



Darya Ganj CPE Study Circle



BASIC CONCEPTS OF INTERNATIONAL TAXATION



Presented by

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AGENDA FOR TODAY

- Introduction to International Taxation
- Scheme of Taxation under Income Tax Act, 1961 ('Act') read with Double Taxation Avoidance Agreements ('DTAA')
- Section 90 of Act
- Basic Concepts of DTAA
 - Introduction
 - Permanent Establishment (Article 5)
 - Royalty under Act and DTAA (Article 12/13)
 - Fee for Technical Services under Act and DTAA (Article 12/13)
 - Most Favoured Nation

INTRODUCTION

WHY DOES DOUBLE TAXATION OCCUR ?

- Tax systems generally followed
 - Residence based tax system
 - Connecting factor is “residence”
 - Unlimited taxing rights due to “personal attachment” of persons
 - Source based tax system
 - Connecting factor is “income”
 - Limited taxing rights due to “economic attachment” of persons
- Double taxation occurs in situations where the country of residence **and** the country of source seek to tax the same income

TYPES OF DOUBLE TAXATION

Economic double taxation

- Same economic transaction, item or income is taxed in two or more states during the same period but in the hands of different taxpayers

Juridical double taxation

- Two or more states levy taxes on same entity or person on same income for identical periods
- Is the result of a conflict between two tax systems
- Arises due to overlapping claims of tax jurisdictions on interrelated economic activities

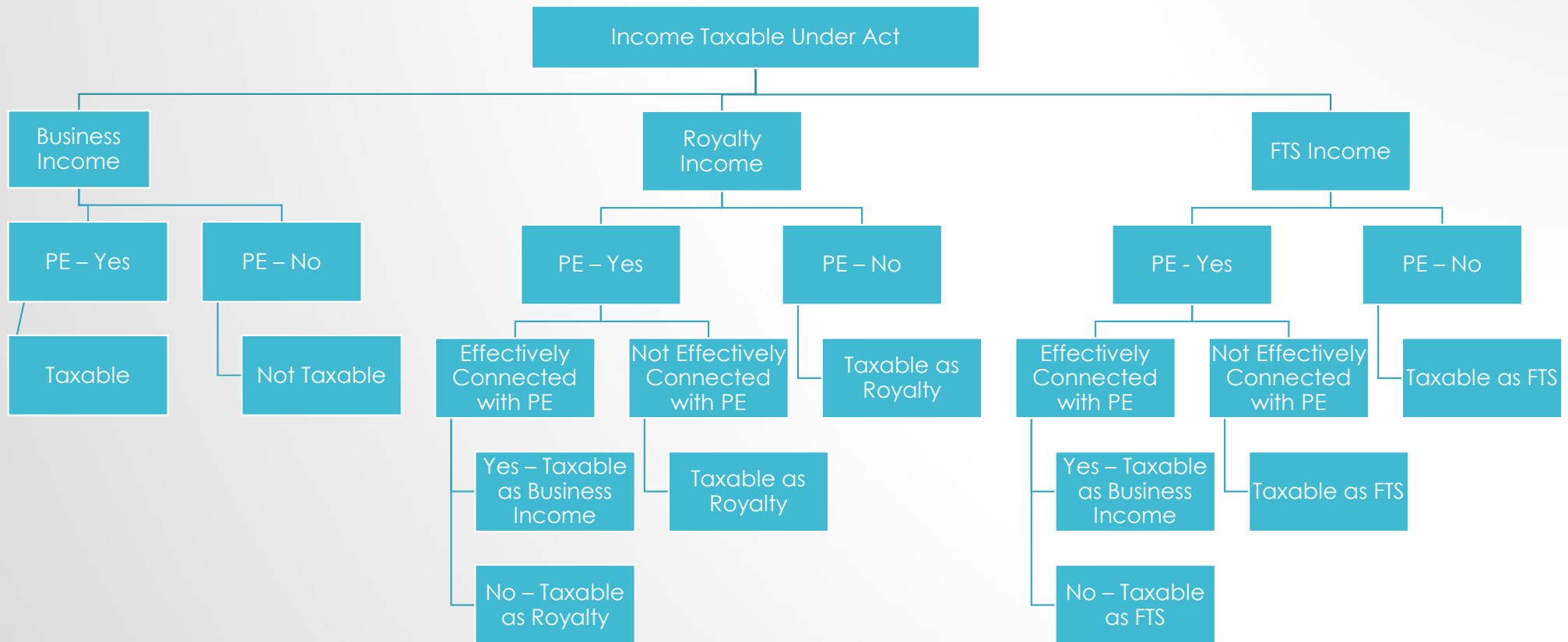
Tax treaties prevent/ mitigate juridical double taxation – mitigation in form of relief and not refund of tax

SCHEME OF TAXATION UNDER
ACT AND DTAA

OVERVIEW SCHEME OF TAXATION UNDER ACT



OVERVIEW SCHEME OF TAXATION UNDER ACT R/W DTAA



MEANING OF TREATY

- ▶ Vienna Convention on Law of Treaties, 1969 ('VCLT') defines treaty as –

“An international agreement concluded between States in written form and governed by international law, whether embodied in a single instrument and whatever its particular designation”

- ▶ The Oxford Companion to Law definition of treaty: "an international agreement, normally in written form, passing under various titles (treaty, convention, protocol, covenant, charter, pact, statute, act, declaration, concordat, exchange of notes, agreed minute, memorandum of agreement) concluded between two or more States, on subjects of international law intended to create rights and obligations between them and governed by international law"

TREATY: BASIC UNDERSTANDING

- Understanding between Governments is to share tax revenues equitably as between themselves, while mitigating hardship for taxpayers
- Treaties can only relieve tax burden
- Treaties do not create any charge
- Klaus Vogel : *“A tax treaty neither generates a tax claim that does not otherwise exist under domestic law nor expands the scope or alters the type of an existing claim”*

CATEGORIES OF TAX TREATIES

- Limited treaties –
 - Deals with specific subject matter
 - DTAA between India and Pakistan is limited to air transport only
 - Exchange of information with British Virgin Islands
- Comprehensive treaties – Deals with most sources of income
- Multilateral treaties vs. Bilateral treaties
 - EU Directives
 - SAARC Income Tax Agreement - Bangladesh; Bhutan; India; Maldives; Nepal; Pakistan; Sri Lanka (sharing of tax policies, training to tax administration, teachers, students taxation, etc.)

TEXTURE OF TREATY: OECD MODEL

- Organisation for Economic Co-operation and Development (OECD)
 - Established in 1961 with developed countries as its members
 - Essentially a model treaty between two developed nations with comparable tax systems and tax objectives
 - Advocates residence principle
 - Lays emphasis on the right of state of residence to tax
 - Royalty taxation in the state of residence
 - Excludes taxation on services in the name of service PE
- Currently 34 countries including Australia, US, UK, France, Germany etc are OECD members
- India not a OECD member
 - Currently has been granted the “Observer” status

TEXTURE OF TREATY: UN MODEL

- ▶ Tax treaties between countries with unequal economic status - Developed and lesser developed countries, or between developing countries
- ▶ Drafted in 1980, designed to encourage flow of investments from the developed to developing countries
- ▶ Is a compromise between source principle and residence principle
- ▶ Gives more weightage to source principle, i.e., income should be taxed where it arises
 - ▶ Payer of income is considered as the source of taxation
 - ▶ Reduced threshold of construction PE

SECTION 90

90. (1) The Central Government may enter into an agreement with the Government of any country outside India or specified territory outside India,—

- (a) for the granting of relief in respect of income tax paid both under this Act and in that country , or
(FOREIGN TAX CREDIT)
- (b) for the avoidance of double taxation of income under this Act and in that country, or
(ELIMINATION OF DOUBLE TAXATION)
- (c) for exchange of information for the prevention of evasion or avoidance of income-tax
- (d) for recovery of income-tax under this Act and under the corresponding law in force in that country or specified territory

(2) Where the Central Government has entered into an agreement with the Government of any country outside India or specified territory outside India, as the case may be, under sub-section (1) for granting relief of tax, or as the case may be, avoidance of double taxation, then, in relation to the assessee to whom such agreement applies, **the provisions of this Act shall apply to the extent they are more beneficial to that assessee.**

ARTICLES OF A TREATY

ARTICLES OF A TREATY

SCOPE PROVISIONS

1. Article 1 - Personal Scope
2. Article 2 - Taxes covered
3. Article 29 - Entry into force
4. Article 30 - Termination

DEFINITION PROVISIONS

1. Article 3 - General definitions
2. Article 4 - Residence
3. Article 5 - Permanent Establishment

MISCELLANEOUS PROVISIONS

1. Article 24 - Non-discrimination
2. Article 27 - Diplomats
3. Article 28 - Territorial Extension

ELIMINATION OF DOUBLE TAXATION

1. Article 23 - Elimination of double taxation
2. Article 25 - Mutual Agreement

ANTI-AVOIDANCE

1. Art 9 - Associated Enterprise
2. Art 26 - Exchange of Information

SUBSTANTIVE PROVISIONS

1. Article 6 - Immovable property
2. Article 7 - Business Profits
3. Article 8 - Shipping, etc
4. Article 10 - Dividends
5. Article 11 - Interest
6. Article 12 - Royalties & FTS
7. Article 13 - Capital gains
8. Article 14 - Independent Personal Services
9. Article 15 - Dependent Personal Services
10. Article 16 - Directors
11. Article 17 - Artistes & Sports persons
12. Article 18 - Pensions
13. Article 19 - Government service
14. Article 20 - Students
15. Article 21 - Other income
16. Article 22 - Capital

