Seminar on International Taxation

Deeming provisions in respect of non-residents

Section 9 - Indirect transfer of shares, Interest, Royalty, Fees for technical services

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Contents

Scheme of taxation for a non-resident

Under the Income Tax Act 1961 ('the Act')

Section 5 inter-alia states that a non-resident shall be liable to tax in India in respect of:

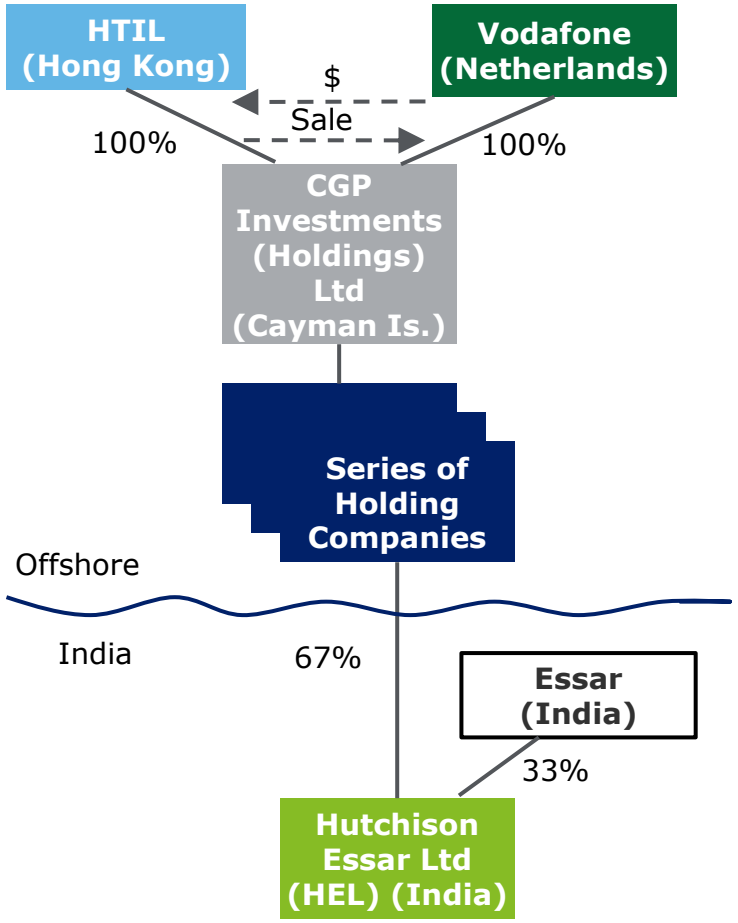
Income received or deemed to be received in India → Income which accrues or arises in India → Income deemed to accrue or arise in India in terms of section 9 of the Act

Section 9 of the Act is a deeming fiction created by law to deem certain incomes as taxable in India. Certain deeming fictions are discussed in subsequent slides

Indirect transfer of shares

Indirect transfer of shares

Background - Section 9(1)(i)



- Vodafone International Holdings B.V [Vodafone], registered in Netherlands, sought to expand its footprint in the Indian Telecom market by acquiring entire stake in a Hutchison Group company situated in Cayman Islands which in turn had an Indian subsidiary (HEL)
- The Indian tax authorities sought to bring the aforesaid transaction between two non-resident companies (HTIL and Vodafone) under the Indian tax net contending that by means of the aforesaid transaction effectively interest in HEL was sought to be indirectly transferred and the same was eligible to capital gains tax as per the Indian tax statute
- Vodafone filed a writ petition in Bombay High Court challenging the income tax authority's notice. Bombay HC dismissed the writ petition stating deeming accrual provisions in the tax statue were wide enough to include within its ambit the said transaction. Vodafone escalated the matter to the Indian Supreme Court which delivered a landmark judgment in the favor of Vodafone stating, inter-alia, the deeming provisions in the tax statues could not by a process of interpretation be extended to cover indirect transfers of capital assets/property situated in India

Indirect transfer of shares

Background - Section 9(1)(i)

