# Withholding tax from Payment to Non Residents

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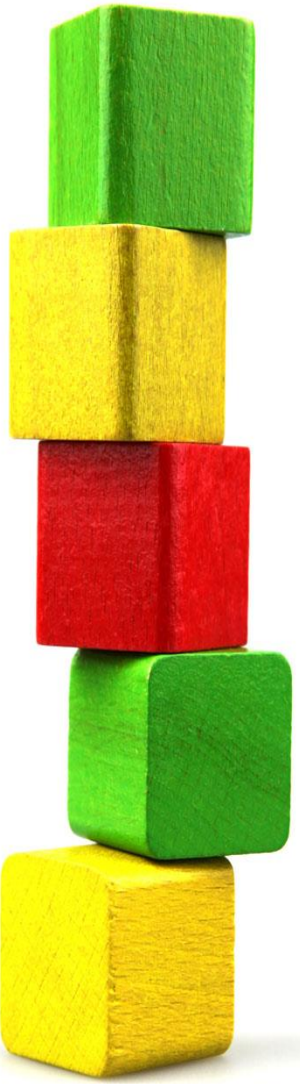
**Western India Regional Council of ICAI Baroda Branch**

# Contents





# Section 195 of the Income Tax Act

Provides for the Deduction of Tax at Source on payments made to Non – Residents

**Features of Section 195:**

- **Payer:** Any person
- **Payee:** A non-resident, not being a Company, or a Foreign Company.
- **Subject Matter:** Deduction of Income-Tax at Source (TDS)
- **Payments:** Interest or any other sum chargeable under the provisions of Income Tax Act.
- **Rate of TDS:** At the Rates in Force

# A Glimpse of Section 195

**195(1)**

- payment by any person responsible
- to a non resident
- interest or any other sum chargeable to tax
- payment or credit which ever is earlier
- at rates in force
- other than Salary and
- dividend referred in section 115-O

**195(2)**

- Application by “Payer” if it considers whole of sum is not income chargeable

**195(3), (4) and (5)**

- Application by “Payee” viz. Foreign Banking Company or non-resident having branch in India for lower or Nil Withholding
- Powers to CBDT to issue notification

**195(6)**

- Furnishing of information in prescribed form viz. 15CA/15CB

# Chargeability of Income

Determine - Chargeability under Income Tax Act

- Section 5: Scope of Total Income
- Section 9: Income Deemed to Accrue or Arise in India

Determine - Chargeability as per DTAA

- Royalty or Fees for Technical Services
- Business Income
- Independent Personal Services
- Dependent Personal Services
- Other Incomes

# Chargeability under Income Tax Act

Section 5: Scope of Total Income - In case of Non – Resident

- Income received or deemed to be received in India; or
- Income accrues or arises or deemed to accrue or arise to him in India.

Section 9: Income Deemed to Accrue or Arise in India.

An income is said to be deemed to accrue or arise in India if the same is accruing or arising directly or indirectly, through

- a business connection in India or
- from any property in India or
- from any asset or source of income in India or
- the transfer of a capital asset in India* any other which derives its value from assets in India.

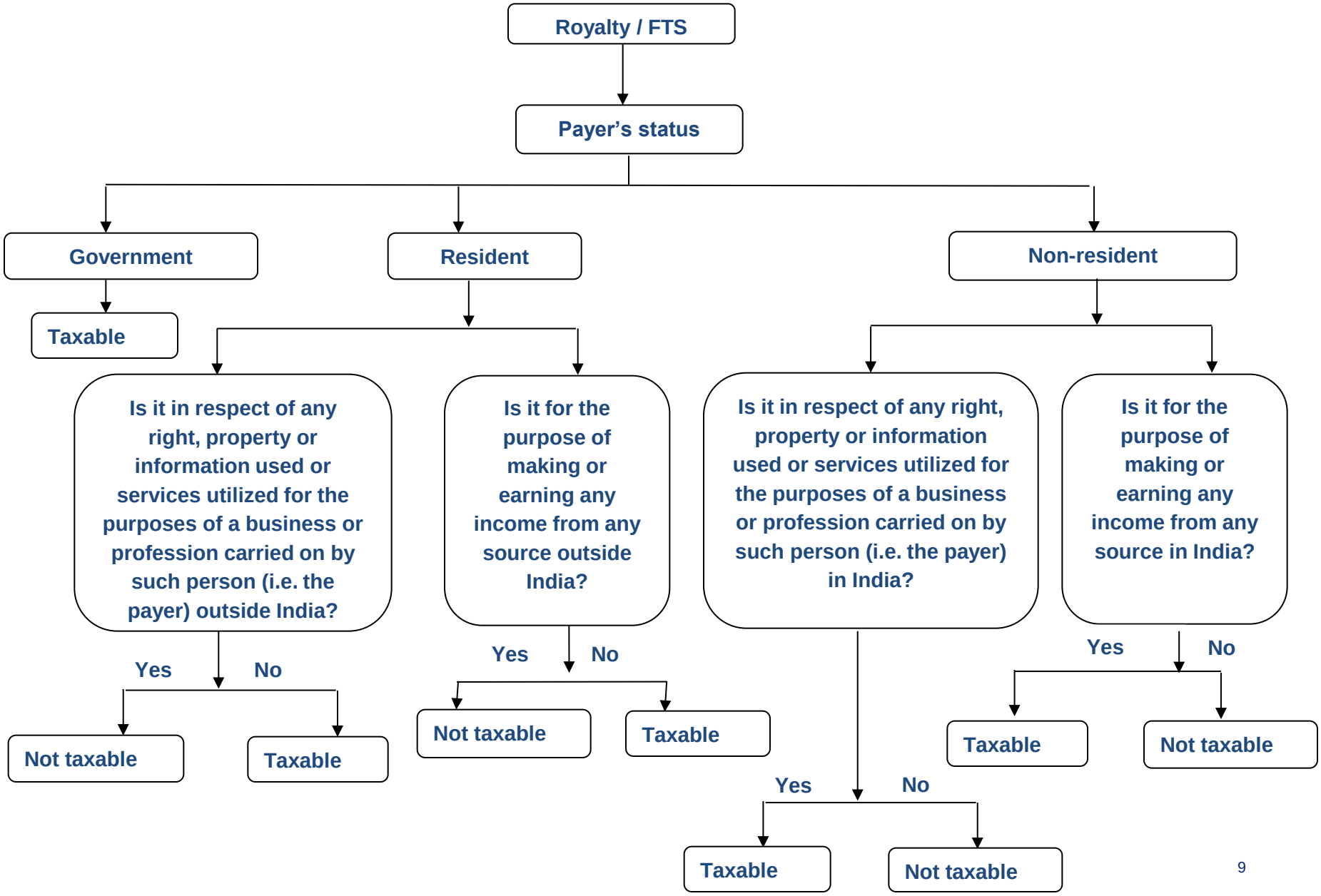
* It also includes any share or interest in a company or entity registered or incorporated outside India which derives its value from assets in India.

# Any sum chargeable to tax

- Person responsible for paying to a non-resident any sum chargeable to tax under the Act but does not include -
  - Payments on capital account, for example, gifts, loans, repayment of loans, etc.
  - Sums which are on revenue account and which are not chargeable to tax at all under the Act in the hands of the recipient.
  - Sums taxable but which are expressly exempt under the Act. E.g, dividend income.
- CBDT vide Instruction No 2/2014 instructed that in cases where the assessee does not withhold taxes under section 195 of the Act, the AO is required to determine the income component involved in the sum on which the withholding tax liability is to be computed and the payer would be considered as being in default for non-withholding of taxes only in relation to such income component.

# Taxation of Royalty – under the Income Tax Act

# Taxability of royalty and fees for technical services



# Taxation of royalty – Under the Income-tax Act ('Act')

- Scope of Total Income – Section 5

- Section 9 – Income deemed to accrue or arise in India
  - Section 9(1)(vi)
    - Whether royalty is deemed to accrue or arise in India
    - Definition of royalty

- Section 115A – Tax rate on royalty in case of non-resident

- Section 44DA – Special provisions for computing royalty income in case of a non-resident having a PE