CONCEPT OF PERMANENT ESTABLISHMENT



CONCEPT OF PE

- Business profits in case of non-residents are taxable only if there is a **PE**.
- **Concept of a PE** is to determine the right of a Source State to tax the Business profits of the foreign enterprise.
- Under Article 7 of the tax treaty, a Contracting State cannot tax the profits of an enterprise of the other Contracting State unless it carries on its business through a PE situated therein
- Existence of PE also enables the Source State to tax capital gains, dividends, interest and royalties that are effectively connected/attributable to such PE.
- Business Profits taxable in the country of residence. Business profits can be taxed in the source country i.e. country in which they arise if:
 - Business is carried on through a PE in the source country
 - Only those profits which are attributable to the PE can be taxed in the source country

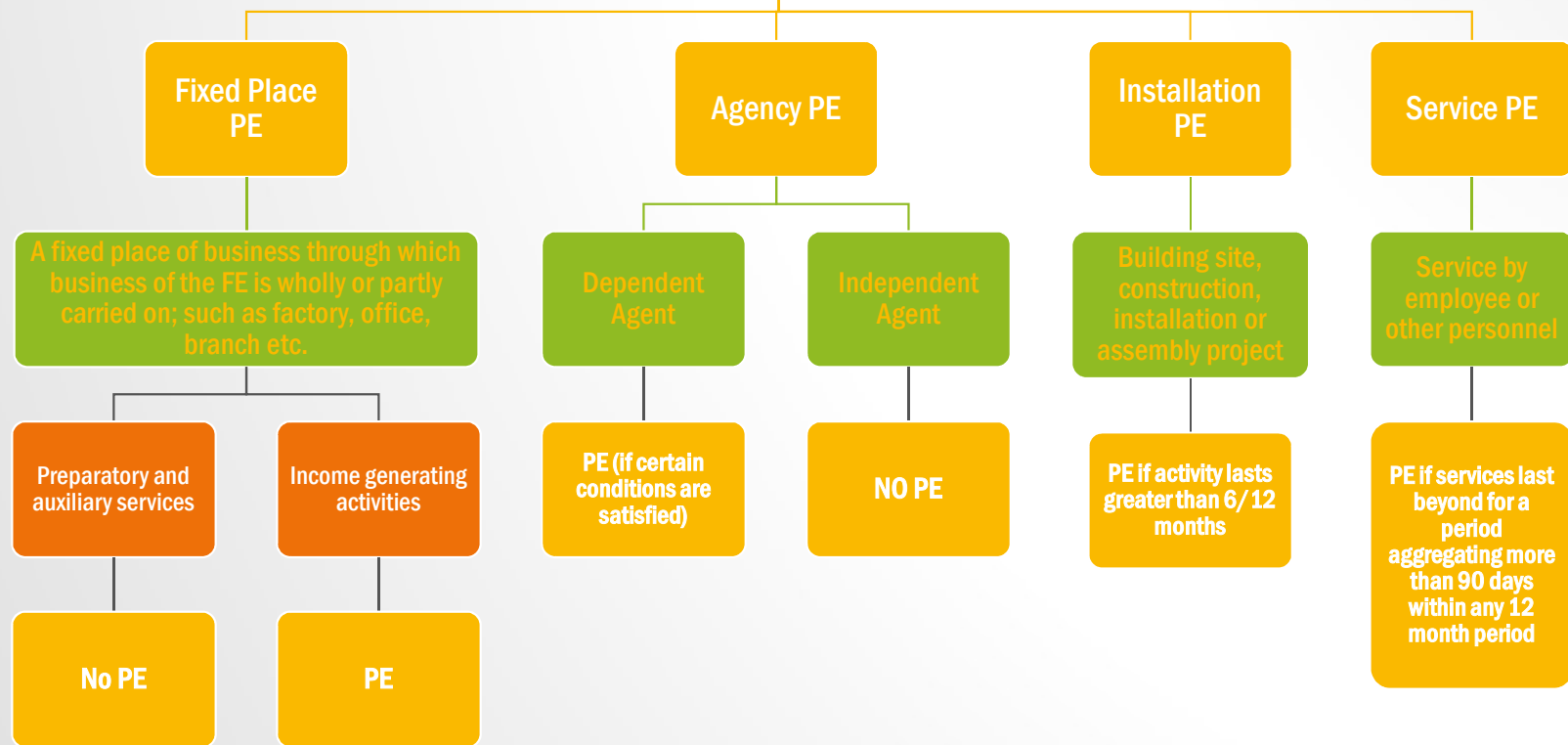
ARTICLE 5 - TYPICAL STRUCTURE OF A PE

ARTICLE



- ✓ Article 5(1) Basic Rule for PE (Fixed Place PE)
- ✓ Article 5(2) Specific inclusions
- ✓ Article 5(3) Construction PE
- ✓ Article 5(4) Exclusions from PE
- ✓ Article 5(5) Dependent Agent PE
- ✓ Article 5(6) Deemed PE for Insurance Business
- ✓ Article 5(7) Independent Agent
- ✓ Article 5(8) Subsidiary Company

TYPES OF PE

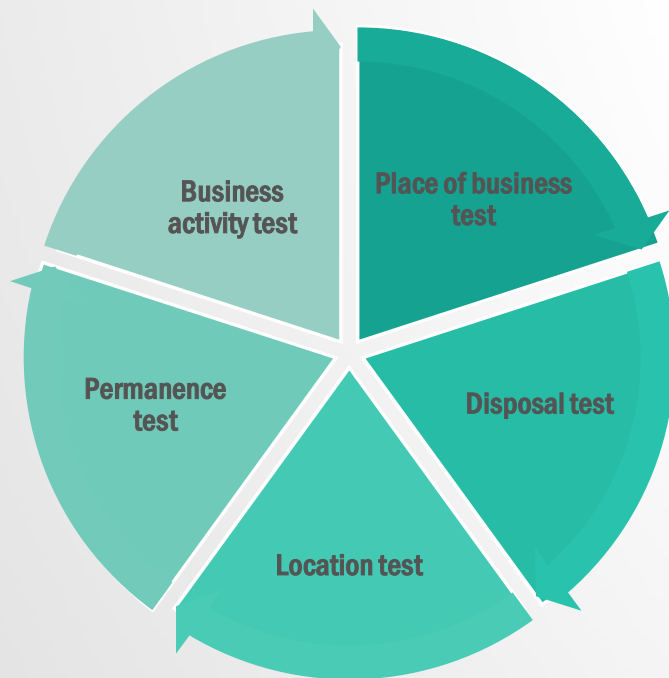


ARTICLE 5(1) - BASIC RULE FOR PE (FIXED PLACE PE)

Article 5: Permanent Establishment

(1) “For the purposes of this Convention, the term ‘permanent establishment’ means a fixed place of business through which the business of the enterprise is wholly or partly carried on.”

ARTICLE 5(1) - BASIC RULE FOR PE (FIXED PLACE PE)



Under Article 5(1), PE exists if all the following conditions (based on commentaries and judicial precedents) are satisfied cumulatively:

- ▶ There is a **place of business** (“place of business test”)
- ▶ Such place of business is at the **disposal** of foreign enterprise (“disposal test”)
- ▶ Such place of business is **fixed** (“location test” and “permanence test”)
- ▶ The **business** of the foreign enterprise is **carried on** (“business activity test”) wholly or partly through such fixed place of business

DIGITAL ECONOMY

- Digital Economy includes FEs having presence in India through online advertising, online retail stores, cloud service providers, web based applications etc.
- Generally, in case of Digital Economy, the internet web-site does not constitute a tangible property – therefore it does not have a location that can constitute a “place of business”
- Even the server which is used in most circumstances, is situated outside India
- The website operated by FEs, per se, should not satisfy the tests of a fixed place PE (such as location test), and hence should not create a PE – this has been accepted by OECD as well as various decisions in India
- However, there are various adverse decisions which have held that equipment of the customer or internet connectivity at customer end or presence of equipment which provides access to overseas server may create an element of physical presence in India which may trigger PE

Digital Economy –Judicial precedent

Issue	Refer
A search engine (Google/ Yahoo), which has a presence through its website, cannot have a PE in India unless the web servers are located in India. The traditional PE tests fail when it comes to e-commerce models and its time to find an alternative to the PE concept	Right Florist Pvt Ltd (143 ITD 445 (Kol)(2013))
A fixed place PE could be constituted for NR, if a master computer system/server located outside India exists in the various computers installed in India through an inter-connected communication network	DIT Vs Galileo International Inc [2009] 336 ITR 264 (Del High Court)
A taxpayer who earns commission or service charges by operating India specific websites which provides an online platform to facilitate purchase and sale of goods by customers within India does not have any place of business in India even if it may be availing certain support services from an Indian Company over which it does not have any control	eBay International AG (140 ITD 20)(Mum)(2012)
Taxpayer who is engaged in the business of providing business information reports comprising of publicly available information may sell the report to an Indian buyer at a price in response to e-request. The downloading of the report does not give rise to any PE or place of business in India	Dun & Badstreet 272 ITR 99 (AAR)

