Webinar on Important International Tax Rulings
(post January 2019)

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UOI v. U.A.E. Exchange Center

[2020] 116 taxmann.com 379 (SC)

ISSUE 1

whether LO = PE → contrary views

- ***In case of a UAE entity rendering remittance services, whether the activity of dispatching cheques/drafts to beneficiaries, by a Liaison Office in India, as per the instructions of its Head Office, could be regarded as activities of preparatory or auxiliary in nature as per Article 5(3)(e) of India-UAE DTAA, and thus the LO would not be considered as a PE of the UAE entity in India?***

RELEVANT PROVISION

- **Article 5(3)(e)** of India-UAE DTAA

  "3. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" ***shall be deemed not to include*** *:*

  (a)………

  ………….

  (e) the ***maintenance of a fixed place*** *of business* ***solely*** *for the purpose of carrying on, for the enterprise, any other* ***activity of a preparatory or auxiliary character****."*

U.A.E. Exchange Center

FACTS

- The **assessee, a tax resident of UAE**, was engaged in **provision of remittance services for transferring funds from UAE to beneficiaries in India.**

- The assessee opened **four liaison office ('LO') in India and carried activities in accordance with the conditions imposed by the RBI.** The **expenses for maintaining the LO** were met out of the funds **received** by the LO **from its Head Office in UAE** and the **LO did not charge any fee/commission** for the services rendered in India, in compliance with the conditions imposed by the RBI.

- The **assessee** entered into **contracts with customers in UAE** for provision of remittance services pursuant to which the customers handed over the funds to the assessee in lieu of one-time fees. **The funds** received from the customers were **transferred to the beneficiaries in India, in the following two ways**:-
  a) By **telegraphic transfer through bank channels**; or
  b) On **request of the customer, the assessee dispatched** instruments/**drafts/cheques through its LO to beneficiaries in India**. (while doing so, the LO remained connected with the main server in UAE for retrieving information related to the beneficiaries and the customer)

- The assessee filed an application before the AAR for determining, whether the activity in the second mode of transfer would result in a taxable presence of the assessee in India.

U.A.E. Exchange Center

CONTENTION OF THE ASSESSEE

- The assessee contended that the **activities undertaken by the LO**, such as printing instruments/drafts and dispatching the same through courier to beneficiaries in India, **were only supportive and auxiliary in nature to the main work undertaken by the assessee in UAE.**

- Accordingly, the assessee contented that the activities would **not** constitute **a PE** in India **in view of Article 5(3)(e)** of the DTAA in as much as the activities were in the nature of preparatory or auxiliary character.

CONTENTION OF THE REVENUE

- The Revenue contented that **the LO assisted the assessee to extend its volume of business in India** and the services rendered by the **LO were connected to the main services rendered by the assessee in UAE.**

- Accordingly, **some portion of the fees/commission** charged by the assessee pertained to the **services rendered by the LO in India** and **hence were to be deemed to accrue or arise in India.**

DECISION OF AAR

- The AAR held that activities undertaken by the **LO would constitute a taxable presence** in India by observing that without the services of the LO, the assessee would not be able to render the remittance services to its customers in UAE. Further, the AAR also observed that the **commission which the assessee received for remitting the amount covered not only the business activities carried on in UAE but also the activity undertaken by the LO.**

- The AAR further held that, the **activities** undertaken by the LO constituted a main function of the business of the assessee and hence **could not be termed as preparatory or auxiliary in nature.**

DECISION OF HIGH COURT

- The HC reversed the **decision of the AAR**, by relying on the decision of **Supreme Court in case of Morgan Stanley & Co. [2007] 162 Taxman 165 (SC)**, and held that the **activities** undertaken by the **LO were auxiliary in nature since it supported/aided** the **execution of the main activity undertaken by the assessee in UAE** and hence the LO would not be considered as a PE of the assessee in India.

DECISION OF SUPREME COURT

- The SC placed reliance **on the approval given by the RBI for establishing the LO** in India and observed that **the LO was not allowed to enter into any contract with any person in India nor the LO was allowed to charge any fees/commission** in respect of the services rendered in India.

- The SC observed that **Article 5(3)** of the DTAA, opens with a **non-obstante clause**, which indicates that **notwithstanding the fact that a PE is constituted under Article 5(1) or 5(2)**, **if the nature of activities carried by the assessee fall within the purview of Article 5(3)**, it would be deemed that the assessee does **not** have a **PE** in the Contracting State.

- The SC referred **Black's Law and Oxford Dictionaries** to interpret the expression **'preparatory'** and **'auxiliary',** and observed that the expression **'preparatory'** has been defined as ***'Materials used in preparing the ultimate form of an agreement or statute'*** and the expression **'auxiliary'** has been defined as ***'aiding or supporting or subsidiary or supplementary'.***

- The SC observed that the **LO was conducting** a **combination of virtual and physical activities** i.e. **downloading the particulars of remittances through remaining connected to the main servers of the assessee in UAE and then printing cheques/drafts drawn on the banks in India, which, in turn, were couriered or dispatched to the beneficiaries in India, in accordance with the instructions of the NRI remitter.**

DECISION OF SUPREME COURT (……continued)

- The SC observed that the **RBI** had given **permission to the assessee** to open a **LO for conducting activities** such as **responding to enquiries from correspondent banks, reconciliation of bank accounts, act as a communication center, printing INR drafts etc.**

- The SC observed that the **above mentioned conditions implied** that the **LO would not be able to undertake any commercial activities (such as charging fees/commission for its services or entering into commercial contracts)** and **hence the activities carried by the LO were in nature of preparatory or auxiliary character.**

- In view of the above observations, the SC held that the **LO was not carrying on any business activity in India as such, but only dispensing with the remittances by downloading information from the main server of respondent in UAE and printing cheques/drafts drawn in India and accordingly no income u/s 2(24) was earned by the LO in India.**

- The SC also relied on the decision of co-ordinate bench in case of **E-Funds IT Solutions Inc, [2017] 86 taxmann.com 240 (SC),** wherein the SC held that when the **Indian subsidiary company only rendered support services** which **enabled assessee** (two American companies) to **render services to their respective clients abroad, this outsourcing work to India, in nature of auxiliary operations, would not give rise to a fixed place PE in India.**

DECISION OF SUPREME COURT (……continued)

- Accordingly **the SC upheld the order of the HC** and held that the LO was not allowed to undertake any commercial activities and hence the activities were **preparatory or auxiliary in nature**, which did **not result** in constitution of a **PE of the assessee** in India. Thus, no part of the income of the assessee could be taxed in India.

RBI – not conclusive but persuasive

Jebon Corp – 125 ITD 340 (Bang)

Hitachi High Technologies S'pore Pte Ltd [2020] 113 T.com 327 (Del. Trib)

[A → communication channel / Revenue → negotiation / obtaining orders]

Brown & Sharpe – 51 T.com (All) – U.S Treaty "negotiation"

SOJITZ CORP – 117 TTJ (Del) 724

Nagase & Co – [2019] 109 taxmann.com 288 (Mum. Trib)

Considerations – core, integral, revenue generation, quantum of expd, presence of technical experts

MLI

DIT v. Samsung Heavy Industries Co. Ltd.

[2020] 117 taxmann.com 870 (SC)

ISSUE 2

- ***Whether the Project Office of a Korean company established in India to act as a communication channel between the assessee and ONGC in relation to a project awarded by ONGC for the purpose of surveys, design, engineering, fabrication etc., would constitute a permanent establishment of the assessee within meaning of Article 5(1) of India-Korea DTAA, where its activities in India comprised of pre-engineering survey, hook-up and commissioning and other activities ?***

adm

- ***Whether any part of the revenue pertaining to activities of engineering and fabrication carried on outside India could be taxed in India on the ground that the same is attributable to the activities carried out in India ?***

PE → office

LO → Reg 2(e) FEM regulation 2000

PO → notification FEMA 22/2000-RB dt 3/5/00

→ executing project

comm chan

RELEVANT PROVISION

- **Article 5(1) of India-Korea DTAA**

  *"1. For the purposes of this Agreement, the term "permanent establishment" **means a fixed place of business through** which **the business of an enterprise** is wholly or partly **carried on.**"*

  fewer core laws

- **Article 5(4)(e) of India-Korea DTAA**

  *"the **maintenance of a fixed place** of business **solely** for the purpose of **carrying on**, for the enterprise, **any other activity of a preparatory or auxiliary character**;"*

DIT v. Samsung Heavy Industries Co. Ltd.

[2020] 117 taxmann.com 870 (SC)

RELEVANT PROVISION (….continued)

- **Article 7(1) of India-Korea DTAA**

  "1. The profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, ***the profits of the enterprise may be taxed*** *in the other State but* ***only so much of them as is attributable to that permanent establishment."***

FACTS

- The **assessee**, a tax resident of Korea, **was awarded a 'turnkey' contract**, for **carrying out survey, design, engineering, procurement, fabrication, installation, modification, start-up and commissioning of facilities** covered under the 'Vasai East Development Project' ("Project"), **by Oil and Natural Gas Company ("ONGC").**

- **Subsequently**, the assessee **opened a Project Office (PO)** in Mumbai for the **purpose of acting as a communication channel between the assessee and ONGC in respect of the said Project.**

- For the year under consideration (i.e. AY 2007-08), the **PO prepared the Profit & Loss Account** on the basis of the project completion method, whereby the **PO recognised revenue in relation to pre-engineering survey, insurance and hook-up and commissioning activities**. In relation to the said revenue, the **PO claimed certain expenses namely a.) Pre-engineering survey; b.) Insurance (which was incurred for and behalf of ONGC; c.) hook-up and commissioning and d.) general administrative expenses such as rent, salaries etc.**

- Thereby, the **assessee filed the return of income** declaring a loss of INR 23.50 lakhs. **Activities in relation to engineering, procurement and fabrication were done outside India.** (see Tribunal order reported in (2011) 133 ITD 413 (Delhi) at paragraph 17, 18, 34 to 37, 64 and 71)

FACTS (…continued)

- The **AO** during the course of assessment proceedings, **passed a draft assessment order by holding that the Project was a single indivisible "turnkey" project** and thereby **the profits arising from the commissioning of the Project would arise in India.** The **AO further**, held that the **work relating to fabrication and procurement of material was very much a part of the turnkey contract** and the said work **was wholly executed by the PE in India.**

- The **AO distinguished the decision of SC in case of Hyundai Heavy Industries Co. Ltd.**, [2007] 7 SCC 422, **by observing that, in the case of Hyundai Heavy Industries** (supra), **the project was in two separate parts, unlike the Project in the present case.** Accordingly, the **AO then attributed 25% of the revenue** as the **income of the assessee** liable to be taxed in India.