Retrospective amendment by Finance Act 2012

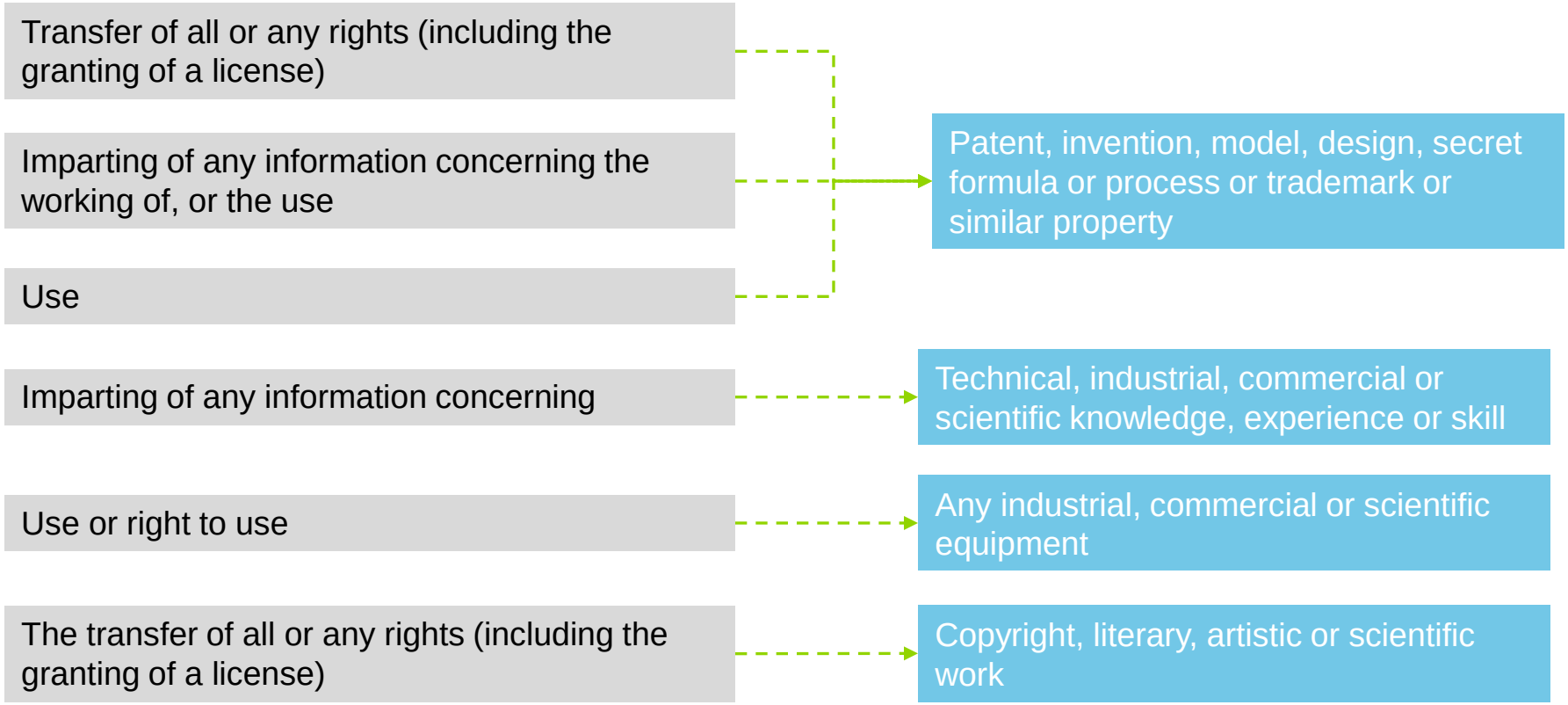
# Royalty definition – Section 9(1)(vi) of the Act

Consideration paid for –

(a) includes lump sum payments

(b) excludes income chargeable as capital gains

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



# Amendments by the Finance Act 2012 (Retrospective w.e.f. 1 June 1976)

**Explanation 4**

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

**Explanation 5**

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

**Explanation 6**

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

# Royalty - Retrospective amendments

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

- 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 to use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred. *[Explanation 4]*

- Royalty shall include consideration in respect of any right, property or information whether or not such right, property or information (a) is under the control of the payer, (b) is used by the payer, (c) is located in India. *[Explanation 5]*

- The expression “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret. *[Explanation 6]*

# Taxation of Royalty – under the tax treaty

# Taxation of royalties – typical structure of royalty article

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

# Royalty – Definition under model conventions

## OECD Model

- payments of any kind received
- as a consideration
- for the use of, or the right to use
  - any copyright of literary, artistic or scientific work
    - including cinematograph films
    - any patent, trademark, design or model, plan, secret formula or process
    - for information concerning industrial, commercial or scientific experience
      - Article 12.2

## UN Model

- payments of any kind received
- as a consideration
- for the use of, or the right to use
  - any copyright of literary, artistic or scientific work
  - including cinematograph films, or films or tapes used for radio or television broadcasting
  - any patent, trademark, design or model, plan, secret formula or process
  - for the use of, or the right to use, industrial, commercial or scientific equipment
  - for information concerning industrial, commercial or scientific experience
    - Article 12.3

## US Model

- payments of any kind received
- as a consideration
- For the use of, or right to use:
  - copy right of literary, artistic or scientific or other work (including, computer software, cinematograph films, audio or video tapes or disks, and other means of image or sound reproduction)
  - any patent, trademark, design or model, plan, secret formula or other like property
  - Information concerning
    - industrial, commercial or scientific experience

# Differences in the Various Definitions

| | |
|---|---|
| OECD Model | Income from equipment leasing would fall under rules for taxation of business profits – Article 5 and Article 7 |
| UN Model | Consideration for use of, or the right to use, industrial, commercial or scientific equipment covered within the meaning of Royalties |
| US Model | Specifically includes consideration for use or the right to use copyright of computer software |
| Income Tax Act | Specifically excludes consideration for sale, distribution and exhibition of cinematographic films |

# Royalty under certain Treaties

| Country | Definition |
|---|---|
| Singapore | Includes gains from alienation of IPRs |
| Morroco, Namibia, Russia, Trinadad & Tobago, Turkministan, Kazakstan and Kyrgyz Republic | Specific inclusion of software |
| Libya, UAE | Rental and other income from cinematograph films considered as business profits and not Royalties |
| Greece, Israel, Sweden, The Netherlands, Belgium | Does not include 'Equipment Royalty' |
| Singapore, Thailand | Transfer of technology irrespective of nature of consideration |
| Canada, USA | Transfer of technology with contingent consideration |
| Hungary | Transmission by satellite, cable, optic fibre or similar technology |
| Egypt, Greece | Only source State has right to tax |
| Belgium, Israel, Netherlands and Sweden | Does not contain the provision for "use or right to use industrial, commercial or scientific equipment". |

# Taxation of Fees for Technical Service – under the Income Tax Act

# Fees for Technical Services as defined by section 9(1)(vii)

Explanation 2 to section 9(1)(vii) of the ITA defines “fees for technical services” to mean 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”

Extra-territorial operation
Validity upheld in Electronics Corporation of India Ltd. v. CIT (183 ITR 44)(SC)

# Taxation of Fees for Technical Service – under the tax treaty

# Fees for Technical Service under some DTAA's

- In many of DTAAs India has entered into, the term FTS has been defined to include any payment made in consideration for the provision of managerial, technical, or consultancy services, including the provision of services of technical or other personnel.
- Under DTAA's with Australia, Bangladesh, Brazil, Greece, Indonesia, Mauritius, Myanmar, Nepal, Philippines, Namibia, Saudi Arabia, Sri Lanka, Syria, Tajikistan, UAE, UAR Egypt and Zambia treaty, there is no separate definition for FTS however the same is included in Royalty.
- DTAA with US, UK, Canada, Australia, Finland, Singapore restrict the scope of "FTS"/"FIS" based on the "make available".
- DTAA's with Canada, Finland, Netherlands, UK and US restrict the scope of the term "FTS" to only technical and consultancy services (i.e., managerial services are not included within the fold of the definition).
- Protocols to some of the DTAAs extend the restrictive definition (i.e., the "make available" criteria) of "FTS" / "FIS" pursuant to the ''Most Favoured Nation'' clause

# Fees for technical services

FTS clause in most Indian tax treaties

| FTS clause | FTS clause + Make available |
| --- | --- |
| • FTS means<br>– payments of any amount in consideration<br>– for managerial, technical or consultancy services<br>– including the provision of services of technical or other personnel<br>– does not include payments for services mentioned in Independent / Dependent Personal Services | • FTS means<br>– payments of any amount in consideration<br>– for managerial, technical or consultancy services<br>– including the provision of services of technical or other personnel<br>– does not include payments for services mentioned in Independent / Dependent Personal Services<br>• which make available technical knowledge, experience, skill know-how or processes |

# Fees for technical services

Key components of FTS

**Technical**

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

**Consultancy**

- Advisory services
- Overlaps with technical services

**Managerial**

- Management functions
- Management of affairs / people

**Provision of services of technical or other personnel**

- Providing personnel to render technical services
- For instance, engineers, technicians, consultants, etc. to furnish services for a fee
- May cover deputation arrangements

**Excludes payments for services mentioned in Independent / Dependent Personal Services**

- Excludes payments made by Article 15

# Fees for technical services - Make Available

- Managerial and consultancy services can be rendered with human interface only, whereas technical services can be rendered with or without human intervention;

- For the reason that there is no human touch involved in the whole process of actual advertising service provided by search engines, the receipts for online advertisement cannot be treated as FTS.

***TO v. Right Florists (P.) Ltd. (2013) 32 taxmann.com 99 (Kol. Trib.)***

- 'Managerial and consultancy' is indicative of the involvement of a human element and managerial services and consultancy services have to be given by human only and not by equipment.