ARTICLE 5(2) – SPECIFIC INCLUSIONS

Specific Inclusions – OECD MC

The term “permanent establishment” includes especially:

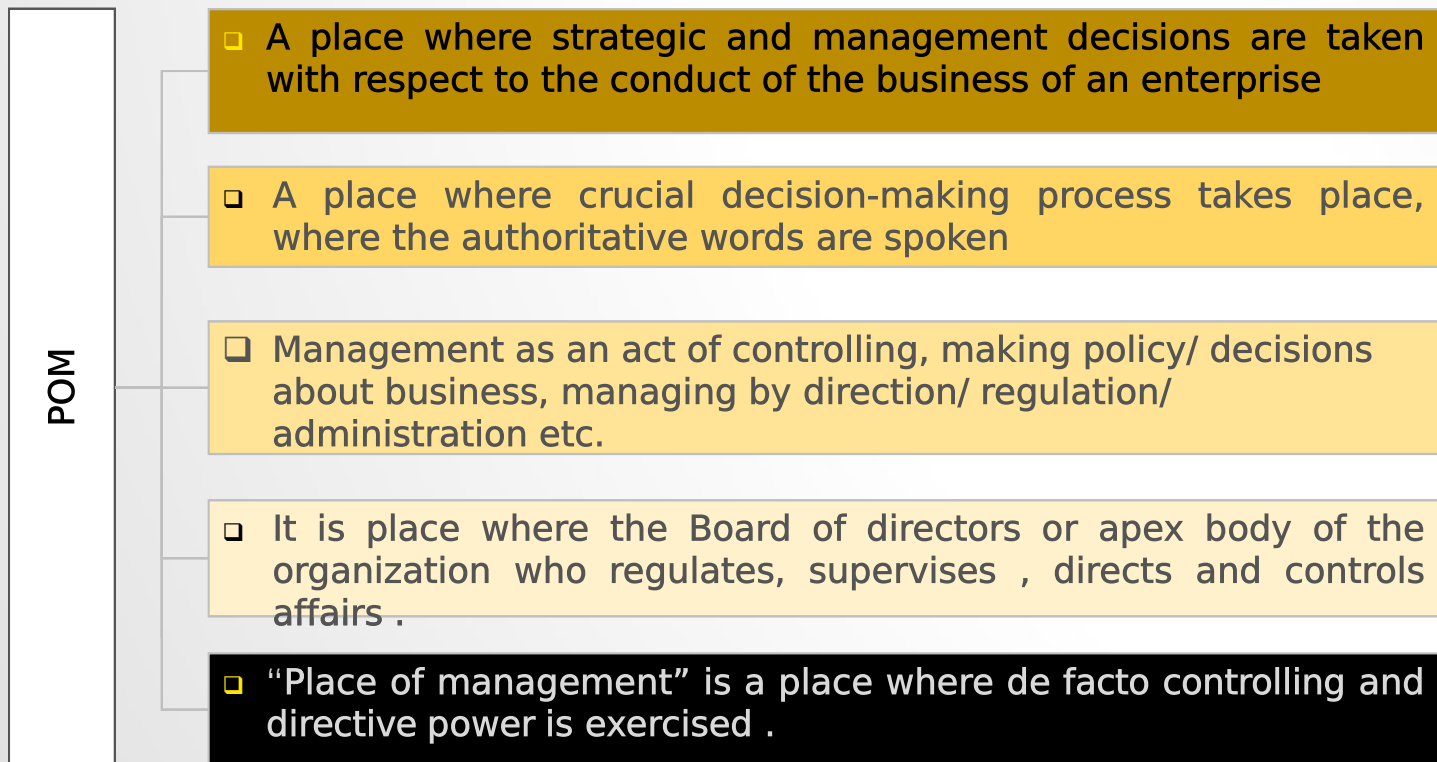
- A place of management
- A branch
- An office
- A factory
- A workshop
- A mine, an oil & gas well, a quarry or any other place of extraction of natural resources
- Furnishing of services (Service PE)

Additional inclusions - Indian Treaties

- Warehouse in relation to person providing storage facilities for others – Treaties with Singapore, USA, Mauritius, Netherlands etc
- A store or premises used as a sales outlet – Treaties with USA, Netherlands, Germany etc

- As per OECD MC, items in 5(2) are subject to fulfilment of conditions of 5(1) to create a PE.
- But India’s reservation – 5(2) item can create a PE by itself
- Delhi HC in National Petroleum Construction Company vs DIT [2016] 66 taxmann.com 16 (Delhi) held that all classes of PE in 5(2) are subject to fulfilment of conditions of 5(1)

UNDERSTANDING POM MEANING



AGENCY PE UNDER THE ACT

- Explanation 2 to Section 9 of the Act inserted by Finance Act, 2003 introduced the concept of Agency PE
- Section 9 - 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...

[Explanation 2.—"business connection" shall include any business activity carried out through a person who, acting on behalf of the non-resident

- (a) has and habitually exercises in India, an authority to conclude contracts on behalf of the non-resident, unless his activities are limited to the purchase of goods or merchandise for the non-resident; or
- (b) has no such authority, but habitually maintains in India a stock of goods or merchandise from which he regularly delivers goods or merchandise on behalf of the non-resident; or
- (c) habitually secures orders in India, mainly or wholly for the non-resident or for that non-resident and other non-residents controlling, controlled by, or subject to the same common control, as that non-resident:

Provided that such business connection shall not include an agent having an independent status, acting in the ordinary course of his business :

Provided further that where such agent works mainly or wholly on behalf of a non-resident, he shall not be deemed to be an of an independent status.

AGENCY PE UNDER THE ACT

- Dependent Agent and hence business connection – four conditions:



AGENCY PE CLAUSE – COMPARISON UNDER THE ACT/ OECD/ UN MODEL

Particulars	The Act	OECD Model	UN Model
1) If agent of independent status	No business connection subject to additional condition	No agency PE	No agency PE subject to additional condition
	Additional condition: - such agent's activities are not wholly or almost wholly dependent on behalf of foreign enterprise and due to controlling interest	No additional condition	Additional condition: - such agent's activities are not wholly or almost wholly dependent on foreign enterprise; - and the agent and principal are in an arms length relationships is another condition and present in some of the India's DTAA
2) If not of independent status #	- Habitually exercises authority to conclude contracts; or	Habitually exercises authority to conclude contracts	- Habitually exercises authority to conclude contracts; or
	- Habitually maintains stock of goods or merchandise; or	No such clause	- Habitually maintains stock of goods or merchandise
	- Habitually secure orders	No such clause	No such clause

#Conditions under the Act are adapted from the tax treaties signed by India – for e.g. all three conditions present in India-US Tax Treaty

SERVICE PE - ARTICLE 5(3)

- ▶ A Service PE could be constituted in India where any enterprise:
 - ▶ renders services in India (other than fees for technical)
 - ▶ to third party/ associated enterprises
 - ▶ through employees or other personnel for a specified period

- ▶ OECD Model – Not included
- ▶ UN Model – Included

REQUIREMENTS TO ESTABLISH SERVICE PE

Country	Services provided to a non-related enterprise	Services provided to a related enterprise
Australia, Canada, USA	More than ninety (90) days within any twelve (12) month period	One (1) day
Singapore	More than ninety (90) days within any fiscal year	More than thirty (30) days in a fiscal year
China	More than one hundred and eighty-three (183) days	Not provided
Norway	Six (6) months within any twelve (12) month period	Not provided
Switzerland, UK	More than ninety (90) days in any twelve (12) month period	More than thirty (30) days in a twelve (12) month period
Nepal	More than one hundred and eighty-three (183) days in any twelve month period	Not provided
Indonesia	more than ninety-one (91) days in any twelve (12) month period	Not provided

SERVICES EXCLUDED FROM SERVICE PE

Country	Whether FTS is excluded
Australia, Canada, Singapore, Swiss Confederation, UK, USA, China, Namibia	Yes
Sri Lanka, Syrian Arab Republic, Thailand, Botswana, Saudi Arabia, Iceland, Nepal, Norway, UAE	No
Belgium, Brazil Malaysia, Mauritius	FTS clause is absent in treaties entered with these countries.

CONSTRUCTION/INSTALLATION PE – ARTICLE 5(3)

- ▶ A building site or construction or installation project constitutes a PE only if it lasts for more than specified period.
- ▶ A building site or construction or installation project includes:
 - ▶ construction of roads, bridges or canals.
 - ▶ renovation (involving more than mere maintenance or redecoration) of buildings, roads, bridges or canals.
 - ▶ laying of pipelines.
 - ▶ excavating and dredging.
 - ▶ installation of new equipment in an existing building or outdoors.
 - ▶ onsite planning and supervision of the construction of a building.