- The **DRP upheld the action of the AO** and **observed that opening of a project office clearly demonstrated that the assessee was doing something more than what would have been done through a liaison office** and therefore **considering the nature of activities** undertaken in India it was clear that **PE existed** in the case of assessee.

- The DRP further **upheld the finding of the AO that since the agreement was a 'turnkey' project, which could not be split, the entire profit earned from the said project would arise in India.** The DRP also **upheld the action of the AO in attributing 25% of the revenue** as the income of the assessee (being the margin earned by comparables from similar projects, by relying on the data obtained from a database namely "Capital Line").

DECISION OF TRIBUNAL

- Before the Tribunal, the assessee **contented that the pre-engineering survey etc. (i.e. hook-up and commissioning) were carried out through contractors**, viz. Fugro Geonics (P.) Ltd., and Offshore Hook-up and Construction Services India (P.) Ltd., and the said activities were carried out for a period of 1-3 days **to facilitate the design, engineering and fabrication activities which were being carried out outside India.**

- The assessee further contented that the **nature of expenses incurred by the PO were general administrative expenses** like rent, telephone, printing, salary, etc., and the **project office was established only to act as a communication channel between ONGC** and the assessee **for the purpose of**, inter alia, **passing on to ONGC the invoices raised by the head office, recovering the invoices, obtaining the milestone completion certificates from ONGC and transmitting the same to head office, arranging security clearance as and when required for personnel and equipment.**

- The assessee further contented that **no technical work was carried out by the project office in India and the activities in relation designing, engineering and fabrication of the platforms were carried outside India.** (see Tribunal order reported in (2011) 133 ITD 413 (Delhi) from paragraph 34 to 37)

DECISION OF TRIBUNAL (….continued)

- The **Tribunal**, by **relying on the application made by the assessee to the RBI for opening a project office and board resolution dated 3rd April, 2006 of the assessee**, **upheld the action of the lower authorities** and observed as follows:
  a. The **scope of activities** to be conducted **by the PO** was **not restricted neither by the RBI nor by virtue of the resolution**. Accordingly, **the decision of Hyundai Heavy Industries (supra) was not similar to the present case**, **since in Hyundai Heavy Industries (supra) permission was granted to the project office to work as a liaison office only and the project office was further not authorized to any conduct business activity.**

     N.A

  b. **Perusal of the board resolution dated 3rd April, 2006 made it clear that the PO was opened for coordination and execution of the Project** and hence it could not be said that the PO was not a fixed place of business of the assessee in India to carry out wholly or partly the impugned contract in India under Article 5(1) of India-Korea DTAA, since all the activities to be carried out in respect of Project were routed through the PO only.

  c. **The assessee had obtained insurance with respect to the entire Project** and the assessee was **unable to demonstrate that the insurance** had been **restricted only with regards to activities outside India.**

∴ core activity

DECISION OF TRIBUNAL (….continued)

d. With respect to the argument of the assessee that the PO was only an auxiliary office; not engaged in any of the core activities of the assessee, as evidenced by the books of accounts which demonstrate that there was no expenditure in relation to the execution of the project, the **Tribunal observed that maintenance of account was in the hands of the assessee and hence merely the mode of maintaining the accounts alone could not determine the character of PE.**

e. The way the terms of the contract are described, that the **PO of the assessee played a vital role in the execution of the Project, the onus was on the assessee to prove that the activities of the PE were preparatory and auxiliary in nature.** [approval of ONGC thru LO]

- The Tribunal, **however remanded the issue of attribution of profits to the PE, in absence of necessary material to ascertain the extent of activities carried out by the PO in India.**

Samsung Heavy Industries Co. Ltd.

DECISION OF HIGH COURT

- The Uttarakhand High Court held that by **submitting the return**, the **assessee had held out that it was carrying on business in India through a permanent establishment** situated in India. **In the circumstances** the **contention of the assessee whether the project office opened at Mumbai could or could not said to be a PE was of no consequence.**

- It further held that the facts of the case indicated **two things** namely i.) the assessee had a **tax identity in India** and a tax identity outside India and accordingly ii.) its **tax liability in India was required to be apportioned**. However, it further observed that **neither the AO nor the Tribunal had made any effort to justify that the project office of the assessee was the PE of the assessee in India through which it carried on business during the relevant year and that 25% of its gross receipts was attributable to it.**

ONUS ON REVENUE WRT ATTRIBUTION

- The **High Court allowed the appeal** of the assessee and **set aside the judgement of the Tribunal** so far as the same related to imposition of tax liability on the 25% of gross receipts of the assessee. (see High Court order reported in 42 Taxmann.com 140 (Uttarakhand)

DECISION OF SUPREME COURT

- The SC after perusing **Article 5 and Article 7** of the DTAA and referring to the decision of co-ordinate benches in case of **Morgan Stanley & Co. Inc.** [2007] 7 SCC 1, **Hyundai Heavy Industries Co. Ltd**. (supra), **Ishikawajma-Harima Heavy Industries Ltd.** [2007] 3 SCC 481 and **E-Funds IT Solution Inc.**[2018] 13 SCC 294, observed that the **profits of the non-resident are taxable only where the said non-resident carries on its core business through a permanent establishment in India** and that the maintenance of a fixed place of business for activities which is of a preparatory or auxiliary character in the trade or business of the non-resident could not be considered to be a permanent establishment.

- The SC **after perusing the above mentioned board resolution, observed that the PO was established to coordinate and execute the "delivery documents in connection with construction of offshore platform modification of existing facilities for ONGC"** and hence **the finding of the Tribunal that the PO was not a mere liaison office, but was involved in the core activity of execution of the project itself was held to be perverse.** The finding of the Tribunal that the mode of maintaining accounts alone could not determine the character of permanent establishment, was also held to be perverse.

DECISION OF SUPREME COURT

- When it was pointed out that the accounts of the Project Office showed that no expenditure relating to the execution of the contract was incurred by the assessee, the Tribunal rejected the argument of the assessee, stating that as accounts were in the hands of the assessee, **the mere mode of maintaining the accounts alone could not determine the character of permanent establishment. This finding of the Tribunal was held to be a perverse finding.**

- The **finding of the Tribunal that the onus is on the assessee and not on the Revenue to demonstrate that project office was not a permanent establishment of the assessee, was held to be contrary to the decision of Supreme Court E-Funds IT solutions Inc. (supra).**

- In view of the above, the **SC held that since only two persons were working in the PO, neither of whom were qualified to perform any core activities, it could not be said to be a fixed place of business through which the core business of the assessee were wholly or partly carried on under Article 5(1) of the DTAA.**

NB

- Also, the SC held that the PO, **based on the facts of the present case**, would fall within **Article 5(4)(e**) of the DTAA, in as much as the **PO was solely an auxiliary office, meant to act as a liaison office between the assessee and ONGC.**

(1) ONUS ON REVENUE FOR PE/ ATTRIBUTION

(2) Nomenclature - not - wh[illegible] PO = LO

(3) MLI - A.13 - Artificial Avoidance of PE thru sp. Activities

(4) Commissioning = Installation 183 days (sp. v. core Activity Exm)

CIT v. TAJ TV LIMITED

[2020] 115 taxmann.com 305 (Bombay)

INCOME TO BE ATTRIBUTED TO DAPE (Calliere)

ISSUE 4

- ***Whether income from distribution activity of a foreign TV channel company carried on through an exclusive distributor in India acting on a principal to principal basis, would be taxable in India on the ground that the same is attributable to the DAPE, admittedly constituted by the very same distributor acting in his capacity as an advertising agent for the very same foreign TV channel company, whose advertising income is admittedly taxable in India being attributable to the said DAPE ?***

whether all income earned thru an ICD (DAPE) can be taxed in India ?

RELEVANT PROVISIONS

- **Article 5(4)** of India-Mauritius DTAA

  *4. Notwithstanding the provisions of paragraphs (1) and (2) of this article, **a person acting in a Contracting State** for **or on behalf** of an **enterprise of the other Contracting State** [**other than an agent of an independent status** to whom the provisions of paragraph (5) apply] **shall** be **deemed** to **be a permanent establishment** of that enterprise in the first-mentioned State if :*
  *(i) he has and habitually exercises in that first-mentioned State, **an authority to conclude contracts** in the name of the enterprise, unless his activities are limited to the purchase of goods or merchandise for the enterprise ; or……*

FACTS

- The **assessee, a tax resident of Mauritius**, was **engaged in the business of telecasting sports channel viz. 'Ten Sports'** channel and **earned revenue by way of advertisement and distribution of channel in India**.

- The **assessee** had entered into the following **two types of agreements** with **Taj India (a subsidiary** of the assessee, incorporated in India):
  a. **Distribution Agreement** – Through which **Taj India** was appointed as an **exclusive distributor** in India to distribute the said channel for exhibition to subscribers. The distribution revenue collected by Taj India was shared in the ratio of **60:40 between the assessee and Taj India** ; and
  b. **Advertisement Agreement** – Through which **Taj India** was appointed as **advertising sales agent** in India to sell commercial advertisements slots on the said channel, for which it received commission @ 10% of the advertisement revenue.

- The **AO** concluded the assessment proceedings by holding that the **Taj India had an authority to conclude contracts w.r.t the advertisement agreement**. Further **w.r.t the distribution agreement, the AO observed that Taj India had an exclusive right to represent before the cable operators on behalf of the assessee** and hence the AO held that a **Dependent Agent PE (DAPE)** of the assessee was established in India.

CIT(A)'S OBSERVATION

- The **CIT(A)** observed that **w.r.t advertisement agreement, Taj India was fully dependent on the assessee** for its business activities and hence **Taj India constituted a PE.**

- **W.r.t the distribution agreement**, the **CIT(A)** held that **Taj India had acquired rights of distribution of channel from the assessee on its own behalf and hence it was held that Taj India did not constitute a DAPE of the assessee as per Article 5(4) of India-Mauritius DTAA.**

TRIBUNAL'S OBSERVATION

- **Assessee's appeal w.r.t advertisement agreement was dismissed as being time barred** by the Tribunal.
- **W.r.t the distribution agreement, the Tribunal** observed that **none of the conditions as stipulated in Article 5(4) of the DTAA were applicable since Taj India was acting independently qua its distribution rights and the entire agreement was on a principal to principal basis and hence DAPE was not established.**

DECISION OF THE HIGH COURT

NO

- **The Court analyzed Article 5(4)** of the DTAA and **observed that a DAPE is constituted only if the agent habitually exercises** in the first contracting State **an authority to conclude contracts in the name of the enterprise** or **he habitually maintains** in the first contracting State **a stock of goods or merchandise belonging to the enterprise from which he regularly fulfills orders on behalf of the enterprise.**

vis-a-vis cable operators

- The **Court relied on the order of the Tribunal, wherein it was factually determined (after perusal of the distribution and the sub-distribution agreements) that Taj India was not acting as agent of the assessee but it had obtained the right of distribution of the channel for itself and subsequently, it had entered into contracts with other parties (i.e. the sub-distribution agreements) in its own name in which the assessee was not a party.**

i.e P-P

- In view of the above, the Court held that since none of the conditions as mentioned in Article 5(4) of the India-Mauritius DTAA were fulfilled, **DAPE** of the assessee **was not established** in India i.e. qua the distribution agreement.