- Merely because there would be some human involvement and certificates would be provided by human after a test is carried out in a laboratory automatically by the machines, it cannot be held that services are provided through human skills. Therefore, the payment does not fall within the ambit of section 9(1)(vii)

***Siemens Ltd. v. CIT (2013) 30 taxmann.com 200 (Mum. Trib.)***

# Fees for Technical Services - Make Available

Make available clause

- Rendering of services by US Co such that Indian Co can use inventions, ideas and improvements obtained from US Co
- Providing technical designs to enable Indian Co to perform mining job by themselves
- Providing technical services and start-up services to enable promoters to set up power plant and run it on a going forward basis
- Sending technicians to show personnel in Indian Co to undertake certain tasks

# Fees for Technical Services – Included Services

Fees for Included Services

| Fees for Included Services | Exclusions |
| --- | --- |
| • FTS means …<br>– which are ancillary and subsidiary to the application or enjoyment of the right, property or information for which royalty is received<br>– which make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design | • FTS does not include …<br>– for services that are ancillary and subsidiary, as well as inextricably and essentially linked, to the sale of property other than IPRs mentioned in royalty clause<br>– for teaching in or by educational institutions<br>– for services for the personal use of the individual or individuals making the payments<br>– to an employee of the person making the payments or to any individual or firm of individuals (other than a company) for professional services as defined in Independent Personal Services |

# Fees for Technical Services - Most Favoured Nation (MFN) clause

- More favorable terms granted to other countries extended to existing treaty countries
- Lower tax rate
- Narrowing scope of income liable to tax
- Binds the contracting country (‘A’) to offer to the other contracting country (‘B’) the same benefits which A may offer to a third country
- Generally MFN status provided under the protocol/ exchange of notes
- India has MFN clauses in tax treaties with Netherlands, Belgium, France, Sweden, Norway, Switzerland, Spain, Kazakhstan, Philippines and Hungary

# Fees for Technical Services - Most Favoured Nation (MFN) clause

## India – France Tax Treaty

- Notification No. S.O. 650(E), dated July 10, 2000 -Treaties with Germany and United States referred.

- Tax rate reduced to 10 percent

- Protocol: "…if under any Convention, Agreement or Protocol signed after September 1, 1989, between India and a third State which is a member of the OECD, India limits its taxation at source on dividends, interests, **royalties, fees for technical services** or payments for the use of equipment to a rate lower or a scope more restricted than the rate or scope provided for in this Convention on the said items of income, the same rate or scope as provided for in that Convention, Agreement or Protocol on the said items of income shall also apply under this Convention…"

# Cases where FTS not defined under Treaty

1. In such cases generally it is conclude that any sum paid which is in the nature of FTS to a tax resident of countries where term FTS is not defined or not included in royalty definition, then it should not be liable to tax in India in absence of a PE.

   Case relied on

   - Tekniskil (Seniderian) Berhard vs. CIT [1996] (222 ITR 551) (AAR)
   - GUJ Jaeger GMBH vs. ITO [1990] (37 ITD 64) (Mumbai ITAT),
   - Christiani & Nielsen Copenhagen vs. ITO [1991] (39 ITD 355) (Mumbai ITAT)
   - Golf in Dubai, LLC, vs. DIT [2008] (306 ITR 374) (AAR).
   - Bangkok Glass Industry v ACIT (2013) 34 Taxmann.com 77 (Madras HC)

2. However, in case of Lanka Hydraulic Institute Limited [2011] (AAR) has held that such income would be covered within the ambit of the Article dealing with "Other Income" as opposed to the Article dealing with "Business Profits".

# Taxation of Commission paid to Overseas Non – Resident Agent

# Commission Paid to Non Resident - Whether Deemed to Accrue or Arise in India

**Section 9 (1) (i): Business Connection in India: Commission paid to Non Resident**

- Section 9 (1) (i) is applicable on the net the profits of a non – resident which can reasonably be attributed to operations carried out in India.

- The expression "business connection" nominates a real and intimate relating between trading activity carried on outside the taxable territories and trading activity within the territories, the relating between the two contributing to the earning of income by the nonresident in his trading activity. – **SC in CIT vs. R. D. Aggarwal & co. (56 ITR 20)**

- Any activity carried on in India by Broker, General Commission Agent or any other agent having Independent Status in the ordinary course of business will not constitute Business Connection in India. [**Explanation 2 to Section 9 (1) (i)]**

# CBDT Circulars

**Circular No. 23 dated 23rd July, 1969**

- A foreign agent of Indian exporter operates in his own country and no part of his income arises in India.

**Circular No. 786 dated 7th Februray 2000**

- The deduction of tax at source under section 195 would arise if the payment of commission to the non-resident agent is chargeable to tax in India.
- Where the non-resident agent operates outside the country, no part of his income arises in India.

**Circular 7/2009 dated 22nd October 2009**

Withdrawal of Circular 23 and 786 – As the interpretation of the circular by the taxpayers to claim relief is not in accordance with the provisions of section 9 or the intention of the Circular.

**However, the principle still holds good that the payments to non-resident are liable for tax in Indian only if they satisfy the test of chargeability in India.**

# Section 206AA of the Income Tax Act

- Section 206AA overrides the entire Act.

- It is been introduce to strengthen the PAN mechanism. It provides in absence of PAN tax shall be deducted at the higher of the following.

  (*i*) at the rate specified in the relevant provision of this Act; or
  (*ii*) at the rate or rates in force; or
  (*iii*) at the rate of twenty per cent.

- Applicability restricted to transactions where tax is deductible?

  Section 206AA also uses the word '*notwithstanding any other provisions of the act any person entitled to receive any sum or income or amount, on which tax is deductible under Chapter XVIIB* '.

  In this regard, a question arises, whether the provisions of Section 206AA will apply, if the payments are not taxable by virtue of the beneficial provisions of the tax treaty, though taxable under the Act.

# Section 206AA of the Income Tax Act

- Higher rate of tax under section 206AA is not applicable for grossing up while tax is borne by the payer.(Bosch Ltd. v. ITO (2013) 141 ITD 38/155 TTJ 354 (Bang.)(Trib.)

- Overriding effect on tax treaties.

  The provisions of section 206AA will prevail over the section 90(2) and hence nonresident will not be able to avail the tax treaty benefits in absence of PAN.

- Credit under relevant tax treaty of the non-resident's home country for higher taxes paid.

# Tax residence certificate (TRC)

- Finance Act 2012 mandated non-residents to obtain TRC (in prescribed format) from resident tax authorities.

- Finance Act 2013 which did away the format, stated that it would be enough if tax payer obtains TRC and maintains prescribed documents/information

- Notification No. 57 of 2013 (applicable w.e.f 1 April 2013) - additional documents and information – Form 10F

- Issues
  - Stage/time limit to obtain TRC
  - Different tax years
  - TRC not obtainable / delay

# Questions

# Thank you!

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# Judicial precedents on income characterization under the head “royalty”

# Judicial Precedents – Royalty (Software)

## DCIT v. Nokia Networks OY (TS-700-HC-2012) Del.

**Facts:**

- Tax payer, foreign company, manufactures advanced telecommunication systems and equipment (GSM equipment) used in fixed and mobile networks
- Tax payer entered into agreements with Cellular Operators for supply and installation work and supplied both hardware and software to Indian Cellular Operators
- Tax payer sold GSM equipment manufactured outside India to Indian operators
- Installation activities were undertaken by its subsidiary in India

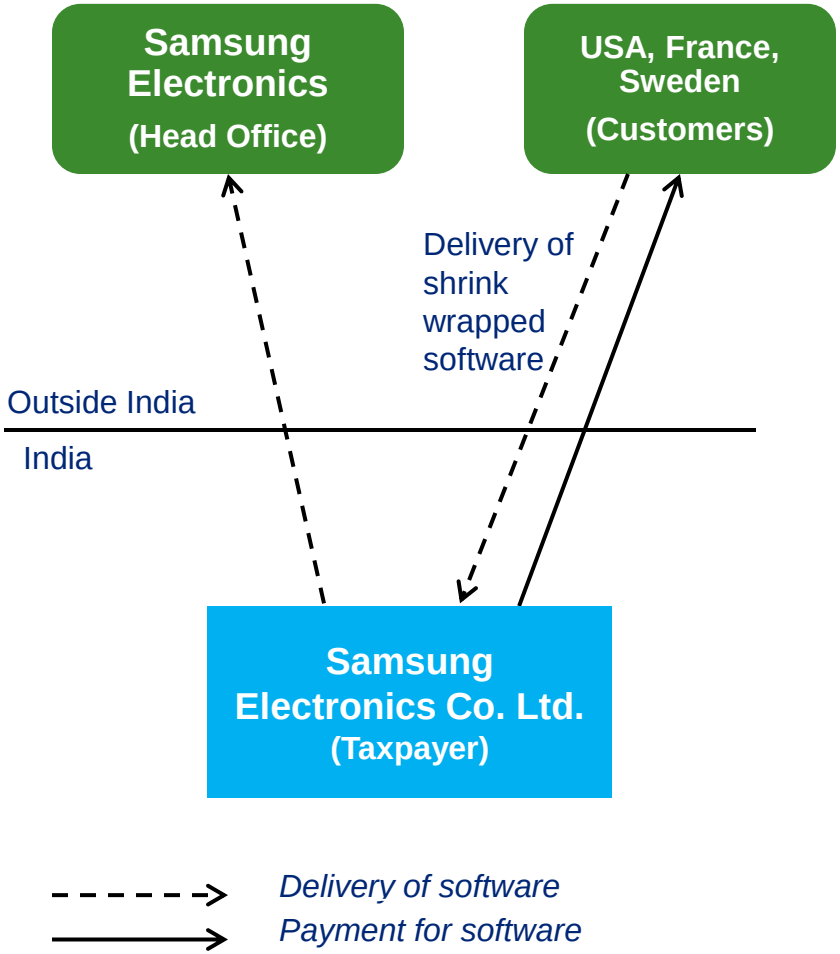
**Issue:** Whether supply of software is taxable as royalty under the Act and treaty?