- The relief from the favorable judgment was short-lived. The Indian legislator made sweeping changes to the Indian tax statute *vide* The Finance Act 2012 which were far-reaching and expanded various provisions to capture indirect transfers
- **Explanation 5 – Finance Act, 2012**

  "For the removal of doubts, it is hereby clarified that 'transfer' includes and shall be deemed to have always included disposing of or parting with an asset or any interest therein, or creating any interest in any asset in any manner whatsoever, directly or indirectly, absolutely or conditionally, voluntarily or involuntarily, by way of an agreement (whether entered into in India or outside India) or otherwise, notwithstanding that such transfer of rights has been characterised as being effected or dependent upon or flowing from the transfer of a share or shares of a company registered or incorporated outside India"
- The aforesaid amendments were made with a retrospective effect from 1962. This was done with intent to effectively nullify the favorable judgment by the Supreme Court in the favor of the non-resident taxpayers. Pursuant to the amendments becoming effective retrospectively, the tax authorities latched a demand on Vodafone along with penalty and interests
- The amended law not only impacted Vodafone but numerous of similar other deals including the much-publicized Cairn Energy deal

Indirect transfer of shares

Section 9(1)(i)

Term "substantially" defined

- Share or interest in a foreign company/ entity which derives its value substantially from assets located in India where value of Indian assets:
  - exceeds Rs.10 crore and
  - represents at least 50% of value of all assets owned by the foreign company / entity

Reporting obligation on Indian company

- Furnish information relating to offshore transaction having the effect of directly or indirectly modifying ownership structure or control of Indian company
- Penalty leviable on Indian company for non-reporting
- ***Does reporting obligation have to be complied with even if indirect transfer of shares is not taxable?***

  As per section 285A, once indirect transfer provisions are triggered (i.e., foreign entity derives value substantially from assets located in India), irrespective of taxability of capital gains, Indian entity has to comply with reporting obligations. Hence, it is recommended that reporting be done even if capital gains are not ultimately taxable

Indirect transfer of shares

Explanations and rules to Section 9(1)(i) are retrospective or prospective?

- The Delhi ITAT laid down an important principle that the provisions of explanation 6 and 7 to section 9(1)(i) of the Income Tax Act 1961 have to be tagged along with explanation 5 to section 9(1)(i) of the Act and have to be given a retrospective effect [**Augustus Capital Pte Ltd v. DCIT ITA no 8084/IDel/2018 (Delhi ITAT)**]

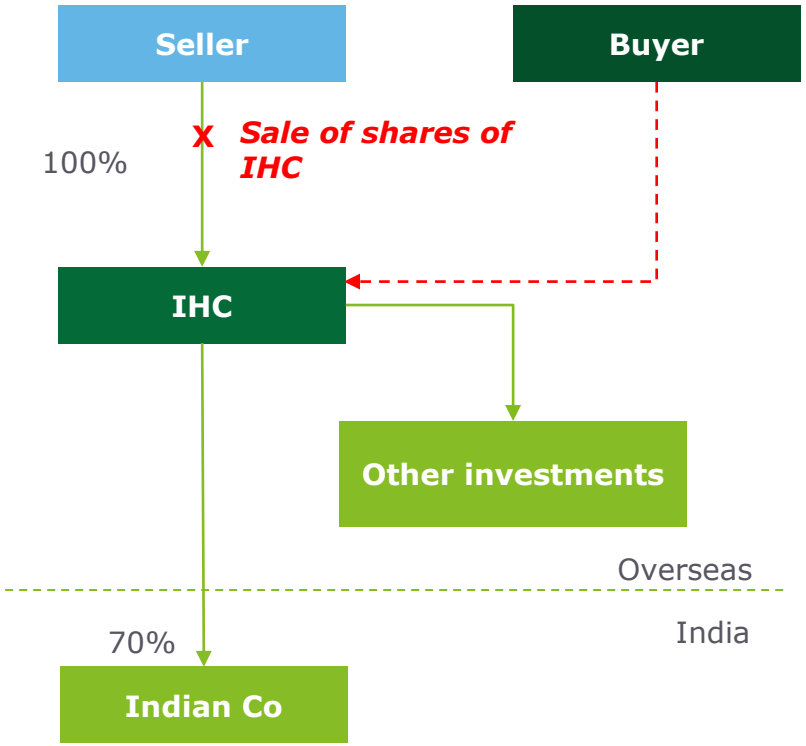
- From 2012 to 2015 the word "substantially" appearing in Explanation 5 to section 9(1)(i) was not defined in the Act. However, it was held that "substantially" will mean at least 50% [**DIT (international) v. Copal Research Ltd. (2015) 371 ITR 114]**

