  - **DIT v. Panalfa Autoelektrik Ltd., (272 CTR 117)**
  - **GVK Industries vs. ITO (371 ITR 453)**

Absence of FTS clause in DTAA

- **Tekniskil (Sendirian) Berhard v. CIT (22 ITR 551 (AAR))** , AAR had the opportunity to evaluate the old Malaysia treaty, which did not have FTS clause. The AAR ruled that there is no incompatibility between recognizing the receipts as 'FTS' and also looking upon them as the profits of a business. In light of this observation, the AAR held that **the transaction would be governed by the 'Business Profits' Article and would be taxable in India only if the tax payer had a PE in India**.
- Madras High Court in the case of **Bangkok Glass Industry Co. Ltd. v.ACIT** (34 taxmann.com 77) affirmed this principle
- Mumbai Tribunal in the case of **McKinsey & Co. (Thailand) Co. Ltd. v. DDIT (**36 taxmann.com 375 (Mum.)), **Channel Guide India Ltd v. ACIT (139 ITD 49)** and **ACIT v. Viceroy Hotels Ltd. (11 taxmann.com 216 Hyd)., Spice Telecom vs. ITO (113 TTJ 502 Bang.)**
- **DCIT vs. TVS Electronics Ltd. (TS-421-ITAT-2012(Chny)) took a different view (!!)**

5. Impossibility of performance

- Verizon Communications Pte Chennai is on the taxability of the non-resident; **can the payer predict the amendments or this judgment?!**
  - Impossibility of performance important in context of Finance Act 2010 to S.9 and Finance Act 2012 amendments to Royalty
- In context of Finance Act 2010 amendment:
  - **Metro & Metro vs. ACIT (ITA No.393/Agra/2012 dated 1st Nov., 2013)**
  - **Channel Guide vs. ACIT (139 ITD 49)**
  - **Sterling Abrasives vs. ITO (ITA No.2234 and 2244/Ahd/2008)**

Impossibility of Performance

- **CIT vs. NGC Networks (India) Pvt. Ltd. (ITA No.397 of 2015 dated 29th January 2018)**
- Relies on **CIT vs. Cello Plast (209 Taxmann 617 Mum. HC)**
  - **lex non cogit ad impossibilia** (law does not compel a man to do what he cannot possibly perform)
- S. 40(a)(i) TDS disallowance: A party cannot be called upon to perform an impossible Act i.e. to comply with a provision not in force at the relevant time but introduced later by retrospective amendment.
- **Interestingly: S. 40(a)(i) disallowance can be made only if the royalty falls under Explanation 2 to s. 9(1)(vi) but not if it falls under Explanation 6 to s. 9(1)(vi)**

6. Foreign Commission Agent Payments

- CBDT had issued Circular No.7 dated 22.10.2009, by which, earlier Circulars No.23 dated 23 July 1969, Circular No.163 dated 29th May 1975 and Circular No. 786 dated 7th February 2000, which were based on Circular No.23, have been withdrawn
  - Department held that commission payments were hence taxable
- Incorrect view of Department: **Commission paid to non-resident (foreign) agents not taxable in India**
  - S.9(1)(i) r.w Explanation : no PE in India to attribute income to, payments not exigible to tax. SKF Boilers of AAR bad law
- **CIT vs. Toshoku Limited, 125 ITR 525 (SC)**
- **CIT vs. Faizan Shoes (P.) Ltd.[2014] 367 ITR 155 (Mad.)**
- **CIT vs. Kikani Exports (P) Ltd. (49 taxmann.com 601 Madras HC)**
- **ACIT vs. Manufax (India) (ITA Nos. 434 434/Agra/2015 dated 11.4.2018 Special Bench)**

Foreign Commission Agent Payments

- Beware though!
  - Keep wording of agreement simple
  - Mere existence of line "systematic market research" lead to disallowance u/S. 9(1)(vii)
    - **CIT vs. Evolv Clothing Company (ITA No.2100/Mds/2012 dated 11.3.2013)**
  - Remember, classification of payments as FTS is an easy way for Department to say sum is exigible to tax and lead to S.40(a)(i)
    - "Make available" is not always available ☺

7. Employment related TDS issues
Secondment

- **Centrica India Offshore Pvt Ltd v. CIT & Ors. [TS-237-HC-2014(DEL)]**
  - Held that services rendered by deputed employees "makes available" technical knowledge to the Indian entity and hence payment for those services was taxable as FTS as per DTAA (!!)
  - Also, reimbursement of salary and other associated costs by the Indian Company without an element of income could not be construed as diversion of income by overriding title.
- Secondees functioned exclusively for Centrica India under its control, supervision
- Salary was paid directly by the overseas entities into their overseas bank account and claimed as reimbursement from Centrica India.
- Such salaries were offered to tax in India by the secondees after withholding tax obligations for employee taxes.