**Held:**

- Tax payer opted to be governed by treaty, amendments in Act cannot be read into the treaty
- According to treaty, sale of copyrighted article does not fall within purview of royalty, therefore royalty income not taxable in India.

# Judicial Precedents – Royalty (Software)

## Samsung Electronics Co Ltd (345 ITR 494) (Kar.)

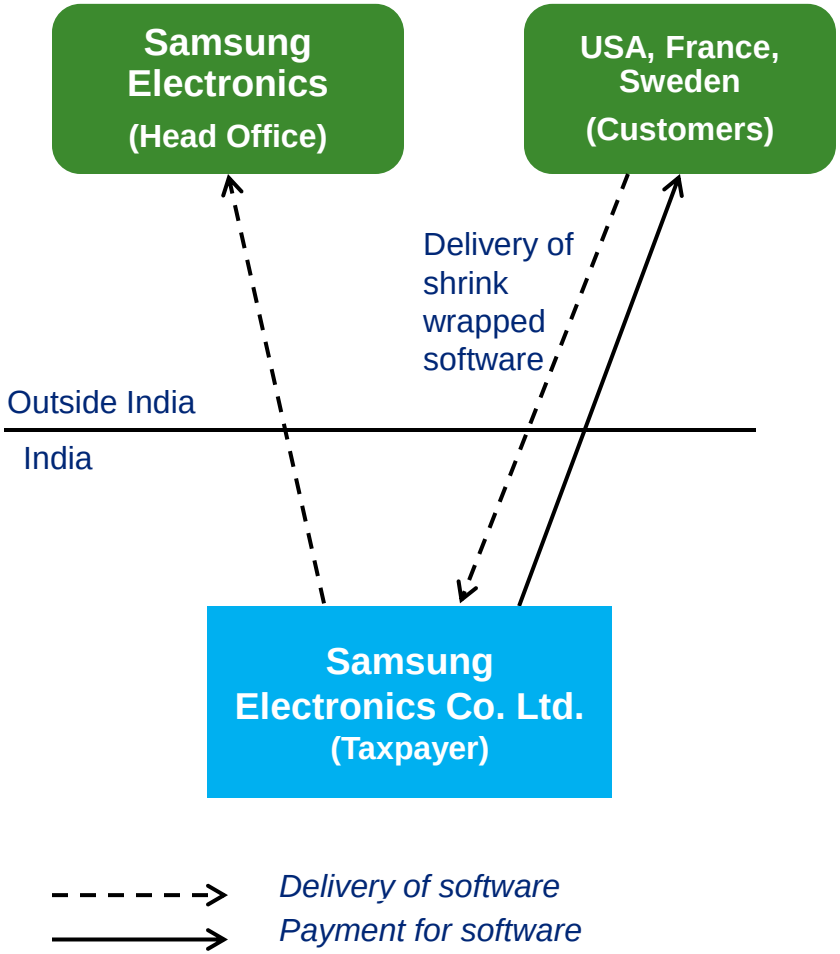



### Facts

- Taxpayer developed and exported computer software to its HO
- Taxpayer imported software from USA, France, Sweden and made payments without deducting tax at source
- AO and CIT(A) taxed such payments 'royalty'. However, the Tribunal held that payments for shrink wrap software did not amount to 'royalty'.
- The HC held that all payments made to non-residents should attract tax withholding unless a certificate from tax officer is obtained.
- On appeal to the Apex Court, the Apex Court observed that HC did not go into the merits of the case and thereby remanded the matter back to HC.

# Judicial Precedents – Royalty (Software)

## Samsung Electronics Co Ltd (345 ITR 494) (Kar.)

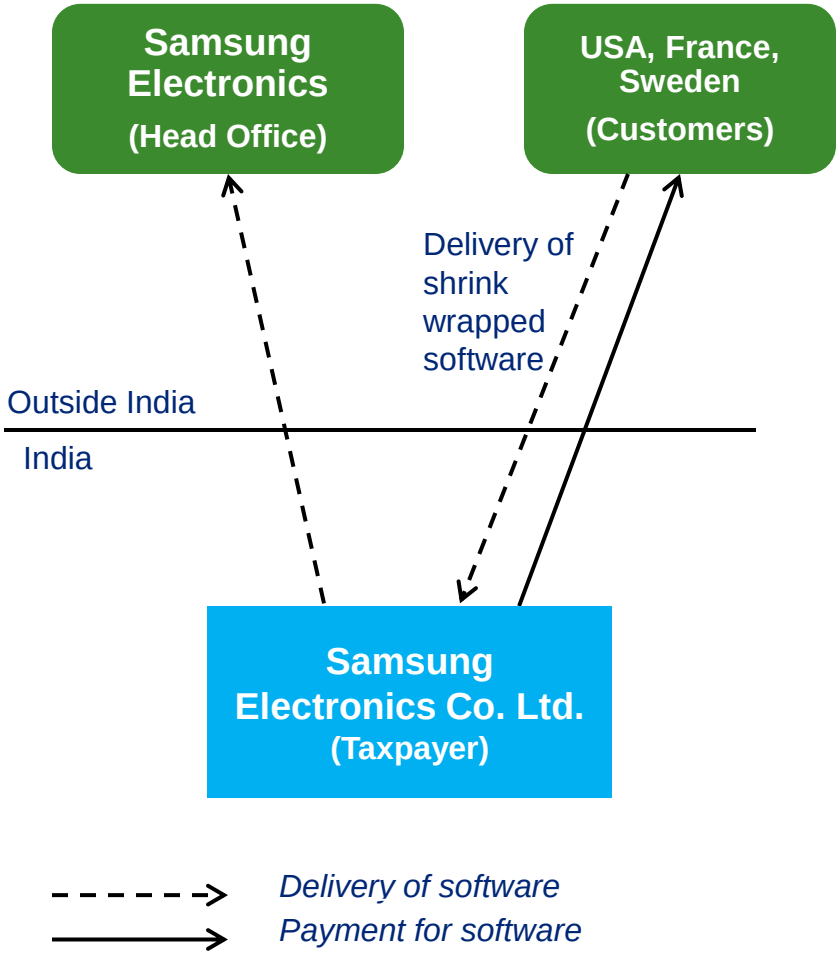



**Issue before HC**

- Whether payment to foreign software suppliers for shrink-wrap software was in the nature of 'royalty' under ITA and under the DTAAs

# Judicial Precedents – Royalty (Software)

## Samsung Electronics Co Ltd (345 ITR 494) (Kar.)




**Ruling of the HC**

- What is transferred is only license to use copyright while the suppliers continue to be owners of copyright and other IPRs
- License is granted for use of copyright contained in shrink-wrapped software or off the shelf software
- Intent of legislature in imposing sales tax and income-tax are entirely different – levy of sales tax on software does not preclude payments from amounting to 'royalty'
- Right to make a copy and use it for internal business would amount to copyright under Section 14(1) of Copyright Act
- Price paid towards shrink software is for combination of CD along with software and the license granted
- Transfer of copyright including right to make copy of software for internal business and payment made in that regard would constitute 'royalty', both under ITA and respective DTAAs

# Judicial Precedents – Royalty (Software)

**ADIT v. Antwerp Diamond Bank NV Engineering Centre [2014] 44 taxmann.com 175 (Mumbai - Trib.)**

**Facts:**

- The assessee was a bank incorporated in Belgium and was a tax resident of Belgium and was operating through branch in India.
- Assessee acquired banking application software from an Indian software company and later on the software license was amended to allow the branch to use same software by making it accessable through the server located at Belgium.
- Branch reimbursed head office the cost of the data processing on pro rata basis for the use of the said resources.
- Assessee is claiming the application of the DTAA

**Issue:** Whether reimbursement of expenses can be treated as royalty under the Act and treaty?

# Judicial Precedents – Royalty (Software)

## ADIT v. Antwerp Diamond Bank NV Engineering Centre [2014] 44 taxmann.com 175 (Mumbai - Trib.)

**Held:**

- The Head Office only has the non-exclusive non-transferrable rights to use the computer software brought for personal use and as per the agreement head office does not have any right to assign, sub-license or otherwise transfer the license of this agreement.

- Thus, the payment is for use of computer software is not the right in the copy right but only for doing the work from the said software which subsists in the copy right of the software. Further the payment made by the Branch is not for 'use' of or 'right to use' of software.

- As per Article 12 of DTAA definition of 'royalty' in said article provides that, when the payment of any kind is received as a consideration for 'use' of or 'the right to use' of any of the copy right of any item or for various terms used in the said article, then only it can be held to be for the purpose of 'royalty‘.

- To fall within the ambit of 'royalty' under article, the payment should be exclusively *qua* the use of the right to use the software exclusively by the Branch. Thus, the reimbursement of the data processing cost to the Head Office did not fall within the ambit of definition of 'royalty' under article 12(3)(*a*).