- No specific discussion in any judgements, on whether the Rules can be applied retrospectively or prospectively

- But, in the case of **GEA Refrigeration Technologies GmbH [A.A.R. No 1232 of 2012] (AAR, New Delhi)** the AAR has adopted Rule 11UB in determining substantial interest to a transaction concluded prior to 2012 thereby giving it retrospective affect

Indirect transfer of shares

Case Study



Particulars	Amount ₹ in million
Value of all assets of IHC	500
Value of all assets of Indian Co	300
Underlying value of indirect transfer	210
% of value of IHC derived from Indian assets	42%

Condition I :

Satisfied as value is more than ₹10 crores

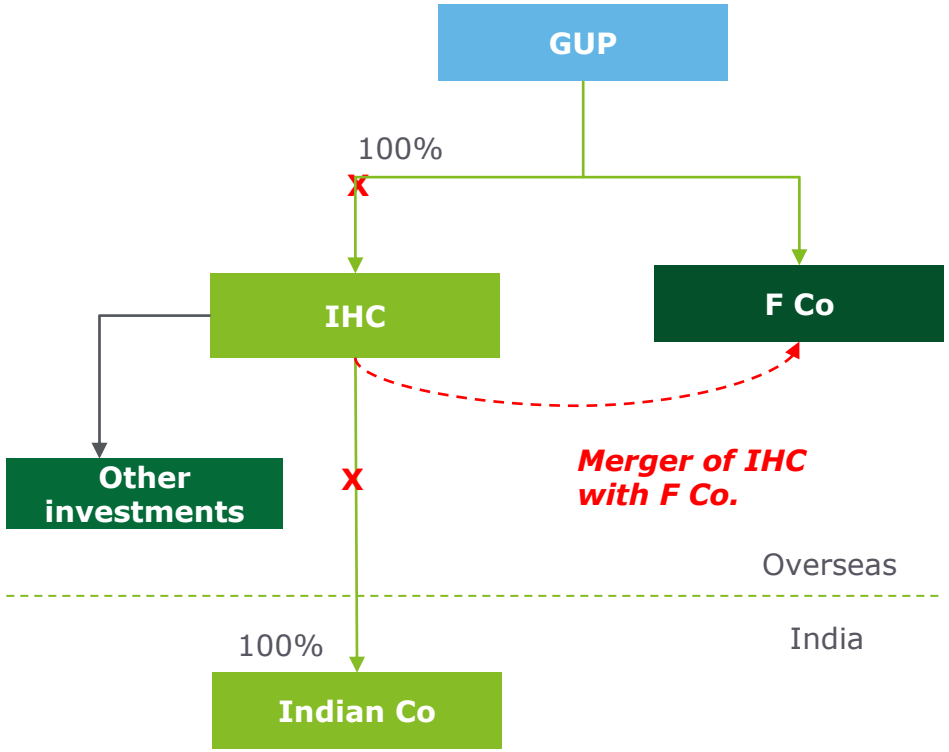
Condition II:

Not satisfied as less than 50% of value of IHC is derived from Indian assets

Therefore, sale of shares of IHC shall not be taxable in India

Indirect transfer of shares

Case Study



Particulars	Amount ₹ in million
FMV of IHC	500
FMV of Indian Co	260
% of value of IHC derived from Indian assets	52%

Condition I :

Satisfied as value is more than ₹10 crores

Condition II:

Satisfied as more than 50% of value of IHC is derived from Indian assets

Therefore, in this case direct and indirect transfer of shares is triggered:

- **Direct transfer of shares of Indian Co by IHC; and**
- **Indirect transfer of shares of Indian Co by GUP**

Indirect transfer of shares

Treaty provisions

Finance Minister speech on treaty benefits

- Reference can be made to speech of the then Finance Minister in Parliament on May 7, 2012. Relevant extract:

  "Hon'ble Members are aware that a provision in the Finance Bill which seeks to retrospectively clarify the provisions of the Income Tax Act relating to capital gains on sale of assets located in India through indirect transfers abroad, has been intensely debated in the country and outside. ***I would like to confirm that clarificatory amendments do not override the provisions of Double Taxation Avoidance Agreement (DTAA) which India has with 82 countries. It would impact those cases where the transaction has been routed through low tax or no tax countries with whom India does not have a DTAA****"*

  In view of the legislative intent underlying the amendatory exercise, the retrospective amendments cannot override the treaty provisions [**Sanofi Pasteur Holding S.A. [2013] 30 taxmann.com 222 (Andhra Pradesh)**]

Can reference be made to Finance Minister's speech while interpreting law?

- While the speech of the Finance Minister would not override the literal interpretation of tax laws, the Supreme Court's judgement in the case of **Sole Trustee Loka Sikshana Trust [1975] 101 ITR 234 (SC)** and **K.P. Varghese [1981] 7 Taxman 13 (SC)** authorize reference to a speech of a Bill, particularly of the Finance Minister regarding a fiscal legislation, to ascertain the object and purpose of the legislative measure and to get a fix on the context
- Various judicial precedents have taken into account the provisions of treaty while adjudicating on matters of taxability of indirect transfer of shares. Hence, relevant to analyse treaty provisions

Indirect transfer of shares

Treaty provisions

Article 13: Capital gains

- Covers gains on 'alienation' of property
  - ✓ **Wide enough to cover sale, exchange, gift, etc.**
- Various categories of Capital Gains which inter-alia includes capital gains from alienation of shares
  - ✓ **Varied treatment under different tax treaties**
  - ✓ Generally, treaties provide that gains from alienation of shares in a company which is **resident** of a contracting state/ **situated** in a contracting state will be taxed in such state (para 4). In an indirect transfer scenario, in absence of alienation of shares of an Indian company the same cannot be said to be taxable in India
  - ✓ **Residuary clause (para 5):** Any other gains from alienation of shares taxable in the country of which alienator/ company is resident. Hence, position can be taken that indirect transfer is not taxable in India
  - ✓ **Exceptions**: Few treaties such as India-USA, India-UK and India-Canada taxes capital gains on alienation of shares as per domestic laws. Hence, indirect transfer of shares would be taxable in India. Reliance cannot be placed on FM speech to claim exemption

Indirect transfer of shares

Treaty provisions

Judicial precedents which conferred benefit of residuary clause

- The Andhra Pradesh High Court adopting India-France DTAA has held that where shares of a company, which was a resident in France were transferred, the resultant capital gains shall be taxable only in France. **The underlying interest of the France company in the shares of an Indian company is irrelevant** [**Sanofi Pasteur Holding S.A. [2013] 30 taxmann.com 222 (Andhra Pradesh)**]

- Explanation 5 to section 9(1)(i), by no means could be stretched beyond comprehension for treating a foreign company itself to be a resident of India. Therefore, as the transfer was not of an Indian company's shares, the taxability of the transfer right lies with the country of which the 'alienator' is a tax resident. [**Sofina S.A. v. ACIT [2020] 116 taxmann.com 706 (Mumbai - Trib.)]**

- It was held by AAR based on the examination of India-Germany treaty that the gains arising from the alienation of shares can be brought to tax only in Germany because the alienators were tax residents of Germany, transfer has been affected in Germany, and the payments have also been made in Germany [**GEA Refrigeration Technologies GmbH [A.A.R. No 1232 of 2012] (AAR, New Delhi)**]