NB: Distribution revenue cannot even be taxed as Royalty as there is no parting of any "copyright" for which payment can be considered as royalty

CIT vs MSM Satellite (S'pore) Pte Ltd [2019] - 106 Taxmann.com 353 (Bom)

Majestic Auto Ltd. v. CIT

[2019] 110 taxmann.com 261 (Punjab & Haryana)

ISSUE 6

- ***Whether payment made to a foreign company for supply of technical designs, drawings and specification would be taxable as Royalty as per the Act as well as under the erstwhile India-Austria DTAA?***

would apply to current treaty also

RELEVANT PROVISIONS

- **Article VI** of erstwhile **India-Austria DTAA**

  "(2) In this Article, the term ***"royalty"*** *means any royalty of other like* ***amount received as consideration*** *for the* **right to use** *copy-rights, artistic or scientific works, cinematographic films, patents,* ***models, designs, plans,*** *secret processes or formulae, trademarks* ***and other like properties or rights.***

- **Explanation 2 to section 9(1)(vi)**

  For the purposes of this clause, **"royalty" means consideration** (including any lump sum consideration ……… for—………

  (i) the **transfer of all or any rights** *(including the granting of a licence) in respect of … model,* **design**….

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

Majestic Auto Ltd.

FACTS

- The **assessee, an Indian Co.,** entered into an **agreement** with an **Austrian Co.** whereby the **assessee** was **granted an exclusive individual right and a license to use manufacturing related information to be supplied by the said Austrian Co. for the purpose of manufacturing and selling vehicles in India.**

- As per the agreement, **the Austrian Co. supplied the requisite drawings, designs, specifications, processes, schedule and all other relevant technical details and documents to the assessee** for which the assessee paid an amount of 3 Million Austrian Schilling.

- Further, **the agreement contained another clause**, whereby the **assessee would pay royalty to the Austrian Co. once the production started**, the quantification of the said amount **was based on the quantum of the vehicles produced by the assessee.**

- **The assessee sought an income tax clearance certificate u/s 195(2), from the AO for paying the lump sum consideration without deducting any taxes on the ground that the captioned payment was made for 'supply' of drawings, designs etc., and not for their 'use'**, which was **denied by the AO on the ground that even payment for supply of designs, drawings specifications etc. would be in nature of royalty and hence tax was liable to be deducted.**

FACTS

- The **CIT(A) held that the said payments was not in nature of royalty**, on the ground that the payments made to the Austrian Co**. were only in respect of drawings and designs and not for any services rendered in India** and accordingly upheld the plea of the assessee.

- However, the **Tribunal** held that there was **no difference between the term 'supply' and 'use' of designs, drawings, specifications etc. and accordingly held that the captioned payments were 'royalty' liable for tax withholding.**

DECISION OF THE HIGH COURT

- The Court held that the term royalty **would mean payments made to an owner for the ongoing use of its assets or property such as patents or natural resources for its business purposes.**

- The Court placed reliance on the decision **of Supreme Court in case of Entertainment Network (I) Ltd. v. Super Cassette Industries Ltd.,** [2008] 13 SCC 30, wherein the Supreme Court had defined the term 'royalty' as ***"the remuneration paid to an author in respect of the exploitation of a work, usually referring to payment on a continuing basis rather than a payment consisting of a lump sum in consideration of acquisition of rights.".***

- The Court also placed reliance on the decision of Supreme Court in case of **State of H. P. v. Raja Mahendra Pal, [1999] 4 SCC 43** which defined the term 'royalty' as "***a payment reserved by the grantor of a patent***, *lease of a mine or similar right, and payable proportionately to the use made of the right by the grantee, which shall on payment of money, but may be a payment in kind being the part of the produce of the exercise of the right.'(excerpts taken from the Supreme Court on Words, Phrases and Legal Expressions (Judicially defined) 1950-2015 Volume III."*

- Further the Court also placed reliance on the Oxford Advanced Learner's Dictionary, whereby the term 'royalty' is defined to mean '***a sum of money** that is paid by an oil or mining company **to the owner** of the land **that they are working on**'.*

DECISION OF THE HIGH COURT

- The High Court observed that **the Austrian Co. had merely authorized its use to the taxpayer, however its actual use would arise only on commencement of production and that would be the stage at which royalty would become payable.**

- Further, **the Court also observed that the Tribunal had given an unnatural meaning to the term 'supply', (i.e. there is no difference between 'supply' and 'use').** The Court also held that based on the agreement, **the actual use of the said drawings, designs etc. would start only when the only when production and sale commenced** and at that point of time it would be construed as 'use' of drawings, designs etc.

- Accordingly, the **Court held that payments for supply of designs, drawings, specifications etc. was not in nature of royalty.**

NOT ON 2 consideration but favourable on t-f / supply of design + use

- DAVY ASHMORE INDIA - 190 ITR 626 (Cal) (UK)
- CREATIVE INFOCITY - 82 T.com 358 (Guj) (US)
- PARSONS BRINKERHOFF - 24 SOT 341 (Del) (Thailand + Aus)
- other ITAT

whether t/f of designs = FTS?

Buro Happold Limited v. DCIT

[2019] 103 taxmann.com 344 (Mumbai - Trib.)

ISSUE 7

- ***Whether payment received for development and transfer of a technical plan or technical design would be in the nature of FTS as per Article 13 of the India UK DTAA, irrespective of the fact, whether it 'makes available' technical knowledge, experience, skill, knowhow, etc. or not?***

RELEVANT PROVISION

- **Article 13(4)** of India-UK DTAA

  “4. For the purposes of paragraph 2 of this Article, and subject to paragraph 5, of this Article, the term "fees for technical services" means payments of any kind of any person in consideration for the rendering of any technical or consultancy services (including the provision of services of a technical or other personnel) which :

  (a)……

  ……….

  (c) ***make available*** *technical knowledge, experience, skill know-how or processes*, ***or*** *consist of the* ***development and transfer*** *of a technical plan or technical design.”*

Swiss 48

Buro Happold Limited

FACTS

- The **assessee, a tax resident of the UK**, is engaged in the **business of providing consulting** and **engineering services** in relation to structural and MEP (Mechanical, Electrical and Public health) designs for buildings.

- The **assessee had a subsidiary in India** (referred as **Buro India**), **which rendered consulting engineering services to its clients**. **However, in areas**, such as master planning, acoustics engineering, environmental engineering, etc., for **which they lacked the expertise, the said services were availed from the assessee.**

- (F18) During the year under consideration, the **taxpayer** had **received income for the provision of consulting and engineering services and income on account of cost recharge to Buro India.** (ICO)

- Skip The **assessee** claimed the **receipt** from provision of consulting and engineering services as **not taxable** in India as per **Article 13** of India UK DTAA **as the consulting and engineering services did not make available technical skills, knowledge etc. to Buro India.**

- Skip However the **AO** held that as per **Article-13(4)(c)**, **payment received for development and transfer of a technical plan or technical design would be** in **the nature of FTS, irrespective of the fact, whether it satisfied the condition of 'make available'** technical knowledge, experience, skill, knowhow, etc., which was **upheld by the CIT(A) on appeal**.

ASSESSEE'S CONTENTION

- The taxpayer contended that the income received for the rendering of consulting and engineering services could be charged to tax as **FTS under Article 13 only** if it **made available** technical knowledge, experience, skill, know-how or processes **or** consists of the **development and transfer of a technical plan or technical design.**

- The taxpayer alternatively also argued that **even if the amount received from rendering of the consultancy services was attributed to the supply of technical design and drawings, the same could not be treated as FTS** under Article 13 as the second limb of Article 13(4)(c) i.e. "**consist of the development and transfer of technical plan or technical design**" could not be **read disjunctively** from the phrase **"make available technical knowledge, experience, skill know-how or processes"**. Thus, the **condition of making available had to be applied even for the second limb**.

REVENUE'S CONTENTION

- The revenue contented that '**make available**' clause goes with technical knowledge, experience, skill, know-how, etc., but **does not go with the second limb of Article 13(4) (c), i.e., the development and transfer of technical plan or a technical design**. Hence, the amount received for consulting and engineering services would be taxable as FTS.

DECISION OF TRIBUNAL

- The Tribunal perused **Article 13(4) (c)** of India-UK Tax Treaty and held that the words "**or consists of the development and transfer of a technical plan or technical design**," appearing in the second limb **had to be read in conjunction with "make available technical knowledge, experience, skill, know-how or processes**."

- The Tribunal further observed that as per rule of '***ejusdem generis***', the words "**or consists of the development and transfer of a technical plan or technical design" would take color from "make available technical knowledge, experience, skill, know-how or processes.**"

- Accordingly, the Tribunal held that the **supply of project-specific designs/drawings/plans did not make available technical knowledge, experience, skill, know-how or process (since the designs were project specific and cannot be used by Buro India subsequently)** and hence, the same was not taxable in India.

Mira Exim Ltd – 81 T.com 33 (Del-T) (UK DTAA)

Gupta Overseas – 153 ITD 357 (Agra) (A.T)

- SNC Lavalin Int. Inc – 26 SOT 155 (Del) (Canada) [on M.A]

Sintex Industries – 14 ITD 98 (Ahd) (U.K)

GERA DEVELOPMENTS

72 T.com 238 (Pune)

S.P.O.C + Trust

+

SB

RELEVANT FOR YUM RESTAURANT [2020] 117 T.com 759 (Del-Trib)

Morgan Stanley Asia (Singapore) Pte. V. DDIT (IT)

[2018] 95 taxmann.com 165 (Mumbai - Trib.)

ISSUE 9

ABOVE RELEVANT FOR

- ***Whether reimbursement of salary cost, by an I Co. to a Singapore company (assessee) in respect of the salary of the employee seconded by the Singapore company (assessee) to the I Co., would be taxable as FTS under the Act / India-Singapore DTAA ?***

RELEVANT PROVISIONS

- **Explanation 2 to section 9(1)(vii)**

  "Explanation 2.—For the purposes of this clause, "fees for technical services" means any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services (including the provision of services of technical or other personnel) **but 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"."**

ICO ← secondment — FCO

REIMB →

FTS?

salary

Seconded Employee

SERVICE PE

Morgan Stanley Asia (Singapore) Pte.