# Other Key Judicial Precedents

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Software Licences | Infrasoft Ltd<br>[2013] 39 taxmann.com 88<br>(Delhi HC) | • If the assessee is claiming the application of the DTAA, then the definition and scope of 'royalty' given in the domestic law should not be read into or looked upon.<br>• License fees towards customized software to be used for designing highways, railways, airports, ports, mines, etc. not taxable under India-USA DTAA. |
| Software Licences | Reliance Infocom<br>[2013] 39 taxmann.com 140<br>(Mum ITAT) | • Copyright is a negative right. It is an umbrella of many rights and license is granted for making use of the copyright in respect of the shrink-wrapped software.<br>• Payment towards software (wireless telecommunication network) is subject to tax as royalty under India-USA treaty |

# Other Key Judicial Precedents

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Information concerning industrial, commercial or scientific experience | ONGC Videsh Ltd. v. ITO [2013] (141 ITD 556) (Delhi ITAT) | Payment of subscription fees for which assesse was granted a non-transferable and non-inclusive licence to assesse to use secret names and passwords to download desired information from the websites would constitute as 'royalty' under the domestic law under section 9(1)(iv) (sic) and (vi) along with article 13(3) of the DTAA with UK. |
| Transponder hire charges | Viacom 18 Media (P.) Ltd v ADIT [2014] 44 taxmann.com 1 (Mumbai - Trib.) | • The definition of term 'royalty' remained unchanged despite insertion of Explanation 6 by Finance Act 2012.<br>• Since the term 'process' is not defined under the DTAA, therefore, by virtue of Article 3(2) of the India-US DTAA, the meaning of term 'process' as defined in the Act would apply for this purpose.<br>• The use of transponder falls in the expression 'process' as per Explanation 6 of section 9(1)(vi).<br>• Therefore the payments made for use/ right to use of process falls in the ambit of expression 'royalty' as per DTAA as well as per provisions of Income Tax Act. |

# Other Key Judicial Precedents

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Use of Process / Equipment and Bandwidth charges / link charges | Verizon Communications Singapore Pte Ltd. v. ITO [2013] 39 taxmann.com 70 (Madras) | • Revenues from provision of telecommunication services to Indian customers is “royalty” in nature as it is use of equipment/use of process and thus subject to withholding tax.<br>• What is relevant here is that the High Court has invoked Article 3(2) of the treaty to read the domestic (2012) amendments in our ‘royalty’ definition in tax treaty as well<br>• Thus holding the income to be taxable in India both under the Income Tax Act and also the treaty. |
| Subscription Charges | ADIT (IT) v. Globus Stores (P.) Ltd [2012] 28 taxmann.com 117 (Mum ITAT) | Subscription made by garment manufacturer to online fashion website constitutes royalty under the Act and the India-UK DTAA. |

# Other Key Judicial Precedents

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Use of Equipment | Poompuhar Shipping Corporation Ltd. v. ITO (IT) [2013] ITA Nos. 2206 to 2208, 2629 & 2630 of 2006 AND 56 to 64 & 598 to 601 of 2013 (Madras HC) | • Payment for time charter was held to be in the nature of “royalty” as per section 9(1)(vi) of the Act (“use of industrial, commercial or scientific equipment”).<br>• The retrospective amendments by FA 2012 by insertion of Explanations 4 and 5 has removed all doubts as far as interpretation of "use or right to use. |
| Use of business information reports | Credit Agricole Indosuez v DDIT(IT) [2013] ITA NO 4295 and 4965 OF 2005 (Mumbai ITAT) | • Where the assesse made payment on account of data processing costs to its head office, the same cannot be considered as royalty as a consideration for the use of the assets specified under Explanation 2 to section 9(1)(vi) and accordingly, there cannot be no disallowance under section 40(a) of the Act. |

# Other Key Judicial Precedents

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Use of Patents | Qualcomm Incorporated v. ADIT [2013] (58 SOT 97) (Delhi ITAT) | For taxing royalty under section 9(1)(vi)(c) what is important is not whether right to property is used 'in' or 'for the purpose' of a business, but to determine whether such business is 'carried on by such person in India'. |
| Telecast of Events | DDIT v. Nimbus Communications Ltd. [2013] (ITA NO.S 1598 and 2270 of 2011) (Mumbai ITAT) | • Payment for obtaining licence for live telecast right of cricket series to be played outside India does not constitute royalty.<br>• The procedure of live telecasting, does not give birth to a 'work' capable of copyright and any consideration for live broadcasting cannot be considered as 'royalty'.<br>• The second or later telecasting of such event shall be considered as use of the 'work' and consideration for the broadcasting of such recorded matches shall be considered as payment for the use of copyright in such event. |

# Examples of Payment Considered in Nature of Royalties

| Nature of Transactions | Decision |
|---|---|
| Access to a portal located outside India | Cargo Community Network PTE Ltd [2007] (289 ITR 355) (AAR) |
| Use or right to use customized software | Airports Authority of India [2010] (323 ITR 211) (AAR). |
| Use of an internet based software hosted on the server of a foreign company | IMT Labs (India) Pvt. Ltd [2006] (287 ITR 450) (AAR) |
| Payment for time charter or bareboat charter of the ship | Poompuhar Shipping Corporation Ltd vs. ITO [2013 (ITA 220 to 2208 of 2006) ( Madras HC),<br>West Asia Maritime Ltd vs. ITO [2013] .2629 to 2630 of 2006 ( Madras HC) |

# Examples of Payment Considered not in Nature of Royalties

| Nature of Transactions | Decision |
|---|---|
| Sale of off the shelf software | • Motorola Inc. vs. DCIT [2005] (95 ITD 269) (Delhi ITAT),<br>• Geoquest Systems B.V. [2010] (234 CTR 73) (AAR),<br>• M/s Velankani Mauritius Limited & Others vs. DDIT [2010] (132 TTJ 124) (Bangalore ITAT) |
| Outright sale of engineering designs, calculations | • CIT vs. Davy Ashmore India Ltd [1990] (190 ITR 626) (Calcutta HC),<br>• Pro-quip Corporation vs. CIT [2001] (255 ITR 354) (AAR),<br>• CIT vs. Klayman Porcelains Ltd [1997] (229 ITR 735) (Andhra Pradesh HC) |
| Transmission of voice and data through telecom bandwidth | • Dell International Services India (P.) Ltd [2008] (305 ITR 37) (AAR),<br>• CIT vs. Estel Communications P. Ltd [2008] (318 ITR 185) (Delhi HC), etc<br>• Contra Verizon Communications Singapore Pte Ltd. v. ITO [2013] 39 taxmann.com 70 (Madras |
| Access to data in a copyrighted web based database | Factset Research Systems Inc. vs. DIT [2009] (317 ITR 169) (AAR). |
| Access to a web-based journal containing views, opinions and news | Factset Research Systems Inc v DIT (2009) (317 ITR 169) AAR contra CIT v Wipro (2011) ( 355 ITR 284)( Karnataka HC) |

# Judicial precedents on income characterization under the head “Fees for Technical Service”

# Judicial Precedents – FTS Make Available

**AAR New Delhi in case of Steria (India) Ltd., In re [2014] 45 taxmann.com 281 (AAR - New Delhi)**

**Facts:**

- The applicant entered into a Management Services Agreement with 'S' France for various management services.
- It was submitted that the 'make available' clause was not satisfied in the case and, hence, the services would not fall under the technical services as per the India-France Treaty.
- Applicant stated that, although there was no 'make available' clause in the India-France Treaty, yet, pursuant to protocol signed between India and France, the restricted scope of FTS in the India-UK DTAA would be applicable
- Therefore, in absence of such 'make available' of the technical knowledge, experience, skill, know-how or processes, the services rendered by S would not fall under the definition of technical services.

**Issue:** Whether in absence of 'make available' clause in India-France DTAA, the payments for services rendered would be FTS.

# Judicial Precedents – FTS Make Available

## AAR New Delhi in case of Steria (India) Ltd., In re [2014] 45 taxmann.com 281 (AAR - New Delhi)

**Ruling:**

- A Protocol cannot be treated as the same with the provisions contained in the treaty itself, though it may be an integral part of the Treaty.
- Protocol to the said DTAA puts restrictions on the rates and 'make available' clause cannot be read in the items.
- The Notification ratifying the protocol did not include anything about the 'make available' provision. Had the intention of the Protocol or the Government been to include 'make available' clause in the Tax Treaty between India and France, it would have been done so in the said Notification.
- Protocol or Memorandum of Association can be made use for interpreting provision of the Treaty. It will not be correct/proper to import words, phrases or clause, that are not available into the Treaties between two Sovereign nations, on the basis of Treaties with another countries.
- Therefore, the payments made by the applicant for the services rendered would come under the definition of fees for technical services both under the Act and the Treaty and would be liable to tax in India.

# Judicial Precedents – FTS - Make Available

## CIT vs ISRO Satellite Centre [2013] 35 taxmann.com 352 (Karnataka) HC

**Facts:**

- The assessee, ISRO Satellite Centre, was in business of manufacturing of satellites.
- It entered into an agreement with A, a French company, for placing its satellites in Geostationery Transfer Orbit in the space.
- The assessee was required to carry the satellites to the location of the launch pad of 'A'. Apart from launch services, 'A' provided several services as per the agreement, which were highly sophisticated and involved complex technologies.
- AO held that payments received by 'A' were fees for technical services under section 9(1)(vii) as per DTAA between India and France.
- Assessee had also entered into an agreement with 'I', an American company, for tracking, telemetry and command support charges for satellites launched by the assessee. Payments for same were also held to be fees for technical services under section 9(1)(vii) and DTAA between India and USA.