Indirect transfer of shares

Treaty provisions

Denial of treaty benefits (tax avoidance)

- Treaty benefit denied by holding that the company is a shell company interposed merely few days before the transaction with no commercial rationale. It was further emphasised that holding TRC cannot prevent an enquiry if it can be established that interposition of a company was a device to avoid tax **[Bid Services Division (Mauritius) Ltd. [2020] 114 taxmann.com 434 (AAR - Mumbai)]**

- AAR did not admit the case for hearing since it was prima facie a device for tax avoidance. AAR observed that key personnel managing and controlling the business were not part of the board and located in another jurisdiction **[Tiger Global International II Holdings, In re [2020] 116 taxmann.com 878 (AAR-New Delhi)]**

International tax update

Arbitration award in case of Vodafone and Cairn under the respective Bilateral Investment Treaty (BIT)

Arbitration Award

Particulars	Vodafone International Holdings B.V	Cairn UK Holdings Ltd
BIT which was used to initiate arbitration	India – Netherlands	India - United Kingdom
Court	Permanent Court of Arbitration, The Hague, Netherlands	Permanent Court of Arbitration, The Hague, Netherlands
Excerpt of the award as available in public domain	The Respondent's conduct in respect of the imposition of the Claimant of an asserted liability to tax notwithstanding the Supreme Court Judgement is in breach of the guarantee of fair and equitable treatment laid down in Article 4 (1) of the Agreement, as is the imposition of interest on the sums in question and the imposition of penalties for non-payment of the sums in question	Declares that the Respondent has failed to uphold its obligations under the UK-India BIT and international law, and in particular, that it has failed to accord the Claimants' investments fair and equitable treatment in violation of Article 3(2) of the Treaty
Respective article of the BIT - Netherlands – 4(1) - United Kingdom – 3(2)	Investments of investors of each contracting party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other contracting party	Investments of investors of each contracting party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other contracting party
Whether tax disputes specifically excluded from scope of the BITs	No	No

Rules, other relevant provisions and circulars

Indirect transfer of shares

Relief from indirect transfer provisions

Explanation 7 - Small investors who do not hold right of management or control or voting power or share capital or interest exceeding 5% of the foreign company

Section 47(viab)/ 47(vicc) – Inter group restructuring in the form of amalgamation and demerger)

Proviso 1 to Explanation 5 - Investment in a Foreign Institutional Investor from AY 2012-13 to AY 2014-15

Proviso 2 to Explanation 5 - Investment in Category-I or Category-II foreign portfolio investor under SEBI (FPI) Regulations, 2014

Proviso 3 to Explanation 5 - Investment in Category-I foreign portfolio investor under SEBI (FPI) Regulations, 2019

Indirect transfer of shares

Rules on indirect transfer: Notification 55/2016 dated 28 June 2016

Rule 11UB	Manner of Computation of FMV of tangible and intangible assets
Rule 11UC	Determination of Income attributable to assets in India = $\frac{\text{Income from transfer as per the Act x FMV of assets located in India on specified date}}{\text{FMV of all assets of the company/ entity as on specified date}}$
Rule 114DB	Documents to be furnished as per Section 285A: • **Form No, 3CT –** Transferor to obtain CA certificate that the income attributable to assets in India has been correctly computed • **Form 49D –** To be furnished by Indian entity within a period of 90 days from end of FY in which transfer of share or interest in an Indian company / entity or foreign company / entity took place

Indirect transfer of shares

Relief from indirect-transfer provisions

CBDT Circular No 28, 2017

- CBDT issued a Circular clarifying that the **Indirect transfer provisions will not apply to income accruing or arising to a non-resident on account of redemption or buyback of share / interest held indirectly in specified funds in India (being a VCF or a Category I or II AIF), if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds, and such income is chargeable to tax in India**