RELEVANT PROVISIONS

- Article 12(4) of India-Singapore DTAA

> *"4. The term "fees for technical services" as used in this Article means payments of any kind to any person in consideration for* **services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel)** *if such services :*
> *(a) ……. ; or*
> *(b)* ***make available*** *technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein ; or*
> *……."*

- Article 5(6) of India-Singapore DTAA

> *"6.* ***An enterprise shall*** *be* ***deemed*** *to have a* ***permanent establishment*** *in a Contracting State* ***if it furnishes services, other than services referred*** *to in paragraphs 4 and 5 of this Article and* ***technical services as defined in Article 12****, within a Contracting State* ***through employees or other personnel****, but only if :*
> *(a)……..*
> *(b)……..*

Morgan Stanley Asia (Singapore) Pte.

FACTS

- The **assessee, a resident of Singapore, deputed one of its Director/employee to India for the period from May 2004 to April 2007 to set up Morgan Stanley Advantage Services Private Limited (MSAS) i.e. Indian Co., an associate concern in India.**

- The assessee, as per the terms of contract, agreed to continue paying salary of the employee in Singapore and **cross charged Indian Co. for the same.**

- The **assessee before the AO** claimed that the amount received by the assessee was in the nature of **pure reimbursement of cost** incurred by assessee on behalf of MSAS and **hence no income arose in its hands.**

- The **AO** rejected the assessee's explanation by contending that the **employee deputed to India was highly qualified and had technical experience and the role of the assessee was more than an employer.**

- Thus, the **AO** held that amount received by the assessee **was in nature of FTS. The TPO made an adjustment on account of the ALP of the mark-up to be charged, computed @ 23.30% on the amount of reimbursement of salaries.**

- The CIT(A) upheld the AO's order.

Morgan Stanley Asia (Singapore) Pte.

FACTS

- The following **main ground** was raised by the assessee before the Tribunal:

CIT(A) erred

*"1. Ground No.1: In upholding that the **reimbursement of personnel costs** amounting to Rs. 57,825,175 by Morgan Stanley Advantage Services Private Limtied (MSAS) to the Appellant is the **Appellant's income** and in respect of which **transfer pricing provisions would be applicable** in order to determine the Arm's Length Price **(ALP)**."*

NOTE [ITAT + AAR ⇒ both views]

① HCL – 274 ITR 261 (Del) – salary

② Karl Storz – Del HC – reimb + m.A

③ Bom HC → MGS → m.A

④ A.P. Moller – 342 ITR 186 (SC)

⑥ Centrica – Del HC – per curiam ★

⑦ Verizon – Mad HC – FTS < ACT, TREATY (remanded)

Reimb – Remanded

(4 FTS but AAR upheld SERVICEPE)

Yum Restaurant [2020] 117 T.com 754 (Del – ITAT)

LIEN OF EMPLOYMENT WITH ICO

∴ CENTRICA DISTINGUISHED

① ACT VS TREATY

② Spvs. lien 9(1)(vii) vs 9(i)

Mad HC → 3 pers when.

Guj HC – Merlo vs Solvate

③ Substance over form

④ ultimate recipient

TP → loss to Revenue

[ISB – IBM]

DECISION OF TRIBUNAL

- The Tribunal held that **payment by Indian Co. being a pure reimbursement of salary cost**, **would be covered under exception mentioned in explanation 2 to section 9(1)(vii)** and **would not be taxable as fees for technical service under the domestic law.**

- The Tribunal **relied** on **Delhi Tribunal ruling in United Hotels Ltd.** [2005] 2 SOT 0267 (Delhi) wherein it was held that for each deputed person, the amount received by it **is income chargeable under the head "salary"** and therefore, **it could not be termed as "fees for technical services".**

- Further, the Tribunal observed that **receipt had been taxed as salary in the hands of the employee in India.**

ITA No 893 of 2014 → upheld by Bom HC

- The Tribunal **relied** on the decision of Tribunal (Mumbai Bench) in case of **Mark & Spencer Reliance India (P) Ltd.** [2013] 38 taxmann.com 190 (Mumbai – Trib.), wherein it was held that when the seconded employees were deputed for providing assistance in management and set up of business, and worked under direct control, management and supervision of the taxpayer, **the services would not be in nature of FTS under the India-UK DTAA and further the said services would not make available technical skills, know how to the taxpayer.**

- The Tribunal **allowed the main grounds** of the appeal in favor of the assessee and did not adjudicate the balance grounds which had become academic (**once the reimbursement of salaries was not taxable, the corresponding TP adjustment/markup could not be taxed**).

SEE pg. 56

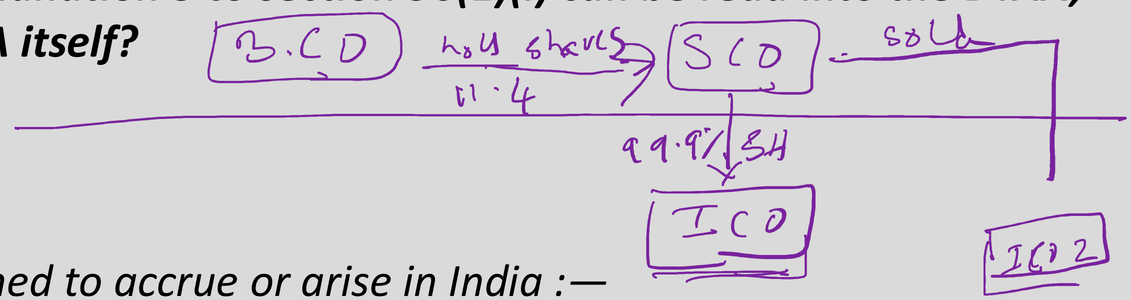
Sofina S.A. v. ACIT

[TS-129-ITAT-2020(MUM)] - ITA No.7241/Mum/2018

ISSUE 10

- ***Whether capital gains on transfer of shares of a Singapore Co. (holding 99.99% shares of an Indian Co.) by a Belgian resident would be taxable in India or Belgium ? (Singapore Co. has no other assets)***

- ***Whether indirect transfer provisions in Explanation 5 to section 90(1)(i) can be read into the DTAA, in absence of similar provisions in the DTAA itself?***



RELEVANT PROVISIONS

- **Section 9(1)(i) and Explanation 5** of the Act

  "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 5.—For the removal of doubts, it is hereby clarified that an asset or a capital asset being any ***share or interest in a company*** *or entity registered or* ***incorporated outside India*** *shall be* ***deemed*** *to be and shall always be deemed to have been* ***situated in India****, if the* ***share or interest derives****, directly or indirectly,* ***its value substantially*** *from the assets located in India"*

RELEVANT PROVISION

- **Article 13** of India-Belgium DTAA

  *"1. **Gains derived** by a resident of a Contracting State from the **alienation of immovable property** referred to in Article 6 and situated in the other Contracting State may be taxed in that other State.*

  *2. **Gains from the alienation of movable property** forming **part of the business property of a permanent establishment** which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such fixed base, may be taxed in that other State.*

  *3. **Gains from the alienation of ships or aircraft** operated in international traffic or movable property pertaining to the operation of such ships or aircraft shall be taxable only in the Contracting State of which the alienator is a resident.*

  *4. Gains from the **alienation of shares of the capital stock of a company**, the **property of which consists directly or indirectly principally of immovable property** situated in a Contracting State may be taxed in that State.*

  *5. Gains from the **alienation of shares other than those mentioned in paragraph 4**, forming part of a participation of **at least 10 per cent of the capital stock of a company which is a resident of a Contracting State** may be taxed in that State.*

  *6. Gains from the alienation of any **property other than that** mentioned in paragraphs 1, 2, 3, 4 **and 5 shall be taxable only in the Contracting State of which the alienator is a resident."***

Belgium

Sofina S.A.

FACTS

- The **assessee, a tax resident of Belgium**, subscribed to the **preference shares of a Singapore Co.** totalling to **11.34%** of its total shareholding. Further, **Singapore Co. in turn held 99.99%** of the total shareholding of an **Indian Co.**

- The **assessee sold its entire stake in Singapore Co. (i.e. 11.34%) to Jasper Infotech Pvt. Ltd. (a tax resident of India). Jasper Infotech Pvt. Ltd.,** while discharging the consideration for the above mentioned transaction, **withheld taxes u/s 195. The assessee filed its return of income declaring NIL income as per the provisions of Article 13(6) of India-Belgium DTAA. As per Article 13(6), gains from alienation of the said shares would be taxable in the state of the alienator i.e. Belgium.**

- The **AO** concluded the assessment proceedings by holding that the Singapore Co. did not have any other assets except for its investment in the Indian Co. and thus the **shares of Singapore Co. derived their value substantially from the shares of Indian Co. and hence the transfer of shares of Singapore Co. would be taxable in India in terms of explanation 5 to section 9(1)(i).**

- Further, the AO held that by virtue of the deeming fiction created by explanation 5 to section 9(1)(i), the shares of Singapore Co. were deemed to be situated in India and **consequently the Singapore Co. was deemed to be a tax resident of India. In view of the same, the AO applied Article 13(5) of the relevant DTAA to conclude that the transfer would be taxable in India.** The assessee filed objections before the DRP, however the DRP upheld the order of the AO.

GO TO ITAT

Sofina S.A.

ASSESSEE'S CONTENTION BEFORE THE TRIBUNAL

- The assessee contended that deeming fiction created by **Explanation 5 to section 9(1)(i) deems shares of a foreign company to be situated in India and does not deem that the company itself becomes a resident in India.**

- The assessee also contended that Explanation 5 to section 9(1)(i) was inserted in the statute by Finance Act, 2012 w.r.e.f 01.04.1962, **however in absence of any similar amendments in the India-Belgium DTAA or India-Singapore DTAA, such amendments could not be read into the said DTAA's.**

- Accordingly, it was argued that the **Article 13(5) would not be applicable as it explicitly provides that the company whose shares are to be transferred should be a resident of either of a contracting states i.e. either Belgium or India.**

REVENUE'S CONTENTION BEFORE THE TRIBUNAL

- The **Revenue placed reliance on the order of the AO** and argued that **the fact pattern** of the captioned transaction **bought the transaction within the ambit of Article 13(5)** read with Explanation 5 to section 9(1)(i)

Sofina S.A.