# Judicial Precedents – FTS - Make Available

## CIT vs ISRO Satellite Centre [2013] 35 taxmann.com 352 (Karnataka) HC

**Issue:**

Payments for transfer of technology could not be taxed as fees for technical services, in view of article 13 of India - France DTAA and article 12 of India USA DTAA.

**Held:**

- Where the assessee entered into an agreement with respect to launching, tracking of satellites and other services in this connection, the payments made under the agreement would come under the ambit of FTS under section 9(1)(vii) of the Act.
- However, since these services do not make available technical knowledge, experience, skill, know-how, or processes or consists of development and transfer of technical plan or a technical design, the payments made would not come under the purview of FTS under the DTAA with France and USA.

# Judicial Precedents – FTS – Make Available

## AREVA T&D India Limited [2012] 18 taxmann.com 171 (AAR - New Delhi)

**Facts:**

- Information Technology Sharing Services Agreement (IT Agreement) between the Indian and French company was proposed to be entered into wherein IT support services would be provided from France
- IT relating to design, engineering, manufacturing and supply of electric equipment that help in transmission and distribution of power would be applied by the Indian company in running its business

**Observations and Ruling of the AAR:**

- The employees of the Indian company would be equipped to carry on these systems on their own without reference to Areva France when the IT agreement would come to an end. Hence, the 'make available criterion' is satisfied
- As the IT Agreement states that Areva France has the capacity and the resources to provide and co-ordinate IT Services, the payment is not in the nature of reimbursement
- The French company had a PE in India since it had equipment in India at its disposal and hence, FTS would be taxable under section 44DA of the Act

# Examples of Payment Considered in Nature of FTS – "Make Available"

| Nature of Transactions | Decision |
|---|---|
| Engineering services (including the sub-categories of bio-engineering and aeronautical, agricultural, ceramics, chemical, civil, electrical, mechanical, metallurgical and industrial engineering) | MOU to the India-US DTAA. |
| Training in the use of simulators. | Sahara Airlines vs. DCIT [2002] (83 ITD 11) (Delhi ITAT) |
| Technical assistance and training to enable the recipient to manufacture aluminum foils | Hindalco Industries Ltd vs. ACIT [2005] (94 TTJ 944) (Mumbai ITAT). |
| Technical plans, designs and information to enable the recipient to execute and install water features. | Gentex Merchants (P.) Ltd vs. DDIT [2005] (94 ITD 211) (Kolkata ITAT). |

# Examples of Payment Not Considered in Nature of FTS – "Make Available"

| Nature of Transactions | Decision |
|---|---|
| Services of reinsurance broking | Guy Carpenter &Co Ltd v ADIT (2012)( 346 ITR 504)( Delhi HC) |
| Referral services | Cushman and Wakefield (S) Pte. Ltd [2008] (305 ITR 208) (AAR) |
| Airborne survey and providing high resolution geophysical data | CIT v De Beers India Minerals (P) Ltd 346 ITR 467( Karnataka HC) |
| Project monitoring services | Worley Parsons Services Pty Ltd [2008] (301 ITR 54) (AAR). |
| Grading and certification reports | Diamond Services International (P.) Ltd vs. UOI [2007] (304 ITR 201) (Bombay HC). |

# Judicial Precedents – FTS – Human Intervention

## DCIT vs Velti India (P.) Ltd [2014] 43 taxmann.com 425 (Chennai - Trib.)

**Facts:**

- Assessee made carrier payments to 'C' Ltd., a service provider situated in South Africa for transmission of bulk SMS.
- AO disallowed the expenditure invoking provision of 40(a)(i).

**Issue:**

Whether payment made to C Ltd were in nature if Fees for technical services.

**Held:**

- The nature of services rendered by non-resident i.e. C Ltd is only to transmit bulk SMS. The nature of service provided by C Ltd requires no technical knowledge and what was rendered was just transmission of data which requires no technical skill.
- Reference is drawn to Delhi High Court the case of *CIT* v. *Bharti Cellular Ltd w*herein it was held that transmit of bulk services do not involve human intervention and these services cannot be regarded as fee for technical services.
- Further in absence of PE and since the services were rendered outside India no part was taxable in India.

# Other Rulings – Argument of not involving human intervention not raised

| Decision | Gist |
|---|---|
| Cochin Refineries (222 ITR 354) (Kerala HC) | *Under the Act-*<br>Tests conducted by a foreign company (to evaluate whether coke produced by an Indian company is suitable for making anode for aluminum industry) and reporting the conclusions thereof constitute a 'technical' service |
| Maruti Udyog Ltd (130 TTJ 66) (Delhi Tribunal) | *India-Germany DTAA-*<br>Carrying out impact tests on cars (to check their quality) and submitting test reports (which are further used in product development) amounts to rendition of 'technical' services |
| Right Florist (2013-TII-61-ITAT-KOL-INTL) | *Under the Act-*<br>Since there was no human touch involved in the whole process of actual advertising service, the receipts for online advertising by search engines cannot be taxed as FTS |
| Hindustan Electrographites Ltd (145 ITR 84) (Madhya Pradesh HC) | *India-France DTAA-*<br>Payment for trial tests conducted in France (so that after passing these tests, the diameter electrodes produced become acceptable in the international market) are towards 'technical' services |

# Other Rulings – Argument of not involving human intervention raised

| Decision | Gist |
|---|---|
| Bharati Cellular Ltd (319 ITR 258) (Delhi HC) and (330 ITR 239) (SC) | *Under the Act-*<br>It would have to be determined whether the services involved human intervention |
| Dampskibsselskabet (130 ITD 59) (Mumbai Tribunal) | *Under the Act-*<br>Expenditure on global telecommunication facility (comprising booking and communication software, hardware, etc.) to enable co-ordination of cargoes for fleet could not be regarded as FTS. Reliance placed on Bharati Cellular Ltd |
| UPS SCS (Asia) Ltd. (ITA No. 2426 (Mum.) of 2010) (Mumbai Tribunal) | *Under the Act-*<br>Ability to use a computer in tracing the movement of the goods (though indirect, remote and not necessary) cannot bring the payment for freight and logistics services within the purview of "technical services" |

# Judicial Precedents – FTS – Source Concept

## AAR New Delhi in case of Oxford University Press., In re., [2014] 45 taxmann.com 282 (AAR - New Delhi)

**Facts:**

- The applicant, Oxford University Press, was an Indian branch of Oxford University Press, U.K. It was engaged in publishing, printing and reprinting of educational books for schools, Universities, and other educational institutions.
- The applicant has appointed Ms Geetha, a resident of Sri Lanka and designated her as "Resident Executive" for promotion of book.
- The month remuneration and reimbursement of expenses were remitted to Ms Geetha's Bank account in Colombo, from the Applicant's bank Account in India.

**Issue:**

- Whether monthly remuneration of retainer fees for services rendered in 'Sri Lanka should be subjected to tax deduction in India?
- Whether reimbursement of expenses on storage space, telephone and internet and local conveyance should be subjected to tax deduction in India?
- Whether outstation tours towards dearness allowance, tour conveyance for stay outside Colombo should be subjected to tax deduction in India?
- Whether on being appointed as a regular employee on applicant's payroll, the salary and other payments made to her directly into her bank account in Sri Lanka will be subjected to tax deduction in India?

# Judicial Precedents – FTS – Source Concept

## AAR New Delhi in case of Oxford University Press., In re., [2014] 45 taxmann.com 282 (AAR - New Delhi)

**Ruling:**

- Ms Geetha rendered her services basically for promotion of books and brand name of the applicant in Sri Lanka, which were just sales promotion activities. Her job description fits in more with a marketing executive than anything else.
- No definition of technical services in India-Sri Lanka Tax Treaty and, therefore, provisions of the Act shall be referred to examine if the payment was fees for technical services.
- The services rendered by ‘Ms Geetha' do not fall under the Explanation 2 to Sec. 9(1)(vii), i.e., managerial, technical or consultancy services. Therefore the services rendered are not in technical in nature as defined under the Income Tax Act.
- Such payment would be covered under the scope of Article 14 of India-Sri Lanka Tax Treaty. However, in view of Article 14 of said DTAA, it would be taxable only in the country in which she had rendered the services, i.e., Sri-Lanka.
- Since reimbursement of expenses are directly linked to the service and accordingly, not taxable drawing the same analogy.
- Therefore, the payment made to Ms Geetha is not taxable either under the Act or under the India-Sri Lanka Tax DTAA.

# Judicial Precedents – FTS – Source Concept

## CIT vs Havells India Ltd. [2012] 21 taxmann.com 476 (Delhi)

**Ruling**

- The export contracts are concluded in India and tax payer products are sent outside India under such contracts. The manufacturing activity is located in India. The source of income is created at the moment when the export contracts are concluded in India.

- Export activity having place or having been fulfilled in India, source was in India
- Mere fact that the export proceeds earned from person situated outside India did not constitute them as the source of income.

- In order to fall within the second exception to section 9(1)(vii)(b), the source of income and not the source of receipt should be situated outside India.