CBDT Circular No 4, 2015

- The CBDT, had also issued a circular dated March 26, 2015, clarified that the indirect tax provisions **are not applicable to dividends declared by a foreign company outside India that does not have the effect of transferring any underlying assets located in India**.
- In light of the Circular, dividend income received by the underlying investors from offshore Fund shall not fall within the ambit of provisions relating to taxation of indirect transfers
- Hence, many Offshore Funds upstream the sale proceeds in the following manner – redemption of shares to the extent of capital invested and any gains to be distributed as dividend

Indirect transfer of shares

Other relevant provisions under the Act

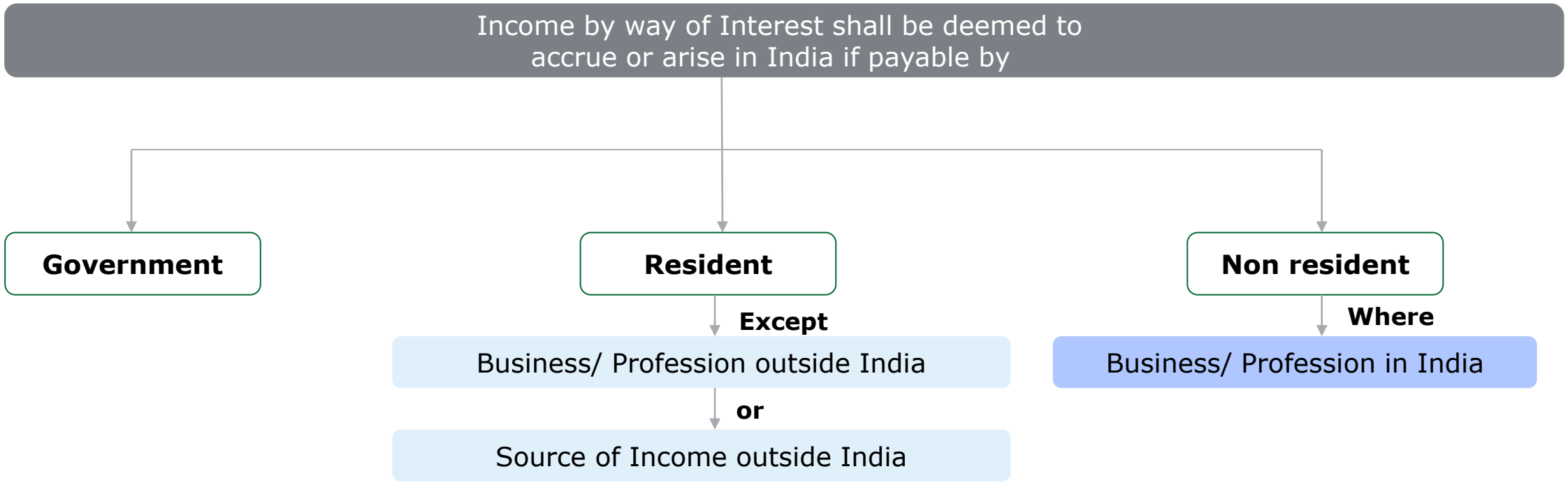
- Section 50CA – If consideration received on transfer of unquoted shares, is less than its FMV, such FMV shall be deemed to be the full value of consideration for purpose of computation of capital gains in the hands of transferor
- Section 56(2)(x) - If shares are received for consideration less than the FMV then difference between excess of such FMV over the actual consideration will be taxable in hands of transferee as IFOS
- Transfer pricing provisions shall apply in case transaction is between two or more associated enterprises
- Payer to comply with withholding tax provisions under section 195