CONSTRUCTION/INSTALLATION PE – ISSUES

▶ Commencement

- OECD MC and UN MC - From the date on which a contractor begins his work including any preparatory
- Time for preparatory activities – Included
- Time for purely preliminary activities such as visits for negotiations – Not Included

▶ Cessation

- OECD MC - On completion of work
- Temporary discontinuation / Seasonal interruptions – Included

▶ Time spent by sub-contractor – Included

▶ Multiple sites/projects

- Threshold time limit determined separately for each individual site or project.
- Time spent previously on other sites or project (which are unconnected) should not be counted.
- No aggregation of duration if projects were separate and independent

INDIA'S TAX TREATIES - KEY FEATURES

Key Features	Countries
Installation not covered in the definition	Bangladesh, Belarus, Brazil, Ireland, Israel, Kenya, Libya, Mauritius, Oman, Philippines, Sri lanka.
Installation and assembly not covered in the definition	Libya, Philippines.
Construction not covered in the definition	Libya.
Supervisory activities not included	Bangladesh, Brazil, Netherlands, Egypt (United Arab Republic), Sri Lanka, Slovenia, Libya, France.
Additional clause for exploration / exploitation of natural resources	Belarus, Germany, Netherlands, France, Denmark, (exploration of natural resources) / Italy, Ireland, China(exploration or exploitation of natural resources) , Philippines, USA.

INDIA'S TAX TREATIES - KEY FEATURES

Key Features	Countries
"Together" with other site, project, or activities continues for specified period	Belgium, Canada, China, Denmark, Italy, New Zealand, Spain, USA.
Words used are "a construction, installation or assembly project or the like"	Greece.
Project / supervisory activity, being incidental to the sale of machinery / equipment, continues for a Specified period and the charges payable for the project / supervisory activity exceed 10 % of the sale price of the machinery & equipment.	Belgium, Italy, Spain, UK.

INDIA'S TAX TREATIES – TIME THRESHOLD

Time threshold	Countries
> 3 months	Norway.
> 6 months	Australia, Belgium, Brazil, France, Germany, Italy, Japan, Ireland, Netherlands, Sweden, UK.
> 120 days in any 12 months	USA, Canada.
183 days in any fiscal year	China, Denmark, Singapore, Thailand.
> 9 months	Korea, Hungary.
> 12 months	Cyprus.

ARTICLE 5(4) - SPECIFIC EXCLUSIONS

An enterprise shall not be deemed to have a permanent establishment merely by reason of:

- the **use of facilities solely** for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- the **maintenance of a stock of goods** or merchandise belonging to the enterprise **solely for the purpose of storage or display**;
- the **maintenance of a stock of goods** or merchandise belonging to the enterprise **solely for the purpose of processing by another enterprise**;
- the **maintenance of a fixed place** of business **solely for the purpose of purchasing goods** or merchandise, **or of collecting information**, for the enterprise; or
- the **maintenance of a fixed place** of business **solely** for the purpose of **advertising**, for the **supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character**, for the enterprise

ROYALTY



WHAT IS ROYALTY?

ORIGIN

- The term originated from the fact that in the Great Britain gold and silver mines were property of the Crown, and such 'royal' metals could be mined only if a payment – royalty – was made to the Crown



Crown



*Payment
"Royalty"*



Mining

WHAT IS ROYALTY?

INCOME DEEMED TO ACCRUE/ ARISE IN INDIA- SEC 9(1)(VI)

Royalty is deemed to accrue or arise in India if payable by

A) Government

- ▶ All payments with no exceptions

B) Resident

- ▶ **All payments except:**
Where royalty is payable in respect of any right, property or information used or services utilized for *business or profession carried on outside India* or for the purpose of earning income *from any source outside India*

C) Non- resident

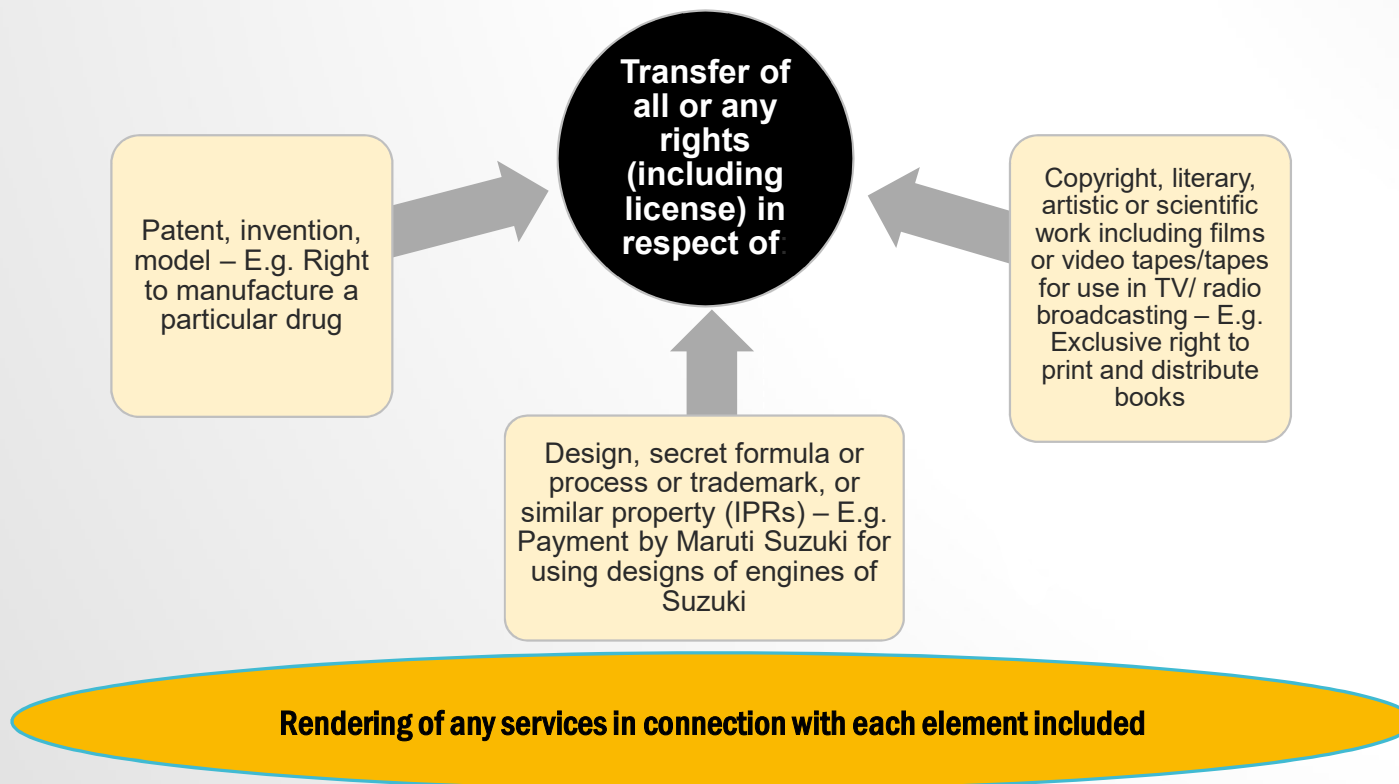
- ▶ **Covers only payments:**
Where royalty is payable in respect of any right, property or information used or services utilized for **business or profession carried on in India** or for the purpose of earning income **from any source in India**
- *Also known as secondary source rule of taxation*

Residential status of recipient of royalty income is not relevant in determining taxability of royalty in India

WHAT IS ROYALTY?

DEFINITION UNDER ITA- EXPLANATION 2 TO SECTION 9(1)(VI)

Consideration (incl. lump sum consideration) for:



WHAT IS ROYALTY?

DEFINITION UNDER ITA- EXPLANATION 2 TO SEC 9(1)(VI)

Consideration (incl. lumpsum consideration) for:

Imparting of any information concerning

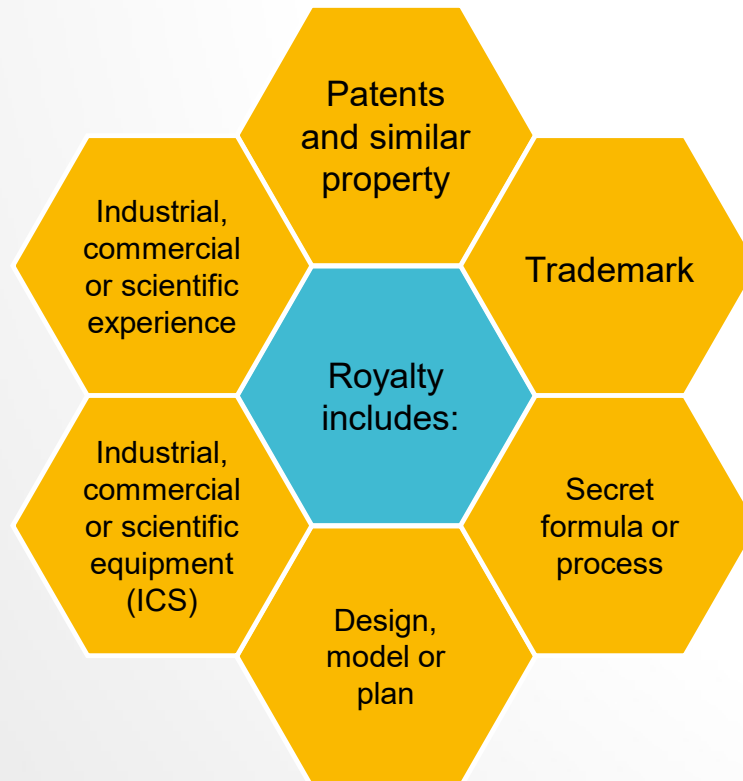
- ▶ Working of or use of IPRs
- ▶ Technical, industrial, commercial or scientific knowledge, experience or skill
- ▶ E.g. - Imparting technical knowledge to use an equipment