**Source of Income is activities which have earned income**

# Judicial Precedents – FTS – Source Concept

**Aqua Omega Services (P.) Ltd v. ACIT [2013] 31 taxmann.com 179 (Chennai - Trib.)**

**Facts:**

- The tax payer company was engaged in the business of providing underwater diving services in Saudi Arabia
- The assessee claimed that the amount paid was in connection with services provided outside India and was covered by the exception of section 9(1)(vii)(b).
- The AO held that services rendered by the divers were technical services, liable for tax deduction at source.

**Issue:** Whether, fees for technical services paid to divers was covered by the exception in section 9(1)(*vii*)(*b*), and therefore, not taxable in India

# Judicial Precedents – FTS – Source Concept

**Aqua Omega Services (P.) Ltd v. ACIT [2013] 31 taxmann.com 179 (Chennai - Trib.)**

**Held:**

- Service was provided outside India and accordingly source of receipt was from business carried on abroad.

- Section 9(1)(vii)(b) provides, that the income by way of fee for technical services, payable by a person who is a resident, shall be deemed to accrue or arise in India except where it is payable in respect of services utilized in a business or profession carried on by such person outside India or for the purposes of making or earning income from any sources outside India

- Except two circumstances, firstly, where the fee is paid in respect of services utilized in a business carried on by the assessee outside India or secondly, fee is paid for the purposes of earning any income from any source outside India.

- Therefore it is held that the services of non-residents to whom the technical fee was paid by the assessee were utilized for the business which was carried on outside India for earning income from a source outside India.

# Judicial Precedents – FTS – Source Concept

## ITO (International Taxation) vs. Bajaj Hindustan Ltd. (2011-TII-123-ITAT-Mum-Intl)

**Facts:**

The taxpayer was in the business of manufacturing sugar, engaged the services of a foreign consultant in for providing consultancy on identification and possible acquisition of a sugar mill or distillery plant in Brazil. Subsequently, the taxpayer incorporated a subsidiary company in Brazil to acquire sugar mill/ distillery plant.

The AO held that the taxpayer ought to have withheld tax on the payment made as the same was in the nature of FTS and did not fall within the exceptions under section 9(1)(vii).

**Held:**

The payment made to foreign consultant would be considered as payment made for creating a future source of income which would be covered by the exception, i.e. for the purpose of making or earning any income outside India and hence not taxable as FTS under the Act and accordingly the taxpayer was not liable to withhold tax under section 195 of the Act.

# Judicial Precedents – FTS – Nature of Service

**ADIT vs DQ Entertainment (International) (P.) Ltd [2014] 45 taxmann.com 17 (Hyderabad - Trib.)**

**Facts:**

- Assessee company was in the business of production of 2D and 3D animation films and secured order for production of animated films.
- Assessee outsourced part of the order to a foreign subcontractor received from its overseas client.
- The assessee made payments to foreign subcontractor as per agreement named as 'Outsourcing Facilities Agreement‘

**Issue:**

Whether payment made to foreign subcontractor are in nature of fees for technical services.

# Judicial Precedents – FTS – Nature of Service

## ADIT vs DQ Entertainment (International) (P.) Ltd [2014] 45 taxmann.com 17 (Hyderabad - Trib.)

**Held:**

- There was no element of any technical services in the production of animation films nor in the production of a part or certain episodes of an animation film so as to attract the provision of section 9(1) (*vii*), read with section 5(2)(*b*) of the Act.
- Merely providing of expertise, knowledge, technology and experience is possessed by the foreign party and the same has been utilized for rendering the services, it cannot be said as fees for technical services without making any technology available to the other party.
- The assessee's business with its Overseas Clients undoubtedly constitute a business carried on by resident outside India, making the assessee to satisfy the first category of income referred to in the sub-clause (*b*).
- However, the AO laid emphasis only on the second category of income to say that originating cause of the income of the assessee is located in India and as such he held that the assessee is not making or earning income from the source outside India.
- The Assessing Officer failed to examine the provisions of sub-clause (*b*) of section 9 (1) (*vii*) in a proper perspective in the aforesaid manner.

# Judicial Precedents – FTS – Nature of Service

## ADIT vs Credit Lyonnais [2013] 35 taxmann.com 583 (Mumbai - Trib.)

**Facts:**

- The State Bank of India [SBI] had issued India Millennium Deposit Scheme [IMD].
- SBI appointed assessee as (*i*) arranger for mobilizing the deposits from the eligible depositors under the IMD programme and (*ii*) collecting bank for receiving and handling application forms and paid paid arranger fees and commission.
- Assessee appointed sub-arrangers for mobilizing deposits both in and outside India for which it paid fees and agency commission to them.
- AO conclude the said payment to non resident as 'Fees for technical services' [FTS] covered under section 9(1)(*vii*) disallowed the said expenditure.

**Issue:**

Whether payment made to sub-arrangers can be described as a consideration for 'managerial or technical or consultancy services‘ under section 9(1)(*vii*).

# Judicial Precedents – FTS – Nature of Service

## ADIT vs Credit Lyonnais [2013] 35 taxmann.com 583 (Mumbai - Trib.)

**Held:**

- The scope of work of arranger or sub-arrangers indicates that the ultimate object of the entire exercise was to explain and convince the NRIs for subscribing to such deposits and assist them in filing the requisite application forms which turn shall be forwarded to collector Bank.
- The primary duty of sub-arrangers as collecting banks was consequential to persuading the NRIs to invest in such deposits.
- The activities done by the sub-arrangers were not in the nature of 'consultancy services'. In order to bring a particular service within the purview of technical service, it is *sine qua non* that some sort of technical knowledge or technical skill or technical education must be essentially required for doing the activity.
- Simply convincing the potential customers and then helping to fill the forms cannot by any stretch of imagination be considered as a 'technical service'
- Doing bits or small parts of overall activity independently here and there cannot be considered as rendering of a 'managerial service' in relation to such activity.
- Thus, payment made was simply in the nature commission or brokerage and not a fees for 'managerial or technical or consultancy services'.

# Judicial Precedents – FTS – Nature of Service

## CIT vs Havells India Ltd. [2012] 21 taxmann.com 476 (Delhi)

### Facts

- Tax payer paid to ‘C’ of USA testing & certification fees of “AC Contractor” which enabled the tax payer to export its products to various Countries.

- Tax payer did not deduct tax at source. AO disallowed testing & certification fees under section 40(a)(ia). Tribunal deleted disallowance on the ground that testing and certification were utilized for export and therefore covered by second exception in section 9(1)(vii)(b).

### Issue

- Whether tribunal was right in holding that no tax is required to be deducted at source from testing and certification fees paid to ‘C’ of USA?

# Other Key Judicial Precedents for FTS

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Design and IPR - Make Available | Bajaj Holdings & Investments Ltd. v. ADIT [2013] (141 ITD 62) (Mumbai ITAT) | • Assessee had right 'to file patent application, design application or any such application for intellectual property rights arising out of foreground IP'.<br>• Technology was made available to the assessee. Payments made pursuant to the agreement held to be 'FTS'. |
| Human Intervention | Siemens Ltd. v. CIT(A) [2013] (142 ITD 1) (Mumbai ITAT) | Any technology or machinery is developed by human and put to operation automatically, wherein it operates without much of human interface or intervention, then usage of such technology cannot per se be held as rendering of 'technical services' as contemplated in Explanation 2 to section 9(1)(vii). |

# Other Key Judicial Precedents for FTS

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Technical Service – Make Available | CIT vs De Beers India Minerals (P.) Ltd [2012] 21 taxmann.com 214 (Kar.) HC | • Dutch company performed servces using technical knowlege and expertise and it had given data, photographs and maps to assessee but they had not made available technical expertise, skill or knowledge in respect of collection or processing of data to assessee, which assessee could apply independently and without assistance and undertake such survey independently excluding Dutch company in future.<br>• Technology is not made available along with technical services whereas what is rendered is only technical services and technical knowledge is withheld, then, such a technical service would not fall within definition of technical services in DTAA and not liable to tax.<br>• In view of above, though Dutch company had rendered technical services as defined under section 9(1)(vii) Explanation 2, yet it did not satisfy requirements of technical services as contained in article 12 of Indo-Dutch DTAA and, therefore, assessee had no TDS liability qua said payment. |

# Other Key Judicial Precedents for FTS

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Technical Services – Make Available | Shell International B.V. v ITO [2013] ITA NO 1150 OF 2007 (Ahmedabad ITAT) | • The term 'make available' means that the person receiving the services has been enabled to utilize that knowledge or the receiver has become wiser to utilize that knowledge independently.<br>• Mere rendering of services is not enough unless the person utilizing the knowledge |
| Technical Services | DIT vs. Rio Tinto Technical Services [2012] 17 taxmann.com 70 (Delhi HC) | • An assessee may carry on manufacturing or trading activities and can enter into a contract separately to furnish technical information for a fee to a third party.<br>• Fess received for such technical information received from third party is 'fee for technical services', as payment made is to acquire technical information. |