Interest, Royalty and Fees for technical services

Source outside India

Interest

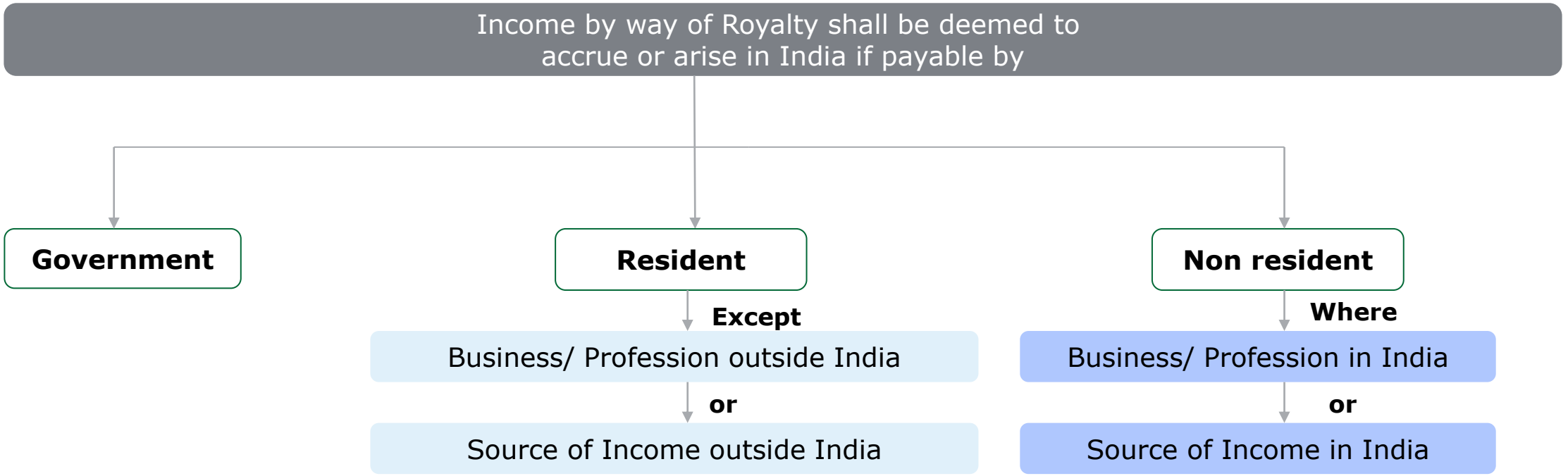
Interest deemed to accrue or arise in India – Section 9(1)(v)



Residential status of recipient of interest is not relevant in determining taxability of interest in India

Royalty

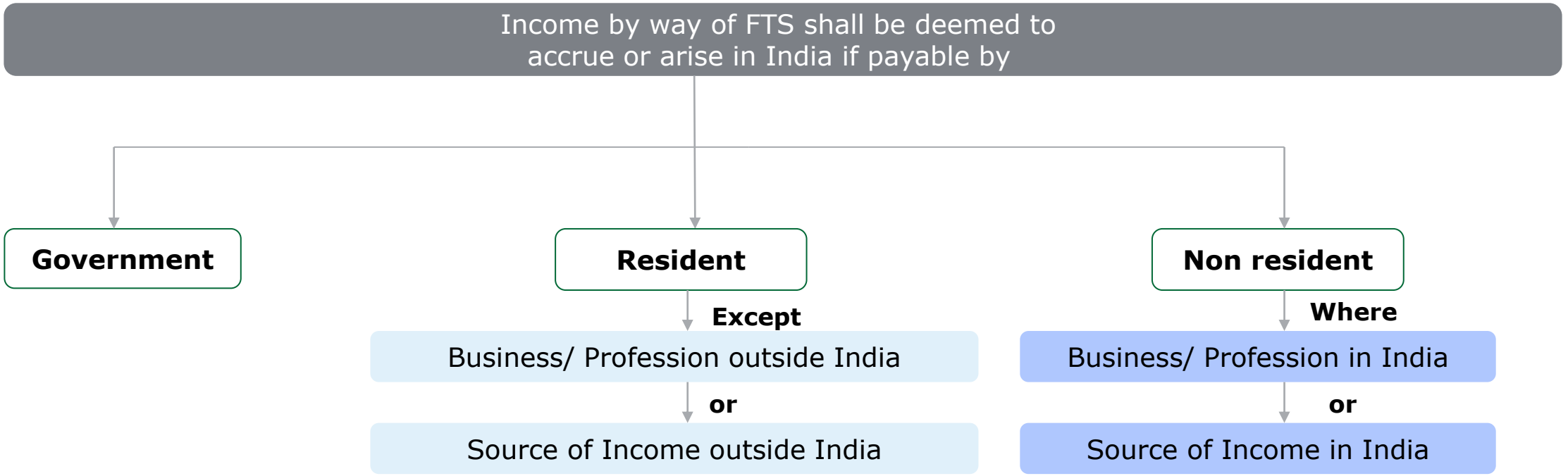
Royalty deemed to accrue or arise in India – Section 9(1)(vi)