Secondment - Centrica

- Whether the reimbursement of salary costs of secondees by Centrica India to overseas entities under the terms of the secondment agreement was in the nature of income accruing to the overseas entities?
- If so, whether Centrica India was liable to be withhold tax under section 195 of the Act?
- Ruling:
  - FTS applicable with secondees making available their technical expertise
  - Service PE – applicable
  - Payment is not reimbursement, rather payment for services
  - Payment is not diversion of income by overriding title

Secondment
Distinguishing Centrica

- **Morgan Stanley International Inc. vs. DDIT (ITA No.6882/Mum/2011 dated 18th Dec. 2014)**
- Rules Service PE created by activities of employees seconded to India
- Not taxable as FIS
- Once a Service PE is created, the provisions of FIS article under the IndiaUS DTAA will not apply.
  - This is clear from the express terms of the FIS provision which excludes profits in connection with PE from its ambit.
  - To this extent, the Delhi HC decision in the case of Centrica (supra) cannot be applied as the Delhi HC did not consider the specific exclusion of PE profits from FIS article under the relevant DTAA.
- On computation of income from Service PE, payments received from Indian company would be treated as a revenue receipt and salary costs of the deputed employees would be allowed as deduction.
- **Bottomline: Way out from Centrica ruling!**

Working abroad

- **Utanka Roy vs. DIT** (W.P.No 369 of 2014 dated 15th Dec., 2016) Held salary received by non-resident for services rendered abroad accrues outside India and not chargeable to tax in India
  - Source of receipt NOT relevant
- **Tapas Kr. Bandopadhyay vs. DDIT (ITA No.70/Kol/2016 dated 1.6.2016)** examined S.5(2)(a) of Act and held salary received by non-resident in India is taxable in India on receipt basis (!!)
  - Relied on Captain A. L. Fernandez Vs. ITO reported in 81 ITD 203 (TM)
  - Distinguished DIT vs. Prahlad Vijendra Rao (198 taxman 551 Kar.)
  - CIT vs. Avtar Singh Wadhman (115 Taxman 536 Bom.)
  - Arvind Singh Chauhan (42 Taxman.com 285 Agra)

Working abroad
Chennai blazes its own path....again

- **Swaminathan Ravichandran vs. ITO (ITA No.299/Mds/2016)**
- Salary received in India by a non-resident for services rendered outside India not eligible to exemption under DTAA
- Among various other observations, the Tribunal held that:
  - As Article 23 of India-China Treaty applies only to residents of India, the taxpayer by virtue of being a non-resident wrt India, was not eligible to claim exemption under Article 15(1) of the treaty (!!)
  - Did not follow judicial precedents and upheld the CIT(A) order

8. Non-discrimination

- **Central Bank of India v/s. DCIT (42 SOT 450)** held that under Art 26(3) of India-USA DTAA payments to Non-Residents are equated with payments to Residents & so s. 40(a)(i) disallowance is not valid
  - This was upheld in **Mumbai HC in DIT vs. Citibank N.A. (ITA No.330 of 2013 dated 11th March 2015)**
- **CIT v. Herbalife International India (P.) Ltd. (ITA No.7/2007 dated 13th May, 2016) :**
  - The Delhi High court in this decision held that S.40(a)(i), before insertion of subclause (ia) in section 40(a) by the Finance (No.2) Act, 2004, were discriminatory in nature, as it provided for disallowance of payments made to nonresidents where tax was not deducted at source, whereas similar payments to residents did not result in any such disallowance.
- Useful in context of introduction of Royalty only from June 2006 and FTS from April 2005 u/s 40(a)(ia)
- Note that all non-discrimination clauses aren't the same across Treaties

Non-discrimination

- **Mitsubishi Corporation India Pvt. Ltd vs. DCIT (ITAT Delhi)**
  - In case of non-resident PE, to avoid discrimination under Article 24(3) of the India-Japan DTAA, the benefit of no disallowance u/s 40(a)(ia) for want of TDS if the recipient has paid the tax to be extended to non-residents u/s 40(a)(i)
  - Further, Tribunal observed that different tax treatment to the foreign enterprise per se is enough to invoke nondiscrimination clause in DTAA.
- Very useful in context of watering down of provisions in S.40(a)(ia)?
  - **CIT vs. Ansal Land Mark Township (ITA 160 & 161/2015 dated 26.8.2015, Delhi HC)** and 30% restriction of disallowance can now apply

Non-discrimination
S.40(a)(ia) changes

S.40(a)(ia) ***thirty per cent of any sum*** *payable to a resident, on which tax is deductible at source under Chapter XVII-B and such tax has not been deducted or, after deduction, has not been paid on or before the due date specified in sub-section (1) of section 139 :*

….