DECISION

- The Tribunal relied on the decision of **Andhra Pradesh HC in case of Sanofi Pasteur holding SA (2013) 30 taxmann.com 222 (Andhra Pradesh) and observed that as per Article 13(5) gains from alienation of shares in a company can be taxed in the State in which the said company is resident** only if the following two conditions are satisfied viz.
  a. **participation of at least 10%** in the capital stock of company; and — 1st con 1n fulfilled
  b. the **company whose** shares are transferred **should be a resident of a contracting state**

- Since the **shares transferred** by the assessee in the present case were of **Singapore Co.**, the pre-condition that the shares transferred should form part of the capital stock of a company which is a resident of a **Contracting State i.e. India was not fulfilled** and hence **Article 13(5) would not be applicable in the present case**.

- **Explanation 5 of section 9(1)(i) incorporates a 'see through' approach** i.e. if a person holds shares outside India, which, directly or indirectly, derives its value substantially from the assets located in India, the legislation deems such shares located outside India to be located in India for taxation purposes. However a similar '**see through' approach is not envisaged in Article 13(5) of the relevant DTAA** and hence it cannot be deemed that the above mentioned transaction results in the transfer of shares of Indian Co.

UK SC in Fowlers case

Golden Bella Holdings Ltd. v. DCIT

[2019] 109 taxmann.com 83 (Mumbai - Trib.)

ISSUE 11

- ***Whether an assessee (a Cyprus entity), who had entered into a back-to-back arrangement whereby it received funds (share capital + Loan) from its Parent Co. (M. Co.) for making investment, in the form of CCD's, in another Group Co. (I. Co.), would be considered as a 'beneficial owner' of interest income from India under the India-Cyprus DTAA ?***

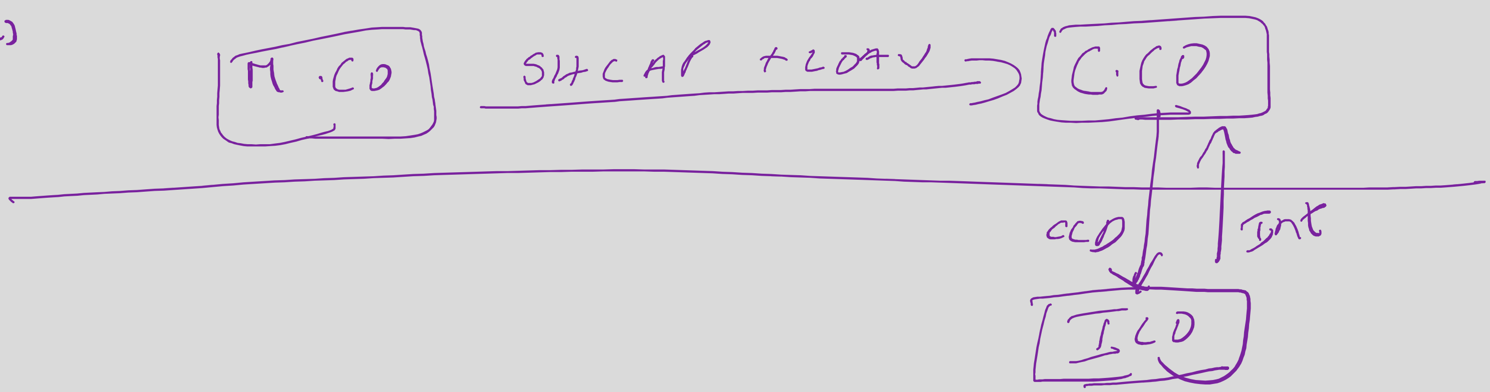
RELEVANT PROVISION

India

- **Article 11(2)** of India-Cyprus DTAA

  *"2. However, such interest may also be taxed in the Contracting State in which it arises, and according to the laws of that State, **but if the beneficial owner** of the interest is a resident of the other Contracting State, the tax so charged shall not exceed 10 percent of the gross amount of the interest."*

Cyprus



FACTS

- The **assessee, a tax resident of Cyprus**, was **incorporated** with the objective of undertaking business activities of an **investment holding company**. The assessee was a **wholly owned subsidiary of a Mauritius Co.** and further the **Mauritius Co. also held 99.5% in an Indian Co.**

- The **assessee** had made **investments**, in the form of **CCD's, in Indian Co.** and had **earned interest** income on such CCD's. **The investment were made by the assessee from its own funds (i.e. share capital infused by the Mauritius Co.) and from the unsecured interest free loan received from Mauritius Co. (loan received a week before making the investments in Indian Co.)**

- The assessee filed its tax return and the said interest income was offered to tax at a reduced rate of 10% in accordance with Article 11 of the India Cyprus DTAA.

- The **AO** passed a draft order by denying benefit of reduced rate of tax under the DTAA on the ground that the **assessee was not the 'beneficial owner' of the interest income received from Indian Co. The AO observed that, the assessee was acting as a conduit for the passage of funds between its shareholder i.e. Mauritius Co. and Indian Co.**

- The DRP upheld the order of the AO and following the same, the AO crystallized the assessment proceedings

ITAT

CONTENTION OF THE ASSESSEE

- The assesse contented that the **assessee was the sole owner of the interest income and was under no contractual, legal, or economic obligation to pass on the interest income** it received to its immediate shareholder, **or to its ultimate parent**, or to any other entity.

- The assesse further contented that, **the fact that the investment was funded using shareholder loan and equity did not ipso facto, mean that corporate status may be disregarded.**

- The assessee further **relied on CBDT Circular No. 789** to contend that **TRC issued by the tax authorities of Cyprus** in its name would be a **sufficient basis** for determining **'beneficial ownership'**, of interest income.

CONTENTION OF THE REVENUE

- The Revenue contended that **investment made** by the assessee in the Indian Co. **was a back-to-back loan transaction** out of the funds received from its immediate parent company, i.e., the Mauritius Co. and hence **the assessee was a conduit company incorporated for passing the funds from the Mauritius Co. to the Indian Co.**

- The assesse was not carrying any business activities other than the investment made and hence was just a name plate company.

DECISION OF TRIBUNAL

- The Tribunal held that the **assesse would** be **eligible for the DTAA benefits** on the following grounds:-

  - The **assessee applied for CCD's using a portion of the share capital and the interest free loan and was still left with a reasonable cash balance.**

  - The **assessee** invested in CCD's and **received interest for its own exclusive benefit** and not on behalf of any other entity. **The transactions between the parties could not be considered as a back-to-back transaction lacking economic substance.**

  - The **AO could not establish that the assessee was constrained by a contractual, legal or economic arrangement with any third party with respect to the interest income received.**

  - The **assessee maintained the foreign exchange risk on CCD's (as they were denominated in INR**), **and counter-party risk on interest payment arising on the CCD's**.

M.Co → Interest Income - India tax @ 40% in this case

yet Cyprus - Beneficial Owner

Today → M.Co - INDIA Interest tax rate - 7.5%.

48%
21B4A
4KBECE
E44AT

Amarchand & Mangaldas & Suresh A Shroff & Co v. ACIT

[2020] 122 taxmann.com 248 (Mumbai - Trib.)

ISSUE 12

- ***In case of a law firm in India which has rendered professional services to its clients in Japan,***
  - whether the said professional fees would be taxable as FTS in Japan under Article 12 of the India-Japan DTAA (in the absence of the make available clause) or
  - whether the same would fall within the purview of Article 14 of the India-Japan DTAA (applicable to resident).

- ***Consequently, whether the assessee firm would be eligible to claim credit of taxes, withheld in Japan by its Japanese clients from the fees remitted to India.***

RELEVANT PROVISION

- **Article 12(4)** of India-Japan DTAA
  *"4. The term 'fees for technical services' as used in this article means payments of any amount to any person **other than payments** to an employee of a person making payments and **to any individual for independent personal services referred to in article 14**, in consideration for the services of a managerial, technical or consultancy nature, including the provisions of services of technical or other personnel."*

Amarchand & Mangaldas & Suresh A Shroff & Co v. ACIT

RELEVANT PROVISION

- **Article 14(1)** of India-Japan DTAA

  *"1. **Income derived by a resident** of a Contracting State in respect of **professional services** or other activities of **an independent character shall be taxable only in that Contracting State** unless he has a fixed base regularly available to him in the Contracting State for the purpose of performing his activities or he is present in that other Contracting State for a period or periods exceeding in the aggregate 183 days during any taxable year or 'previous year' as the case may be. If he has such a fixed base or remains in that other Contracting State for the aforesaid period or periods, the income may be taxed in that Contracting State but only so much of it as is attributable to that fixed base or is derived in that other Contracting State during the aforesaid period or periods.*

- **Article 23(2)(a)** of India-Japan DTAA

  "2. Double taxation shall be avoided in the case of India as follows :

  *(a) Where a **resident of India derives income which, in accordance with the provisions of this Convention, may be taxed in Japan, India** shall allow as a **deduction from the tax on the income of that resident an amount equal to the Japanese tax paid in Japan**, whether directly or by deduction. Such deduction in either case shall not, however, exceed that part of the income-tax (as computed before the deduction is given) which is attributable, as the case may be, to the income which may be taxed in Japan. Further, where such resident is a company by which surtax is payable in India, the deduction in respect of income-tax paid in Japan shall be allowed in the first instance from income-tax payable by the company in India and as to the balance, if any, from surtax payable by it in India."*

Amarchand & Mangaldas & Suresh A Shroff & Co v. ACIT

FACTS

- The **assessee**, a partnership firm and a **tax resident of India**, had **earned income** from **rendering professional legal services to its clients in Japan**. The **Japanese clients** of the assessee **had withheld taxes at 10%** on the gross amount of professional fees paid to the assessee **under Article 12** of the India-Japan DTAA which **does not contain the make available clause** and is applicable to services of a managerial, technical or consultancy nature **excluding,** inter alia, **payments made to individuals for** Independent Personnel Services **(IPS)** which are covered **under Article 14.** The **assessee**, filed its **return of income** in India, **claiming the foreign tax credit (FTC) of the taxes withheld by its Japanese clients.**
- The **AO** was of the **view** that the **income received** from the Japanese clients **qualified as income in nature of IPS under Article 14** of the India-Japan DTAA and **therefore in absence of a fixed base** of the assessee in Japan, the **said income was not liable to be taxed in Japan** and thus **the Japanese clients should not had withheld taxes** on the gross amount of professional fees paid to the assessee. The AO relied on the decision in case of **Maharashtra State Electricity Board Vs DCIT** [(2004) 90 ITD 793 (Mum)], Dy. **CIT v. Chadbourne & Parke LLP** [(2005) 2 SOT 434 (Mum)], and **Ershisanye Construction Group India (P.) Ltd.** vs. DCIT [(2017) 84 taxmann.com 108 (Kol)]. In view of the above, the **AO denied the claim of FTC** by holding that the taxes withheld in Japan **were not 'in accordance with' the India-Japan DTAA** and thus **not eligible for FTC in India**. The action of the AO was upheld by the CIT(A).
- On further appeal, the Tribunal held as under:

DECISION OF TRIBUNAL

- **W.r.t classification of professional fees i.e. whether taxable under Article 12 or Article 14 of the India-Japan DTAA**

  At the outset, the **Tribunal acknowledged that there were overlapping areas under** the definitions of **FTS and IPS** under the India-Japan DTAA inasmuch **as income from professional service could get covered** under **both the Articles**. However, on perusal of Article 12 and Article 14 of the India- Japan DTAA, the Tribunal held that **Article 12 of the India-Japan DTAA was applicable to the assessee**, by observing as under:

  - A **DTAA has to be read as a whole** and the **provisions** of the DTAA are to be **construed in harmony with each other.** Reliance in this regard was placed on the decision in case of **Hindalco Industries Ltd Vs ACIT** [(2005) 94 ITD 242 (Mum)] and **DCIT Vs Boston Consulting Group Pte Ltd** [(2005) 94 ITD 31 (Mum)]
  - **Article 12(4)** of the India-Japan DTAA very **clearly excludes IPS income derived by individuals** from the purview of FTS and thus **such exclusion supports the interpretation that professional income derived by other entities (i.e. non-individuals) were covered by the FTS** Article and IPS Article i.e. Article 14 of the India-Japan DTAA would be applicable only to 'individuals'. Consequently, the Tribunal observed **unless the provisions of Article 14** of the India-Japan DTAA **are held to be applicable only to individuals**, the **exclusion clause under Article 12(**4) of the India-Japan DTAA, which excludes individuals earning income taxable under Article 14, **would not make any sense**.

Amarchand & Mangaldas & Suresh A Shroff & Co v. ACIT

DECISION OF TRIBUNAL

- **W.r.t classification of professional fees i.e. whether taxable under Article 12 or Article 14 of the India-Japan DTAA (contd.)**
  - The **Tribunal recognised** that as per a valid school of thought, **Article 14 comes into play only for individuals while Article 7 is for entities other than individuals** and therefore it was for this reason that Article 14 was removed from the OECD Model Convention. The **Tribunal also placed reliance** on the Mumbai Tribunal decision in case of **Linklaters LLP v. ITO** [(2011) 9 ITR (T) 217 (Mum)].

  - The Tribunal also **distinguished the decisions relied by the AO**, by observing that **said decisions were in the context of the DTAA's** (i.e. China, U.K. and the USA) **other than India-Japan DTAA**, and the provisions of the India-Japan DTAA are **not in pari materia** (since Article 12 and Article 14 of those DTAA's were differently worded vis-à-vis India-Japan DTAA) with the provisions of those DTAA's.

- **W.r.t grant of FTC under Article 23 of the India-Japan DTAA**
  - In view of the above, the **Tribunal held that taxes were rightly withheld by the Japanese clients** which was **in accordance with** the provisions of the India-Japan **DTAA** and thus the assessee was entitled to claim FTC.

Amarchand & Mangaldas & Suresh A Shroff & Co v. ACIT

DECISION OF TRIBUNAL

- **W.r.t grant of FTC under Article 23 of the India-Japan DTAA (contd.)**
  - Further, the Tribunal observed that **for ascertaining whether the income is taxed "in accordance with"** the provisions of the DTAA for the purpose of FTC, it has to be seen as to **whether the view so adopted by the source jurisdiction** (i.e. Japan in the present case) **is a reasonable and bona fide view.** The Tribunal relied on the ruling of **Canadian Pacific Ltd. v. the Queen [76 DTC 6120] at p. 6135**, wherein the Federal Court emphasized the **importance of uniform interpretation of phrases** used in global treaty networks and held that **unless the interpretation given in the source country is "manifestly erroneous"**, **the same may be followed** in the resident country also to achieve a uniform interpretation of the tax treaty. The Tribunal also acknowledged that while it may not always be possible to desire uniformity in interpretation due to the law being made by various judges and legal frameworks in which tax treaties are to be interpreted in each country, different treatments by treaty partner jurisdictions could result in hardship to taxpayers.
  - The Tribunal, accordingly, held that **since the Japanese tax authorities had consciously taken a call rejecting the plea of the assessee** for **non-taxation of the income received by the assessee under Article 1**4 of the India-Japan DTAA, **the view of the Japanese Tax Authorities** was a **reasonable view** in the context of India- Japan DTAA and, at the minimum, was **not a 'manifestly erroneous' view.**

Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT

[2021] 125 taxmann.com 42 (SC)

ISSUE 12

- ***Taxability under the DTAAs / withholding tax obligation u/s 195 – w.r.t consideration paid for purchase of shrink-wrap computer software, by I Co. to F Co.***

RELEVANT PROVISION

9 (1) (vi)

- Relevant extract of **Explanation 2** to section 9(1)(vi) of the Act

  *"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)………

  …….

  *(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] ; or*

  ……..”

Engineering Analysis Centre of Excellence (P.) Ltd. v. CIT

- **Explanation 4** to section 9(1)(vi) of the Act

  *"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."*

- As an illustration – **Article 12(3)** of the India-Singapore DTAA

  *"3. 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** :*

  *(a) **any copyright of** a **literary**, artistic or scientific work, including cinematograph film or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or for information concerning industrial, commercial or scientific experience, including gains derived from the alienation of any such right, property or information ;*

  (b) any industrial, commercial or scientific equipment, other than payments derived by an enterprise from activities described in paragraph 4(b) or 4(c) of Article 8."

Facts

- The assessee, an Indian Co., imported shrink-wrapped computer software from an F Co. During AY 2001-2002 and 2002-2003, the assessee made payment to the said F Co. for the purchase of shrink-wrapped computer software without deduction tax at source.

- The Assessing Officer (AO) held that the F Co. had transferred copyright in the said software and hence the payment was taxable as royalty under the Act as well as under the relevant DTAA, and hence the assesse was held as an 'assessee in default'. The Commissioner of Income-tax (Appeals) [CIT(A)] dismissed the appeal of the assessee, however the Tribunal decided in favor of the assessee. On further appeal, the Karnataka High Court held that since no withholding application was made u/s 195(2) of the IT Act, the assessee was liable to deduct tax at source u/s 195(1) of the IT Act.

- On further appeal, the Supreme Court (hereinafter referred as 'SC') while adjudicating / disposing a batch of **103 connected appeals**, categorized the appeals under the following four categories:
  - Sale of software directly by non-resident (NR) - to an **end user**
  - Sale of Software by an NR - **to Indian distributors for resale to end customers** in India
  - Sale of software by an NR - **to a foreign distributor for resale to end customers in India**
  - Sale of **software bundled with hardware** by an NR - to **Indian distributors** or **end users**

- On further appeal, the Supreme Court held:

Applying the provisions of DTAA at the time of withholding taxes u/s 195

- After taking into consideration the provisions of **section 4, section 5, section 9, section 90 and section 195** of the IT Act, the SC held that once provisions of **DTAA** are applicable to a non-resident, the provisions of the IT Act could only apply **to the extent that they are more beneficial** to the assessee and not otherwise. The SC reaffirming the position laid down in **GE Technology Centre Pvt Ltd** v. CIT [2010] 193 Taxman 234 (SC) and **Vodafone International Holdings BV** v. UOI [2012] 17 taxmann.com 202 (SC), held that **the machinery provisions u/s 195** of the Act were inextricably **linked with the charging provisions** (i.e. section 4, section 5 and section 9), as a result of which, tax withholding obligation arose only when the payment to the non-resident was chargeable to tax under the provisions of the IT Act, read with the DTAA.

- The SC also referred to the **CBDT Circular No 728 dated 30 October 1995**, wherein it was clarified that the **tax deductor should take into consideration the effect of the DTAA provisions** in respect of payment of royalties and technical fees while deducting taxes at source u/s 195 of the IT Act.

- Further, the SC also distinguished the decision of SC in case of **PILCOM v. CIT [2020] 271 Taxman 200 (SC)** by observing that the said judgement was in the context of **section 194E** of IT Act, dealing with "income" payable to a non-resident sportsman which does not have any reference to payments made to non-resident being **"chargeable to tax"** as in section 195 under the Act.

Relevance of the Copyright Act, 1957

- **Explanation 4 to section 90** of the IT Act provides that **if any term used in the DTAA** is defined therein, the said term shall have the **same meaning** as assigned to it under the said DTAA; and where any term is not defined in the DTAA, **but defined in the Act,** the **said term shall have the same meaning** as assigned to it in the Act and explanation, if any, given to it by the Central Government.

- **Article 3(2)** of the DTAA provides that **any term not defined in the DTAA shall**, **unless the context otherwise requires**, have, the meaning which it has under the **law of that State** concerning the taxes to which the DTAA applies.

- Further, the SC observed that the expression **"copyright"** has to be understood in the context of the **statute which deals with it**, it being accepted that municipal laws which apply in the Contracting States must be applied unless there is any repugnancy to the terms of the DTAA.

- Section 16 of the Copyright Act provides as follows –
  "16. No copyright except as provided in this Act.-- ***No person shall be entitled to copyright*** *or any similar right in any work, whether published or unpublished,* ***otherwise than under and in accordance with the provisions of this Act*** *……."*

Relevance of the Copyright Act, 1957

- Section 14 of the Copyright Act provides as follows–

  *"14. **Meaning of copyright.**-- For the purposes of this Act, **copyright means the exclusive right** subject to the provisions of this Act, **to do or authorise the doing of any of the following acts** in respect of a work or any substantial part thereof, namely–*

  *(a) **in the case of a literary, dramatic or musical work, not being a computer programme,--***

  *(i) **to reproduce the work** in any material form including the storing of it in any medium by electronic means;"*

  *(ii) to **issue copies** of the work to the public not being copies already in circulation;*

  (iii) to perform the work in public, or communicate it to the public;

  (iv) to make any cinematograph film or sound recording in respect of the work;

  (v) to make any translation of the work;

  (vi) to make any adaptation of the work;

  (vii) to do, in relation to a translation or an adaptation of the work, any of the acts specified in relation to the work in sub-clauses (i) to (vi);

  *(b) in **the case of a computer programme**–*

  (i) to do any of the acts specified in clause (a);

  *(ii) to **sell or give on commercial rental** or offer for sale or for commercial rental any **copy of the computer programme**:*

  Provided that such commercial rental does not apply in respect of computer programmes where the programme itself is not the essential object of the rental."