Use of

- ▶ Any IPRs
- ▶ or right to use any industrial, commercial or scientific equipment (ICS) (other than those referred to in S. 44BB)
- ▶ E.g. – Consideration for right to use secret formula

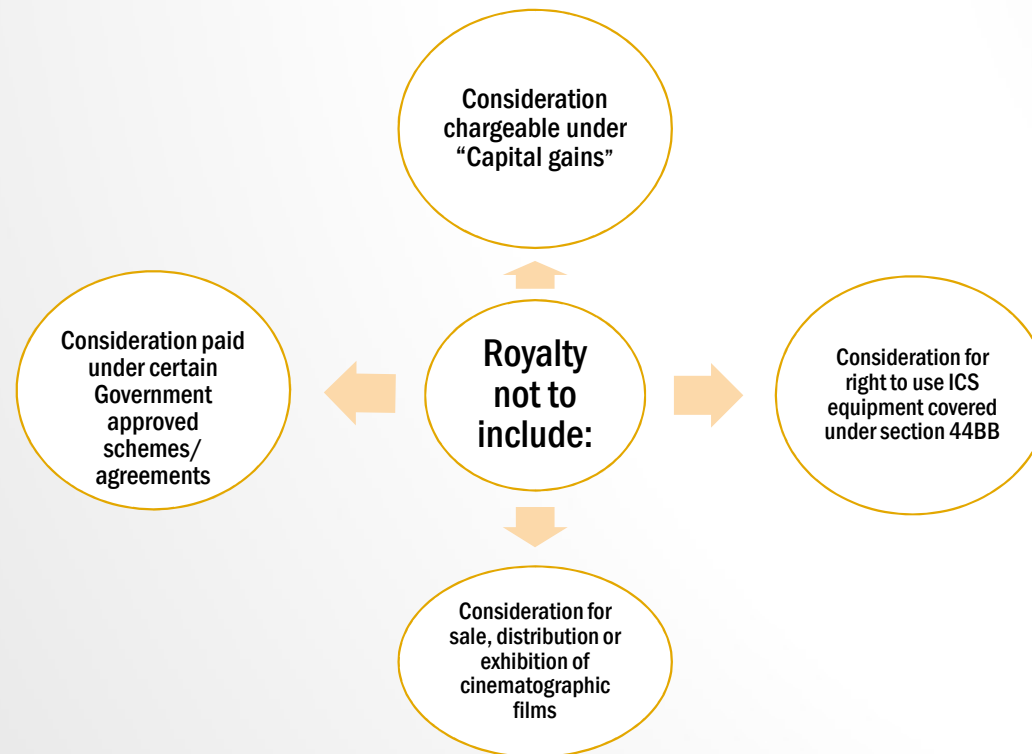
WHAT IS ROYALTY?- INCLUSIONS

EXPLANATION 2 TO SECTION 9(1)(VI)



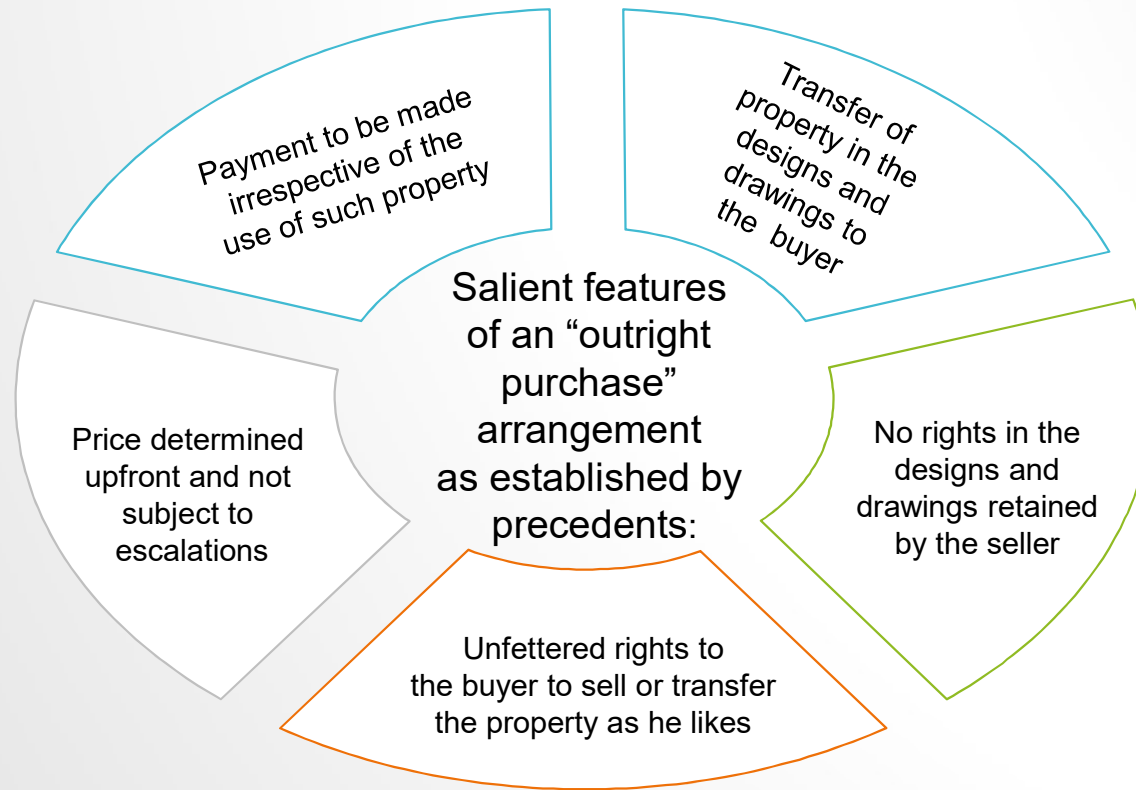
WHAT IS ROYALTY?- EXCLUSIONS

EXPLANATION 2 TO SECTION 9(1)(VI)



Section 44BB deals with providing services or supplying plant and machinery on hire used in relation to extraction or production of mineral oils

OUTRIGHT PURCHASE *COVERED UNDER 'CAPITAL GAINS'*



RECENT AMENDMENTS TO SECTION 9

(*VIDE FINANCE ACT 2012 W.R.E.F. 01-06-1976*)

Explanation 4

- ▶ *For the removal of doubts, it is hereby clarified that the transfer of all or any rights in respect of any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a licence) irrespective of the medium through which such right is transferred”*

Explanation 5

- ▶ *For the removal of doubts, it is hereby clarified that the royalty includes and has always included consideration in respect of any right, property or information, whether or not—*

(a) the possession or control of such right, property or information is with the payer;

(b) such right, property or information is used directly by the payer;

(c) the location of such right, property or information is in India.

Explanation 6

- ▶ *For the removal of doubts, it is hereby clarified that the expression “process” includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret*

These explanations were introduced to put to rest on going litigation on interpretation of some aspects of definition of royalty

ROYALTY UNDER ITA

EFFECTIVELY CONNECTED WITH PE

Section 44D

- ▶ Royalty received by a Foreign Co. from Govt. or Indian Concern under agreements entered after 31 March 1976 but before 01 April 2003 - taxable on gross basis (as per the provisions u/s 115A)

Section 44DA

- ▶ Royalty received by a non-resident from Govt./'Indian Concern' under agreements entered on/after 01 April 2003 through PE/ Fixed Place of profession would be computed as 'business income' provided right / property / contract is 'effectively connected' with such PE/Fixed place.
- ▶ No deduction for
 - Expense not wholly & exclusively incurred for PE/Fixed Place, or
 - Payment to Head Office or other overseas branches (except reimbursement of expenditure)
- ▶ Non-resident – Compulsory maintenance of Books of accounts, Audit & filing of ROI