# Other Key Judicial Precedents for FTS

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Referral Fees | CLSA Ltd. v. ITO [2013] (56 SOT 254) (Mumbai ITAT) | • Referral fees received by the assessee from Indian subsidiary for referring the subsidiary to overseas financial institution with which the assessee had business relations cannot be considered as technical, managerial or consultancy services as envisaged in Explanation 2 to section 9(1)(vii).<br><br>• Also, there did not exist any real and intimate relation between the activities carried on outside India by the applicant and the activities in India that contributed to the earning of income. Hence, the same cannot be considered as taxable as business income. |
| Consultancy Services | English Indian Clays Ltd. v ACIT(IT) [2013] ITA No 337 to 339 of 2013 (Cochin ITAT) | Where the assessee company entered into an agreement with a foreign entity to identify potential customers and file a report regarding the market strategy and developmental studies would be in the nature of consultancy services taxable in India. |

# Other Key Judicial Precedents for FTS

| Nature of Transaction | Decision | Gist |
|---|---|---|
| Seismic Surveys and related activities. | Geofizyka Torun Sp. Zo. O. Chrobrego v/s DIT [2009] (320 ITR 268) (AAR) | Income from services in connection with seismic surveys, data acquisition, processing and interpretation of such data is covered under Section 44BB of the Act (i.e. special provision applicable to non- residents for computing profits and gains in connection with the business of exploration, etc. of mineral oil) and cannot be regarded as "FTS" as defined in section 9(1)(vii) of the Act. |
| Reimbursement of salary and other cost | Temasek Holdings Advisors (I) (P.) Ltd. v. DCIT [2013] ITA NO 4203 & 6504 OF 2012 (Mumbai ITAT) | It was held that payments made by the Indian company on account of reimbursement of salary of two employees and other costs, was not in the nature of 'fees for technical services', being rendering of managerial and consultancy services within the ambit of section 9(1)(vii) and also under article 12(4)(b) of the India Singapore DTAA. |
| Dependent Agents | eBay International AG v. DDIT [2013] 40 taxmann.com 20 (Mumbai - Trib.) | Revenues earned by foreign company through its dependent agents who were assisting said company in operating websites in India was in nature of business profits as per article 7 of Indo-Swiss DTAA but could not taxed as assessee had no PE in India |

# Examples of Payment Not Considered in Nature of FTS

| Nature of Transactions | Decision |
|---|---|
| Freight and logistics services, loading and unloading | UPS SCS (Asia) Ltd vs ADIT (2012) 18 taxmann.com 302 ( Mumbai ITAT) |
| Sourcing services in relation to goods | Adidas Sourcing Ltd. v. ADIT (IT) [2012] (55 SOT 245) (Delhi ITAT) |
| Line production services | Endemol India Private Limited(2013) ( AAR no 1083 of 2011); Yashraj Films (2013) (ITA No.4856 of 2008). |
| VSAT charges, Demat charges, etc. paid by members to the stock exchange for use of facilities | DCIT vs. Angel Broking Ltd [2009] (35 SOT 457) (Mumbai ITAT). |
| Provision of bandwidth/internet facilities | CIT vs. Estel Communications P. Ltd [2008] (318 ITR 185) (Delhi HC). |

# Judicial precedents on income characterization under the head “Commission to overseas agent”

# Judicial Precedents – Commission

## Southern Borewells v. CIT [2014] 43 taxmann.com 378 (HC - Kerala)

**Facts:**

- The tax payer entered into a contract for providing marketing support to win the contract for construction of bore wells
- The agent did not have a permanent establishment in India and the agency commission had to be paid in a foreign country in foreign currency.

**Issue:** Whether assessee was not liable to deduct tax at source from payments made to agent

**Held:**

- The scope of section 195(1) especially the expression 'sum chargeable under the provisions of the Act.
- If the payment does not contain the element of income the payer cannot be made liable.
- In absence of PE in India, payment made to agent cannot be construed as income accrued in India.

# Judicial Precedents – Commission

## ITO vs Trident Exports [2014] 44 taxmann.com 297 (Chennai - Trib.)

**Facts:**

- Assessing Officer noted that assessee had made commission payments to its foreign agents without deducting tax at source and disallowed said payments by invoking provisions of section 40(a)(i)

**Issue:** Whether commission payments to non resident agents were are taxable in India

**Held:**

- Foreign agents had rendered services in their respective countries and had received the commission. It is also evident that the foreign agents did not have any PE in India and there was nothing on record to show that the agreements between the assessee and commission agents were entered in India.

# Judicial Precedents – Commission

## ACIT v. Avon Organics Ltd. (2013) 55 SOT 260 (Hyd.) (Trib.)

**Facts:**

- Tax payer paid commission to foreign agents for services rendered by them in connection with effectuating export sales
- Foreign agents were paid by way of telegraphic transfer obtained from banks

**Issue:** Whether income earned by foreign agents is taxable in India

**Held:**

Merely because commission was paid to foreign agents in their bank accounts by telegraphic transfer through banks in India, it could not be said that income was deemed to have been arisen to such foreign agents in India when there was no material on record to show that such foreign agents had rendered any part of services in India or had a permanent establishment and business connection in India.

# Judicial Precedents – Commission

## Dy. CIT v. Angelique International Ltd. (2013) 55 SOT 226 (Delhi) (Trib.)

**Facts:**

- Tax payer engaged in export services, paid commission to foreign agents.
- Agents operated out of India and provided their services outside India.
- AO held the payments to be in the nature of FTS and therefore liable to TDS u/s 195.

**Issue:** Whether export commission paid to non-resident agent is chargeable to tax in India.

**Held:**

The relationship between the assessee and its agents was on a principal to principal basis; that the agents of the assessee did not have any PE in India Accordingly, export commission is paid to a non-resident agent for services rendered outside India, it is not chargeable to tax in India.

# Judicial Precedents – Commission

## CIT v. Eon Technology (P) Ltd. (2012) 246 CTR 40 (Delhi)(High Court)

**Facts:**

- The tax payer company was engaged in the business of development and export of software
- The tax payer paid commission to its parent company in the U.K. on the sales and amounts realised on export contracts procured by it for the tax payer and the same was claimed as deduction.

**Issue:** Whether income deemed to accrue or arise in India

**Held:**

When a non–resident agents operates outside the country, no part of income arises in India and since payment is remitted directly abroad and merely because an entry in the books of account is made in India, it does not mean that non-resident has received any payment in India, therefore, assessee is not liable to deduct tax at source hence, no disallowance can be made by applying the provision of section 40(a)(i).

# Other Rulings – Commission Paid to Non Resident Agent

| Decision | Gist |
|---|---|
| CIT vs Model Exims [2014] 42 taxmann.com 446 (Allahabad - HC) | • Explanation added to section 9(1)(vii) by Finance Act, 2010 with effect from 1-6-1976 was not applicable in view of fact that agents had their offices situated in foreign country and they did not provide any managerial services to assessee.<br>• The agreement did not show the applicability or requirement of any technical expertise as functioning as selling agent, designer or any other technical services. |
| Allied Nippon Ltd vs Dy. CIT [2013] 37 taxmann.com 135 (Delhi - Trib.) | Export commission, paid to foreign agent for procuring order and pursuing payment from foreign buyer, is not taxable as no services are rendered in India |
| Exotic Fruits (P.) Ltd vs ITO [2013] 40 taxmann.com 348 (Bangalore - Trib.) | Export commission to its non-resident agent, services of non-resident agent were rendered outside India and commission was also paid outside India, income of such agent by way of commission could not be considered as accrued or arisen or deemed to be accrued or arisen in India |

# Other Rulings – Commission Paid to Non Resident Agent

| Decision | Gist |
|---|---|
| Gujarat Reclaim and Rubber Products Ltd. ITA No.8868/Mum/2010 (Mum Trib) | Amount not taxable as the services provided by agents were utilized outside India and the commission was also payable/paid outside India. |
| CIT v. Toshoku Ltd., (2002-TII-03-SC-INTL) | As non-resident taxpayer did not carry on any business operations in India, amounts earned for services rendered outside India could not be deemed to be incomes which had either accrued or arisen in India. |
| Armayesh Global vs ACIT [2012] 21 taxmman.com 130 (Mum Trib.) | Where services rendered by overseas commission agent were not of managerial/technical nature and, moreover, it did not have a PE in India, amount paid to said agent for rendering services did not accrue in India |
| DCIT v. Divi's Laboratories Ltd. - (2011-TII-182-ITAT-HYD-INTL) | Commission paid to a foreign agent for services rendered outside India is not taxable in India as an overseas agent of Indian exporter operates in his own country and no part of his income arises in India and amount is directly paid outside India. |

# Other Rulings – Commission Paid to Non Resident Agent

| Nature of Transactions | Decision |
|---|---|
| AAR in case of SKF Boilers and Driers (P.) [2012] 18 taxmann.com 325 (AAR - New Delhi) | • The words 'accrue' or 'arise' occurring in section 5 have more or less a synonymous sense and income is said to accrue or arise when the right to receive it comes into existence.<br>• No doubt the agents rendered services abroad and have solicited orders, but the right to receive the commission arises in India when the order is executed by the applicant in India.<br>• The fact that the agents have rendered services abroad in the form of soliciting the orders and the commission is to be remitted to them abroad are wholly irrelevant for the purpose of determining the situs of their income.<br>• The provision of section 195 would apply since the right to receive the commission arises in India when the order is executed by the applicant in India |