Provided further *that where an assessee fails to deduct the whole or any part of the tax in accordance with the provisions of Chapter XVII-B on any such sum but is not deemed to be an assessee in default under the first proviso to sub-section (1) of section 201, then, for the purpose of this sub-clause, it shall be deemed that the assessee has deducted and paid the tax on such sum on the date of furnishing of return of income by the resident payee referred to in the said proviso.*

9. MFN clause

- State A binds itself to State B with respect to favourable treatment afforded by it in future to State C
- India has MFN clause with following countries –Sweden, Swiss Confederation, France, Israel, Philippines, Belgium, Netherlands, Kazakhstan, Hungary, Spain
- India-France example: *If under any Convention, Agreement or Protocol signed after September 1, 1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interests, royalties, fees for technical services or payments for the use of equipment to a* ***rate lower or a scope more restricted than the rate of scope provided for in this Convention*** *on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention*.

MFN Clause

- **Steria India Ltd. v. CIT (W.P.(C) 4793/2014 & CM APPL. 9551/2014**)
  - Relying on the MFN clause under the India – France DTAA held that payments made by an Indian company to a French company for management services does not constitute Fees for Technical Services ("FTS")
- Prior to filing the WP, AAR ruling was sought on whether the payment made by the Taxpayer for the Management Services provided by Steria France will be taxable in India in the hands of Steria France as per the India – France DTAA. The argument was that **Clause 7 of the Protocol did not require any separate notification and could straightway be operationalized** wasn't accepted by AAR.
  - **The Taxpayer argued that the provisions of the India – UK DTAA pertaining to FTS were more restrictive than as provided in the India - France DTAA and ought to be imported into India-France.**

MFN Clause : Steria ruling

- The Court ruling in favour of the Taxpayer held that the **Protocol becomes automatically applicable and there is no need for a separate notification incorporating the beneficial provisions of the India – UK DTAA into the India – France DTAA**.
- The Court also dismissed the contention of the Revenue that when reference is made to one convention signed between India and another OECD member state for the purposes of ascertaining if it had a more restrictive scope or a lower rate of tax, then only that convention has to be used for both the purposes
- The Court also upheld the judgment of the Kolkata Tribunal in the case of DCIT vs. ITC Ltd. (82 ITD 239 Kol.) wherein also it was held that benefit of a lower rate or restricted scope of FTS under the India - French DTAA was not dependent on any further action by governments.
- **Court concluded that the FTS provision of the India- UK DTAA should be read into the India- France DTAA** and hence Managerial Services provided by Steria France did not constitute FTS

10. Sound of one-handed clapping

- **Changes being done unilaterally**
  - Either by directly adding Sections to Act with non-obstante clause such as S.206AA (or)
  - Introducing new kinds of tax: “a rose by another name would smell as sweet” (or have the same thorns!) such as Equalization Levy
- S.94B is another example: Cyprus notified as notified jurisdictional area by CBDT on 1st Nov 2013, rescinded retrospectively from 14th Dec. 2016
  - Madras HC upheld S.94A as constitutional in **T.Rajkumar vs UOI (Appeal Number : Writ Petition Nos.- 17241 to 17243 & 17407 to 17412 of 2015 dated 12/4/2016)**

Sound of one-handed clapping

- S.206AA prescribed flat rate
  - DTAA rate might be lesser!
  - Watered down by Rule 37BC w.e.f 1.6.2016 ; shall not apply to interest, royalty , FTS and payments on transfer of capital asset
  - **Nagarjuna Fertilizers and Chemicals Ltd. vs. ACIT (ITA 1187/H/2014 dated Feb 13, 2017 SB)**
- **Bottomline: Goes against the principle of Bilateral Treaties to make unilateral changes**

Thanks!

V. Vikram

vvikram@gmail.com

vvikam@saprlaw.com