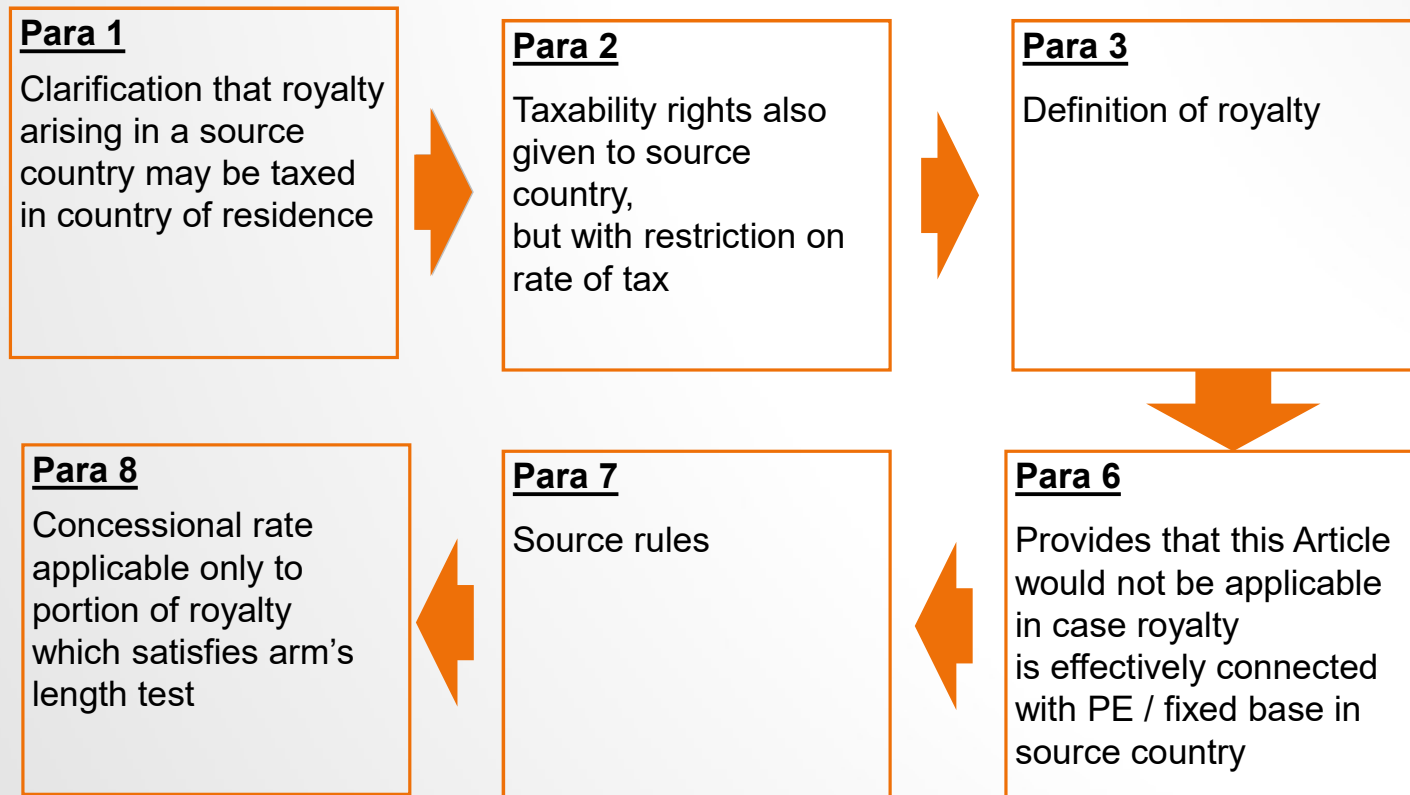
Section 115A

- ▶ Royalty (excluding Section 44DA) received by non-resident from Govt. or Indian Concern under agreements approved by Central Government or in accordance with Industrial policy (except copyright in book/ computer software to Indian Concern/Resident - taxable on gross basis at 10 percent*

EFFECTIVELY CONNECTED

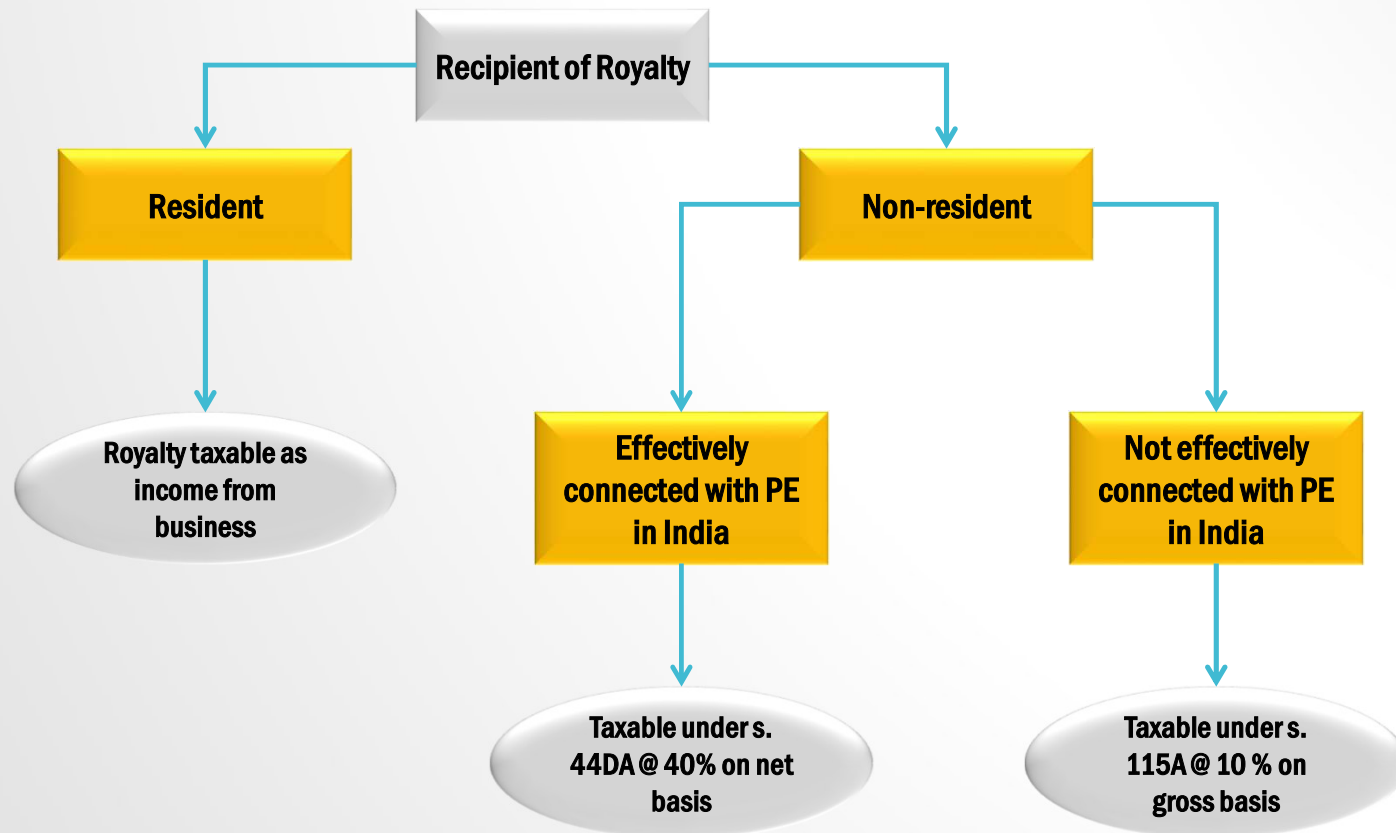
- ▶ **Mere existence of PE in source state is not enough**
- ▶ **Effective connection is equivalent of integral nexus, something really and intimately connected**
 - ▶ Set up, functions, purpose and duration of PE relevant in determining 'effective connection'
- ▶ **Economic ownership of right / property in respect of which royalty is paid should be allocated to PE**
 - ▶ Economic ownership to be judged having regard to fiction of 'separate enterprise'
 - ▶ PE should be exposed to gain or losses related to the property
 - ▶ PE should have the ability to exploit IPRs in its own right
- ▶ **Eg. IPRs resulting from activities of PE**