Relevance of the Copyright Act, 1957

- Section 2(y) of the Copyright Act provides as follows–

  *"(y) **"work" means** any of the following works, namely:—*
  *(i) **a literary**, dramatic, musical or artistic work;*
  (ii) a cinematograph film;
  (iii) a [sound recording]"

- Section 2(O) of the Copyright Act provides as follows–

  *"(o) **"literary work" includes computer programmes**, tables and compilations **including computer databases;**"*

- Section 2(ffc) of the Copyright Act provides as follows–

  *"(ffc) **"computer programme"** means a **set of instructions expressed in words, codes, schemes** or in any other form, including a machine readable medium, capable of causing a computer to perform a particular task or achieve a particular result;"*

- Section 30 of the Copyright Act provides as follows–

  *"30. **Licences by owners of copyright.**— The **owner of** the **copyright in any existing work** or the prospective owner of the copyright in any future work **may grant any interest in the right by licence** in [writing by him] or by his duly authorised agent:*

  Provided that in the case of a licence relating to copyright in any future work, the licence shall take effect only when the work comes into existence.

Relevance of the Copyright Act, 1957

Explanation.— Where a person to whom a licence relating to copyright in any future work is granted under this section dies before the work comes into existence, his legal representatives shall, in the absence of any provision to the contrary in the licence, be entitled to the benefit of the licence."

- Section 52 of the Copyright Act provides as follows–

  *"52. **Certain acts not to be infringement of copyright.***

  (1) The following acts shall not constitute an infringement of copyright, namely,--

  ……..

  *(aa) **the making of copies or adaptation of a computer programme by the lawful possessor of a copy of such computer programme, from such copy**–*

  *(i) **in order to utilise the computer programme for the purpose for which it was supplied**; or*

  *(ii) **to make back-up copies purely as a temporary protection against loss, destruction** or damage in order only to utilise the computer programme for the purpose for which it was supplied;"*

- **The SC observed that the right to reproduce a computer programme and exploit the reproduction by way of sale, transfer, license etc. is at the heart of the said exclusive right.**

Doctrine of First Sale / Principle of Exhaustion – Section 14(b)(ii) of the Copyright Act

- **A copyright owner has an exclusive right to make copies and distribute the same.**

- On the **first occasion** when the **copyright owner parts with its distribution rights (i.e. the right to distribute copies of the work), his rights in the work gets exhausted. This is known as the Doctrine of First Sale / Principle of Exhaustion.**

- **Revenue argued that the Doctrine of First Sale / Principle of Exhaustion was not applicable to the sale of software** in light of the provision of section 14(b)(ii) of the Copyright Act, which is reproduced as under:

  "14. Meaning of copyright.-- For the purposes of this Act, copyright means the exclusive right subject to the provisions of this Act, to do or authorise the doing of any of the following acts in respect of a work or any substantial part thereof, namely--

  …….

  (b) in the case of a computer programme–

  ………

  (ii) ***to sell or give on commercial rental*** *or offer for sale or for commercial rental* ***any copy*** *of the* ***computer programme*** *(regardless of whether such copy has been sold or given on hire on earlier occasions – deleted)"*

- The SC observed that - **"After the 1999 Amendment, what is conspicuous by its absence is the phrase "regardless of whether such copy has been sold or given on hire on earlier occasions". This is a statutory recognition of the doctrine of first sale/principle of exhaustion."**

Doctrine of First Sale / Principle of Exhaustion – Section 14(b)(ii) of the Copyright Act

- A copyright owner has an exclusive right to make copies and distribute the same.

- The SC referred to the **locus classicus on the subject** i.e. **Copinger and Skone James on Copyright** (14th Edition) (1999), as follows:

  "The distribution right: general. **One of the acts restricted** *by the copyright in all work is* **the issue of the original or copies of the work to the public***, often called the* **"distribution right".**

  ………

  "Exhaustion of the distribution right: tangible objects. Exhaustion applies to the tangible object into which a protected work or its copy is incorporated if it has been placed on the market with the copyright holder's consent."

- The SC referred to the decision of **Delhi High Court** in case of **Warner Bros. Entertainment Inc.** v. Santosh V.G., CS (OS) No. 1682/2006 reported in 2009 SCC OnLine Del 835, wherein the Single Judge bench held as under:

  "58. Exhaustion of rights is linked to the distribution right. The right to distribute objects (making them available to the public) means that such objects (or the medium on which a work is fixed) are released by or with the consent of the owner as a result of the transfer of ownership. In this way, the owner is in control of the distribution of copies since he decides the time and the form in which copies are released to the public. **Content-wise the distribution right are to be understood as an opportunity to provide the public with copies of a work and put them into circulation, as well as to control the way the copies are used. The exhaustion of rights principle thus limits the distribution right, by excluding control over the use of copies after they have been put into circulation for the first time."**

Doctrine of First Sale / Principle of Exhaustion – Section 14(b)(ii) of the Copyright Act

- The SC observed that likewise, **when it comes to section 14(a)(ii) of the Copyright Act, the distribution right subsists with the owner of copyright to issue copies of the work to the public, to the extent such copies are not copies already in circulation, thereby manifesting a legislative intent to apply the doctrine of first sale/principle of exhaustion, as has been found by the High Court of Delhi in Warner Bros. (supra).**

- The SC concluded as follows:

  "142. ……….

  Thus, a distributor who purchases computer software in material form and resells it to an end-user cannot be said to be within the scope of the aforesaid provision. The sale or commercial rental spoken of in section 14(b)(ii) of the Copyright Act is of "any copy of a computer programme", making it clear that the section would only apply to the making of copies of the computer programme and then selling them, i.e., reproduction of the same for sale or commercial rental.

  143. The object of section 14(b)(ii) of the Copyright Act, in the context of a computer program, is to interdict reproduction of the said computer programme and consequent transfer of the reproduced computer programme to subsequent acquirers/end-users.

  ………

  Thus, once it is understood that the object of section 14(b)(ii) of the Copyright Act is not to interdict the sale of computer software that is "licensed" to be sold by a distributor, but that it is to prevent copies of computer software once sold being reproduced and then transferred by way of sale or otherwise, it becomes clear that any sale by the author of a computer software to a distributor for onward sale to an end-user, cannot possibly be hit by the said provision."

Analysis of the License Agreements entered by the F Co. and I Co.

- W.r.t the **distribution agreements**, the SC observed as under:
  - It was evident that the distributor was granted only **a non-exclusive, non-transferable** license to **resell computer software** and it was expressly stated that **no copyright was transferred** either to the **distributor** or to the **ultimate end user.**
  - Further, **no right** was granted to sub-license or transfer, nor there was any right to **reverse engineer, modify, and reproduce** in any manner otherwise than permitted by the licence to the end user.
  - **What was paid for by way of consideration** by the distributor in India to the F Co., was therefore the **price of a copy of the computer programme as goods** (direct software sale or hardware embedded with software).

- W.r.t the category where the computer progamme was directly sold to the end user, the SC observed that the end user could only use the computer programme by installing it in the computer hardware and the end user could not reproduce the same for sale or transfer.

- The SC also observed that the License Agreements in all the appeals did **not** grant any such right or interest, least of all, **a right** or interest **to reproduce the computer software** u/s 14(a) and 14(b) of the Copyrights Act (supra) and **such reproduction was expressly interdicted**, and it was also expressly stated that no vestige of copyright was at all transferred, either to the distributor or to the end-user.

Analysis of the License Agreements entered by the F Co. and I Co.

- The SC relied on the decision of SC in case of **State Bank of India v. Collector of Customs (2000) 1 SCC 727** (though delivered under the **Customs Act** 1962) and observed that there was a difference between **'right to reproduce'** and **'right to use',** in as much as that under **right to reproduce, there would be a parting of the copyright by the owner thereof,** whereas in case of right to use, there would not be parting of any copyrights.

- With respect to the **Revenue's argument** that in some of the **EULA's**, it was clearly **stated** that **what was licensed to the distributor / end users by the non-resident would not amount to sale**, thereby making it clear that what was transferred was not goods – the SC, by placing reliance on **Sundaram Finance Ltd. v. State of Kerala, (1966) 2 SCR 828,** observed that the **real nature of the transaction must be looked at upon, by reading the agreement as a whole.**

- Relying on the decision of the **SC** in case of **Tata Consultancy Services v. State of AP (2005) 1 SCC 308** (in the context of a sales tax statute), the SC observed that **what was "licensed"** by the F Co. to the I Co. and resold to the end-user, or directly supplied to the end-user, **was in fact the sale of a physical object which contained an embedded computer programme, and was therefore, a sale of goods.**

Definition of royalty under the DTAA and the IT Act

- The SC observed that by virtue of explanation 4 to section 90 of the IT Act and under Article 3(2) of the DTAA, the definition of the term "royalties" shall have the meaning assigned to it by the DTAA, in Article 12. The said position was also clarified by CBDT Circular No. 333 dated 02.04.1982.

- Taking India-Singapore DTAA as the base, the SC observed that the **definition of royalty under the IT Act was much wider** than the definition under the DTAA, for the following three reasons:
  - 'consideration' under the IT Act also includes **lump sum consideration** other than income chargeable under the 'capital gains'
  - **Granting of a license** is expressly included within transfer of "all or any rights"
  - Transfer should be **"in respect of" any copyright of any literary work.**

- Further, the SC also observed that the **comma after the word "copyright" does not fit** as copyright would obviously exist only in a literary, artistic, or scientific work.

- The SC observed that the **transfer** (license or otherwise) of "all or any rights" (which includes the grant of a license) **in relation to copyright is a sine qua non** under explanation 2 to section 9(1)(vi) of the IT Act, in as much as that **there should be a parting with an interest in any of the rights mentioned in section 14(b) read with section 14(a)** of the Copyright Act.

Definition of royalty under the DTAA and the IT Act

- The SC had also observed that there would be no difference in the position between the definition of "royalties" in the DTAAs and the definition of "royalty" in explanation 2(v) of section 9(1)(vi) of the IT Act, to the extent of the expression "use of, or the right to use".