TYPICAL STRUCTURE OF ROYALTY ARTICLE UNDER A TREATY



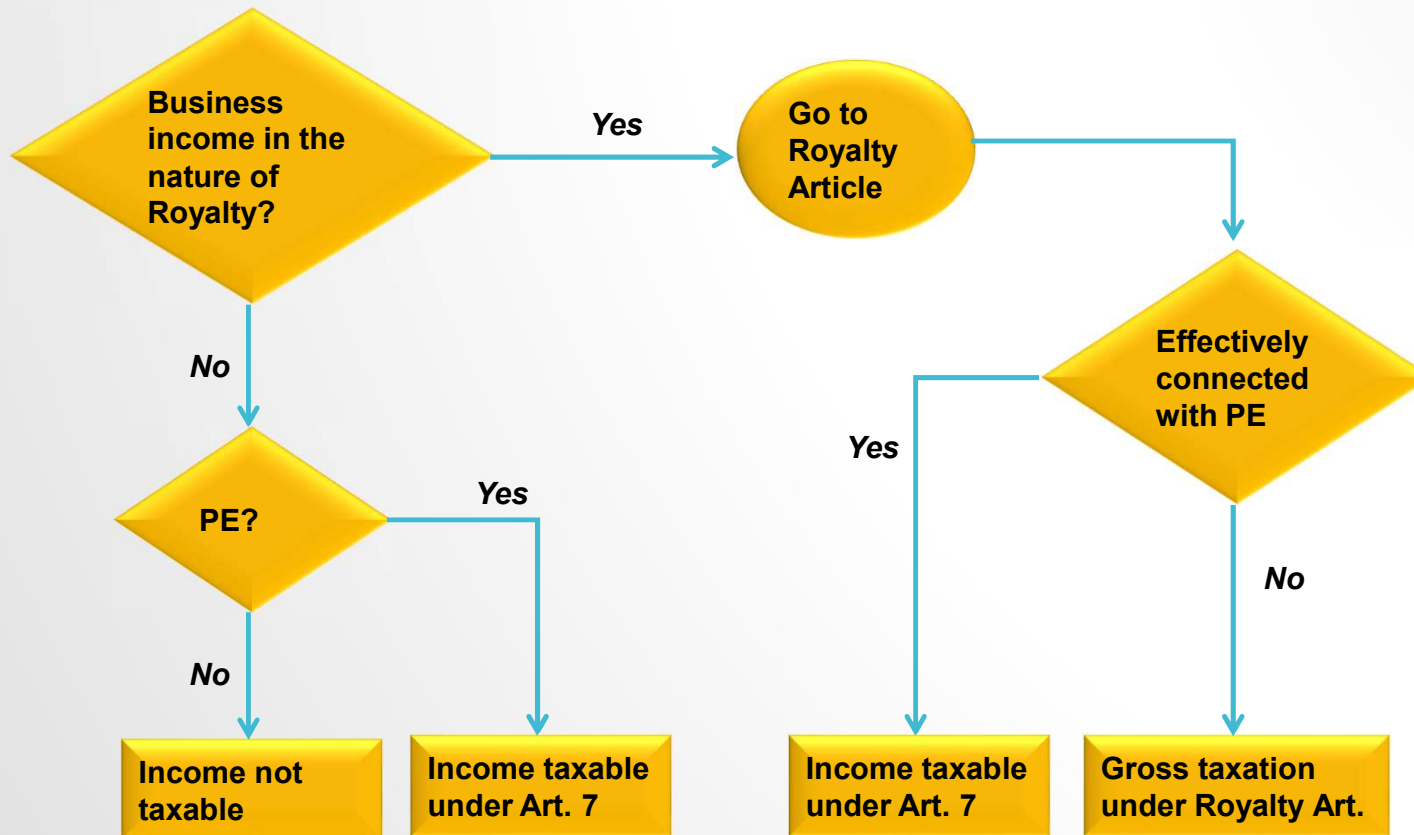
ROYALTY UNDER ITA

EFFECTIVELY CONNECTED WITH PE



DEFINITION UNDER MODEL TAX CONVENTIONS

INTERPLAY BETWEEN ART. 7 AND ART. 12



TREATY VARIATIONS

Country	Specific inclusions
Singapore	Gains from alienation of IPRs
US, Canada	Gains derived from alienation of IPR which are contingent on productivity, use, etc.
Malaysia, Morocco, Namibia, Russia, etc	Computer Software programme
Hungary	Transmission by satellite, cable, optic fiber or similar technology
Greece, Egypt	Royalty taxed only in source state

PRODUCT VS UNDERLYING IPR

Product	Embedded IPR content	What does licensee of IPR expect?	What does purchaser of product get?
Medicines/ Drugs	Patent	License to manufacture	Ownership of drug
Books	Copyright	Publishing house wants right of reproduction	Ownership of books
Packaged drinking water	Trademark	Franchisee wants right to manufacture and sell under trademark	Ownership of product

Receipt constitutes Royalty

Receipt constitutes price

SOFTWARE AS A ROYALTY ?

Position under Act

- Explanation 4 to section 9(1)(vi) inserted by Finance Act, 2012 provides any right, property or information includes and has always included transfer of all or any right for use or right to use a computer software (including granting of a license) irrespective of the medium through which such right is transferred
- The amendment by Finance Act, 2012 removed the difference between software as a copyright vs copyrighted product and sought to tax payment for software notwithstanding the medium through which right was transferred.



Position under certain treaties

- The definition provided under the DTAA is the very short and restrictive definition, whereas, the definition of the royalty as provided under the Income Tax Act is a very wide and inclusive definition but the same seems to be somewhat vague also.
- Payment for supply of software in some DTAA is not in the nature of 'royalty' because the same was for a copyrighted article and not for a copyright.
- Computer software has been recognized as a separate item not only in 2nd proviso to clause (vi) but in "Explanation 4" . The term "computer software" has not been included in the meaning and scope of the term "literary work" under clause (v) to Explanation 2.
- The Hon'ble Delhi High Court in the case of DIT vs. Nokia Networks OY [2012] Taxmann.com 225 (Delhi) has held that though Explanation 4 was added to section 9(1)(vi) by the Finance Act 2012 with retrospective effect from 1.6.1976 to provide that all consideration for user of software shall be assessable as "royalty", the definition in the DTAA has been left unchange



SOFTWARE AS A ROYALTY ?

- In a recent judgment in the case of DIT Vs New Skies Satellite BV, (ITA 473/2012 vide order dated 08.02.2016), the Hon'ble Delhi High Court has observed that no amendment to the Act, whether retrospective or prospective can be read in a manner so as to extend its operation to the terms of an international treaty.
- That an amendment to a treaty must be brought about by an agreement between the parties. Unilateral amendments to treaties are therefore categorically prohibited. Even the Parliament is not competent to effect amendments to international instruments. Therefore, mere amendment to Section 9(1)(vi) cannot result in a change

SOFTWARE TAXATION – CONFLICTING DECISIONS

	Pre amendment scenario	Post amendment
	<ul style="list-style-type: none"> • Ericsson (2011) (Del HC) • Motorola Inc. (Delhi SB) • Dassault Systems K.K. (AAR) • Novell Inc (2011) (Mum ITAT) 	<ul style="list-style-type: none"> • Nokia Networks OY (2012) (Del HC) • Infracsoft (2013) (Del HC) • Convergys Customer Management Group Inc. (2013) (Del ITAT) • DDIT vs. Reliance Industries Ltd (ITAT Mumbai)(2016)
	<ul style="list-style-type: none"> • Samsung Electronics (2011) (Kar HC) • Sunray Computers (2011) (Kar HC) • Synopsys International Old Ltd (Kar HC) • Solid Works Corporation (2012) (Mum ITAT) 	<ul style="list-style-type: none"> • P.S.I. Data Systems (2012) (Kar. HC) • Reliance Infocom Ltd. (2013) (Mum ITAT) • Citrix Systems Asia Pacific Pty Ltd (2012) (AAR) • Acclerys K. K. (2012) (AAR)

The Basic Principle on which various adverse and favorable rulings are adjudged:

 **Favourable** Copyrighted article' is different from 'Copyright' itself. (Ericsson)
 **Adverse** Right to make a copy is part of the Copyright itself. (Samsung)

FEE FOR TECHNICAL SERVICES (FTS)



FEES FOR TECHNICAL SERVICES (FTS)

Domestic Law:

- Consideration (including lump sum consideration) for rendering of:
 - Technical services
 - Managerial Services
 - Consultancy services
- Includes provision of services of technical or other personnel
- Excludes consideration for:
 - Construction, assembly, mining or like project; or
 - Amount chargeable as salaries

FTS

Emphasis on Source rule

- Section 9(1)(vii) of the Act provides that income by way of **FTS** shall be deemed to accrue or arise in India, if payable by
 - the Government, or
 - a resident, **except where** the fees are payable
 - for services utilised in a business or profession carried outside India, or
 - for earning any income from any source outside India
 - a non-resident, **where** the fees are payable
 - for services utilised in a business or profession carried in India, or
 - for earning any income from any source in India
- Income of a non-resident shall be deemed to accrue or arise in India and shall be included in the total income of the non-resident, whether or not
 - the non-resident has a residence or place of business or business connection in India; or
 - the non-resident has rendered services in India

FTS

- **Accordingly, FTS receipt taxable in India regardless of**
 - residential status of the recipient
 - situs and mode of rendition of services
 - purpose whether personal or non-personal
 - situs and currency of receipt
 - situs of conclusion of contract

MEANING OF MANAGERIAL SERVICE

- ▶ A managerial service is one which pertains to or has the characteristics of a “manager”.
- ▶ Manager administers or supervises the business affairs
- ▶ Manager is involved in Controlling, directing or administering the business
- ▶ In order to qualify as managerial services, it is necessary that there should be an independent application of thought process by the service provider in its activities and it should not be acting on behalf of the service recipient as its agent.
- ▶ A managerial service has a definite human element attached to it. Can only be rendered with human intervention. Machine can not render managerial services



MEANING OF MANAGERIAL SERVICE

Judgement

• Managerial services explained

R Dalmia vs CIT [1977] (SC)

- The term “management” includes the act of managing by direction, or regulation or superintendence.

Linde A.G. vs ITO [1997] (Mum ITAT)

- ‘Managerial service’ entails adoption and execution of various policies of an organization and is of permanent nature for the organisation as a whole

'Credit Lyonnais vs ADIT [2013] (Mum ITAT)

- Managerial service' essentially involves controlling, directing or administering the business. When one talks of rendering 'managerial services' in relation to some activity, it is the management of such overall activity. 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.

MEANING OF TECHNICAL SERVICE

- ▶ Technical Service means a service involving technical or scientific knowledge/ assistance/ experience.
- ▶ Special skills or knowledge or education related to a technical field are required for the provision of such services.

Judgement

• **Technical services explained**

Kotak Securities [2016] (SC)

- Services rendered by BSE were not “technical services” as they were not specialized, exclusive or customized to individual requirement of the members.
- 'Technical services' like 'Managerial and Consultancy service' would denote seeking of services to cater to the special needs of the consumer/user as may be felt necessary and the making of the same available by the service provider.

MEANING OF TECHNICAL SERVICE

Judgement

• Technical services explained

CIT v. Bharti Cellular Ltd. [2009]
(Del HC)

- Expression 'technical services' takes colour from the expression 'managerial services and consultancy services' which necessarily involves a human element or, what is now a days fashionably called, human 'interface'.
- Services rendered did not involve any human interface and, therefore, could not be regarded as technical services

Skycell Communications Ltd.[2001]
(Madras HC)

- Mere collection of a 'fee' for use of a standard facility provided to all those willing to pay for it does not amount to the fee having been received for technical services.

MEANING OF CONSULTANCY SERVICE

- Consultancy services involves giving of an advice/ opinion/ recommendations or counselling or advisory service by a professional.
- Advice by someone like a professional, having special qualifications
- Technological expertise/special knowledge essential

Judgement

• Technical services explained

Intertek Testing Services India Pvt. Ltd. [2008] (AAR)

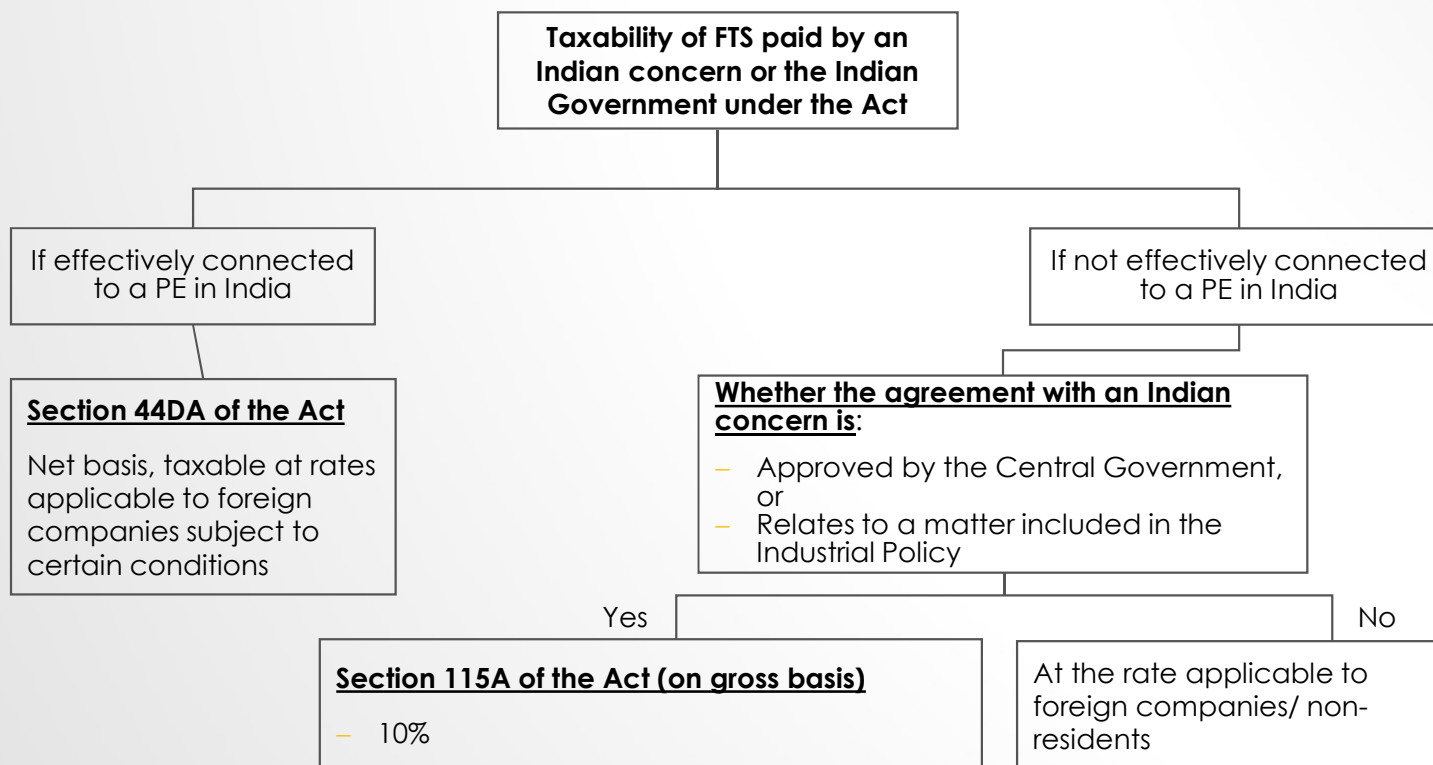
- Advisory service which merely involve discussion and advice of routine nature or exchange of information cannot appropriately be classified as consultancy services. An element of expertise or special knowledge on the part of the consultant is implicit in the consultancy services

CIT v. Bharti Cellular Ltd. [2009] (Del HC)

- Service of consultancy necessarily entails human intervention. The consultant, who provides the consultancy service, has to be a human being. A machine cannot be regarded as a consultant.

FTS

Section 44DA and Section 115A of the Act



**MAKE AVAILABLE
CLAUSE**

MEANING OF “MAKE AVAILABLE”

- Some of the DTAA's contain a restrictive definition of FTS/FIS requiring satisfaction of make available condition- USA, UK, Singapore, Netherlands, Cyprus etc.
- The DTAA's which contain 'make available' clause provide that Fee for Technical Services paid by a resident to a non resident shall be liable to tax only if such services 'make available' technical knowledge, experience, skills, know-how etc.
- Some tests to check whether services have been 'made available'
 - The service recipient is enriched with enough knowledge to independently apply those services
 - Technical knowledge, skills etc. remain with the person receiving the service even after agreement comes to an end
 - The technical knowledge or skills of the provider are transferred/imparted to the recipient
 - The recipient is in a position to deploy similar skills or technology or techniques in future without assistance of service provider
 - If services are recurring and have to be performed year on year by provider, no 'make available' of technical knowledge, skill etc.

CASE LAWS ON “MAKE AVAILABLE”

- Raymonds (80 TTJ 120 , Mum ITAT)
- DCIT vs. PanamDat International Systems Inc (103 TTJ 861)
- CIT vs. Navbharat Ferro Alloys Ltd (244 ITR 261, AP HC)
- DCIT vs ITC Ltd (82 ITD 239 , Kol ITAT)
- CIT vs. Hindustan Shipyard Ltd.(109 ITR 158, AP HC)
- CIT vs. Sundwinger Empg & Co. (262 ITR 110, AP HC)
- Guy Carpenter & Co.Ltd. (346 ITR 504, Delhi HC)
- Debeers India Minerals Ltd. (346 ITR 467, Kar HC)

Peculiar features of various DTAA's

Peculiar features	DTAA
No FTS Clause	Brazil, Thailand, Greece, Mauritius, Sri Lanka
Separate Article for Royalty and FTS	Malaysia, Mauritius, Israel, Oman
FTS and Royalty Clause in same Article	Austria, Belgium, China, Germany, Netherlands
Fees for Included Services (FIS)	USA, Canada, Cyprus, Singapore, Netherlands
Managerial Services not included in FTS	Australia, Netherlands, Canada, UK, USA
Restrictive definition of FTS presence of 'Make Available' clause	USA, UK, Singapore, Netherlands, Cyprus
'Make available' imported through Most Favored Nation clause	Spain, Belgium, Switzerland, Sweden

Absence of Article on FTS in DTAA

In DTAA's which do not contain FTS clause:

- Whether income would be taxed as business income under Article 7?
- Whether income would be taxed under the residuary Article 'Other Income'? Or
- Whether income would be taxed as per provisions of the Act?

View	Decision	Held
1st View	Channel Guide India Ltd vs ACIT (2012) (Mum); Mckinsey & Co (Thailand) Co. Ltd. vs DDIT(2013) (Mum); Bangkok Glass Industry Co Ltd vs ACIT(2013) (Mad)	In absence of FTS clause in the DTAA, income governed as per Article on Business Profits and would be taxed in India only if the taxpayer had a PE in India.
2nd View	Lanka Hydraulik Institute Ltd, In Re (2011) (AAR); XYZ, In Re (2012) (AAR)	In absence of FTS clause, income to be taxed under the 'Other Income' Article.
3rd View	CIT vs TVS Electronics (2012) (Chennai)	In absence of FTS clause, income cannot be construed as business profits and reference should be made to provisions of the Act

WHAT IS MFN CLAUSE ?

- Extends similar benefits to one country as extended to certain other countries
- Attempts to avoid discrimination between a subset of countries/resident of different countries
- Normally benefit under this clause is restricted to a specific group like OECD countries or developing countries
- MFN clause usually found in Protocols, Exchange of notes and sometimes in the Treaty itself
- Examples of MFN-in terms of
 - Rates of taxes
 - Liability to tax
 - Deductions permissible

MFN CLAUSE IN INDIA TAX TREATIES

- In a typical MFN situation, India grants the residents of the MFN, the same beneficial treatment made available by it to the resident of a third country
 - Generally triggered or activated when India enters into a more beneficial provision with a third country under a bilateral agreement
 - Has reciprocal application – benefits extends to Indian residents also
- Examples of Indian tax treaties having MFN Clauses
 - OECD Member States – Belgium, France, Hungary, Israel, Netherlands, Spain, Sweden, Finland and Switzerland
 - Non-OECD States – Kazakhstan, Nepal, Philippines, Russia and Sri Lanka

THANK YOU



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