- The SC also held that **explanation 4 to section 9(1)(vi)** of the IT Act was **not clarificatory** in nature (as it expands the definition of royalty), by observing as under:
  - **Explanation 3 to section 9(1)(vi)** of the IT Act which refers to the term **"computer software",** was introduced for the first time with effect from **1st April, 1991** and therefore explanation 4 could not apply to any right for the use of or the right to use of computer software - even before the term "computer software" was inserted in the statute.
  - Under the **Copyright Act** the term **"computer software"** was introduced for the first time in the **definition of a literary work,** only in the year **1994** (vide Act 38 of 1994).
  - **Technology relating to transmission by a satellite, optic fibre or other similar technology, was regulated by the Parliament for the first time through the Cable Television Networks (Regulation) Act, 1995, much after the year 1976.**
  - Circular No. 152 dated 27th November, 1974 (cited by the Revenue) would not be applicable as it would then be explanatory of a provision (i.e. section 9(1)(vi) of the IT Act) that was introduced vide Finance Act, 1976

Obligation to withhold taxes pursuant the aforesaid retrospective amendments

- The SC, by relying upon two latin maxims - **lex non cogit ad impossibilia,** i.e., the **law does not demand the impossible** and **impotentia excusat legem** i.e., **when there is a disability that makes it impossible to obey the law, the alleged disobedience of the law is excused**, held that the "person" mentioned in **u/s 195** of the IT Act **could not** be **expected to do the impossible, namely, to apply the expanded definition of "royalty" inserted by explanation 4 to section 9(1)(vi) of the IT Act, at a time when such explanation was not actually and factually inserted in the statute.**

- The SC also relied on the decision in case of **Arjun Panditrao Khotkar v. Kailash Kushanrao Gorantyal,** (2020) 7 SCC 1, wherein on the basis of the aforementioned legal maxims, the respondent was relieved of the mandatory obligation to furnish certificate under the Evidence Act, 1872, after failing to obtain it despite several steps taken by the respondent. Further, the SC also referred to the decision of **Bombay HC ruling in NGC Networks (India)** (ITA No. 397/2015) in the context of explanation 6 to section 9(1)(vi) introduced in 2012 w.r.e.f. 1976 and **Western Coalfields Ltd.** (ITA No. 93/2008) in the context of retrospective amendment to section 17(2)(ii) to highlight the impossibility of discharging withholding obligation.

AAR/High Court decisions upheld/set aside by the SC

- The **SC approved** the decision of **AAR** in case of **Dassault Systems, K.K.,** In Re., (2010) 322 ITR 125 (AAR) and **Geoquest Systems B.V.** Gevers Deynootweg, In Re., (2010) 327 ITR 1 (AAR) by observing that the **AAR had correctly applied the principle that the ownership of copyright in a work was different from the ownership of the physical material in which the copyrighted work may happen to be embedded.**

- Further the **adverse decision of AAR** in case of **Citrix Systems** Asia Pacific Ptyl. Ltd., In Re., (2012) 343 ITR 1 (AAR), was **set aside** as it did not state the law correctly, by observing as:
  - Under a non-exclusive license, an end-user only gets the right to use computer software in the form of a CD and does not get any of the rights that the owner continues to retain under section 14(b) of the Copyright Act read with sub-section (a)(i)-(vii) thereof.
  - The **AAR had incorrectly held that it was not constrained by the definition of 'copyright' under the Copyright Act** while construing the provisions of the DTAA, **without appreciating that u/s 16 of the Copyright Act no person shall be entitled to copyright otherwise than under the provisions of the Copyright Act** or any other law in force. The SC also observed that **the expression "copyright"** has to be **understood in the context of the statute which deals with it**, it being accepted that municipal laws which apply in the Contracting States must be applied unless there was any repugnancy to the terms of the DTAA.

AAR/High Court decisions upheld/set aside by the SC

- Similarly, the SC held the **Karnataka High Court in case of CIT v. Samsung Electronics Co. Ltd.,** (2012) 345 ITR 494 made the same error as done by the AAR in case of Citrix (supra) in as much as **that no distinction was made between a computer software that was sold/licensed on a CD/other physical medium and the parting of copyright** in respect of any of the rights or interest in any of the rights mentioned in sections 14(a) and 14(b) of the Copyright Act. In view of the same, the SC held that the payment for such computer software could not amount to royalty within the meaning of Article 12 of the DTAA or section 9(1)(vi) of the Income Tax Act.

- The SC also held that the decision of **CIT v. Synopsis International Old Ltd.,** ITA Nos. 11-15/2008, did not state the law correctly:
  - The observation of Karnataka High Court that the expression **"in respect of" (copyright)** should be given a **wider meaning i.e. "attributable"** to the copyright and therefore consideration paid for **transfer of a copyrighted article, would be taxable,** though the right in the copyright is not transferred, since a right in respect of a copyright contained in the article is transferred.
  - **Section 16** of the Copyright Act, which states that *"no person shall be entitled to copyright…otherwise than under and in accordance with the provisions of this Act or of any other law for the time being in force"* made it clear that the expression *"copyright"* had to be understood in terms of section 14 of the Copyright Act and not otherwise.
  - The HC was wholly incorrect in holding that the **storage of a computer programme** per se would constitute **infringement** of copyright, since it would directly be **contrary to** the provisions of **section 52(1)(aa)** of the Copyright Act.

AAR/High Court decisions upheld/set aside by the SC

- The finding that **when a copyrighted article** was sold, the **end-user gets the right to use** the intellectual property rights embodied in **the copyright** which would therefore amount to transfer of an exclusive right of the copyright owner in the work, was **wholly incorrect.**

- The **SC approved** the decision of **Delhi High Court** in case of DIT v. **Ericsson A.B.** [2012] 343 ITR 470 (Del), DIT v. **Nokia Networks OY** [2013] 358 ITR 259 (Del), DIT v. **Infrasoft Ltd.** [2014] 264 CTR 329 (Del), CIT v. **ZTE Corporation** [2017] 392 ITR 80 (Del), by observing:
  - **Copyright is an exclusive right,** which is **negative in nature, being a right to restrict others from doing certain acts.**
  - Copyright is an **intangible, incorporeal right, in the nature of a privilege,** which is quite **independent of** any **material substance.** Ownership of copyright in a work is different from the ownership of the physical material **in which the copyrighted work may happen to be embodied.**
  - **Parting with copyright entails parting with the right to do any of the acts mentioned in the Copyright Act.**
  - The transfer of the material substance does not, of itself, serve to transfer the copyright therein. The **transfer** of the ownership of the **physical substance, in which copyright subsists, gives the purchaser the right to do with it whatever he pleases, except the right to reproduce the same and issue it to the public.** No copyright is parted.

AAR/High Court decisions upheld/set aside by the SC

- The **right to reproduce** and **the right to use computer software are distinct and separate rights.**
- The **use of a copyrighted product cannot be construed as a license to enjoy** all or any of the enumerated **rights in the Copyright Act.**
- **It would make no difference as to whether the end-user was enabled to use computer software that is customised to its specifications or otherwise.**

- The SC also held that vide Circular No. 10/2002 dated 09.10.2002, the Revenue itself had appreciated the difference between the payment of royalty and the supply/use of computer software in the form of goods, which would be then treated as business income of the assessee taxable in India if it has a PE in India.

Interpretation of the DTAAs in light of the Model commentaries and India's position / reservations on the said commentaries.

- The SC, by placing reliance on the decision of **Azadi Bachao Andolan (2004) 10 SCC 1,** held that the **DTAAs** entered into between India and other Contracting States had to be **interpreted liberally with a view to implement the true intention of the parties.**

- The SC observed that the **DTAAs** under consideration had their staring point either from the **OECD Model Tax Convention** or the **UN Model Convention**, insofar as the taxation of royalty for parting with copyright was concerned. The definition of "royalties" under the concerned DTAAs were in a manner either identical with or similar to the definition contained in Article 12 of the OECD Model Commentary and therefore the same becomes relevant.

- The SC perused the **OECD Model Commentary** on Article 12, which supported the position that
  - There is **a distinction between** the **copyright in the program** and software which incorporates a copy of the **copyrighted program.**
  - **Making a copy or adaptation of a computer program to enable the use of the software for which it was supplied did not constitute royalty**
  - **Payment made by distributors and end users did not qualify as royalty.**

- Further, the SC also referred to the **India's positions / reservations** on the said **OECD Model Commentary** on **Article 12** and observed that the said positions / reservations **were not clear / vague** as contrasted with the categorical language used by India in its positions taken with respect to other aspects in Article 12.

Interpretation of the DTAAs in light of the Model commentaries and India's position / reservations on the said commentaries.

- **India's position / reservation on the commentary dealing with computer software is as under:**

  "4.1 **India reserves the right to: tax royalties** *and fees for technical services at source;* **define these,** *particularly by* **reference to its domestic law;** *define the source of such payments, which may extend beyond the source defined in paragraph 5 of Article 11, and modify paragraphs 3 and 4 accordingly."*

  "17. India reserves its position on the interpretations provided *in paragraphs 8.2, 10.1, 10.2, 14, 14.1, 14.2, 14.4, 15, 16 and 17.3;* **it is of the view that some of the payments** *referred to* **may constitute royalties"**

- **India's position / reservation on the commentary dealing with other aspect of Article 12 (eg. transponder charges) is as under:**

  "20. **India does not agree with the interpretation in paragraph 9.1** *of the Commentary on Article 12* **according to which a payment for transponder leasing will not constitute royalty. This notion is contrary to the Indian position that income from transponder leasing constitutes an equipment royalty taxable both under India's domestic law and its treaties with many countries.** *It is also contrary to India's position that a payment for the use of a transponder is a payment for the use of a process resulting in a royalty under Article 12. India also does not agree with the conclusion included in the paragraph concerning undersea cables and pipelines as it considers that undersea cables and pipelines are industrial, commercial or scientific equipment and that payments made for their use constitute equipment royalties."*

Interpretation of the DTAAs in light of the Model commentaries and India's position / reservations on the said commentaries.

- Further, the **SC** also **referred** to the decision of **Delhi High Court** in case of **Director of Income Tax v. New Skies Satellite BV, (2016) 382 ITR 114** wherein it was held that **mere positions taken with respect to the OECD Commentary do not alter the DTAA's provisions, unless it were actually amended by way of bilateral re-negotiation.**

- Further, **it was also observed that after India took such positions qua the OECD Model Commentary, no bilateral amendments were made by India** and the other Contracting States to change the definition of royalties contained in any of the concerned DTAAs, in accordance with its position.

- The SC also observed that though **India-Singapore DTAA** and **India-Mauritius DTAA** were **amended** several times, however **no changes in the definition of 'royalty'** was made. Therefore, it was thus clear that the **OECD Commentary** on Article 12 of the OECD Model Tax Convention, incorporated in the concerned DTAAs had a **persuasive value** as to the interpretation of the term "royalties" contained therein.

- The SC also observed that the **OECD Commentary** would be **significant for persons deducting tax / for assessees** to conclude business transactions on the basis that they are to be taxed either on income by way of royalties for parting with copyright, or income derived from licence agreements which would be then taxed as business profits depending on the existence of a PE in the Contracting State.

Interpretation of the DTAAs in light of the Model commentaries and India's position / reservations on the said commentaries.

- The SC also held that the **HPC Report 2003 and the E-Commerce Report 2016** were recommendatory reports expressing the views of the committee members, which the Government of India may accept or reject and however, for the purpose of DTAA, **a DTAA would have to be bilaterally amended before any such recommendation can become law in force** for the purposes of the IT Act.

THANK YOU

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