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

Fees for Technical Services

FTS deemed to accrue or arise in India – Section 9(1)(vii)



Residential status of recipient of FTS is not relevant in determining taxability of FTS in India

Source outside/ in India

Interest, Royalty and Fees for Technical Services

- Interest paid to non-resident is not taxable in India, if interest payment is in respect of amount borrowed outside India and is used outside India for investment or for business carried out outside India **[Adani Enterprises Ltd (29 taxmann.com 99) (Ahmedabad Tribunal)]**

- 'Source' does not refer to the person who makes the payment, but it refers to the activity which gives rise to the income [**Asia Satellite Telecommunication Company (85 ITD 478) (Delhi Tribunal)]**

- 'Source' for royalty paid by resident on export sales to a non-resident outside India is outside India [**Aktiengesellschaft Kuhnle Kopp and Kausch (262 ITR 513) (Madras HC)]**

- Source is referable to the starting point or the origin or the spot where something springs into existence. The fact that the customer and the payer is a non-resident and the end product is made available to that foreign customer does not mean that the income is earned from a source outside India **[Dell International Services India (P.) Ltd, AAR, New Delhi, [2008] 172 Taxman 418 (AAR)]**

- Since patent was registered outside country for making an income from a source outside country, amount paid was covered in exception provided in section 9(1)(vii)(b) **[Titan Industries Ltd v/s ITO (11 SOT 206)]**

- Export activity has taken place or has been fulfilled in India, so source of income is located in India and not outside and mere fact that export proceeds emanated from persons situated outside India does not constitute them as source of income. **[CIT v/s Havells India Ltd (352 ITR 376)]**

- The source of income is considered outside India if
  - ✓ Payer is a non-resident **or**
  - ✓ Contract with non-resident is made outside India **or**
  - ✓ Activity yielding income takes place outside India.

  [Lufthansa Cargo India Private Limited reported in (91 ITD 133)(Delhi HC)]

Interest

Interest

Definition – under the Act

Section 2(28A): Interest/ service fee or other charge payable in any manner in respect of any **moneys borrowed or debt incurred** (including a deposit, claim or other similar right or obligation) or in respect of any credit facility which has not been utilised

Explanation to section 9(v): Any interest payable by PE of foreign bank in India to its head office or any PE or any other part of such foreign bank outside shall be deemed to accrue or arise in India

Interest

Tax rates under the Act

Section 115A provides **20%** tax rate on interest income of non-resident or foreign company (not being income by way of interest referred to in Section 194LB or Section 194LC or 194LD)

Lower rates of tax provided for other specific type of interest payments:

Sl.No	Section	Particulars	Rate
1	194LB	Payment of interest by infrastructure debt fund	5%
2	194LC	Payment of interest by an Indian Company or a business trust in respect of money borrowed in foreign currency under a loan agreement or long-term infrastructure bonds by way of issue of rupee denominated bonds or long-term bonds which listed only in any IFSC	5%/ 4%*
3	194LD	Payment of interest on rupee denominated bond of an Indian Company or Government securities to a Foreign Institutional Investor or a Qualified Foreign Investor	5%

**In case where interest is payable in respect of Long-term Bond or Rupee Denominated Bond listed on recognized stock exchange located in IFSC*

Interest

Treaty

Article 11 of OECD and UN Model Convention 2017 defines the term interest

- Income from debt-claims of every kind, whether or not secured by mortgage or carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums and prizes attaching to such securities, bonds or debentures
- Penalty charges for late payments shall not be regarded as interest for the purpose of this article
- The definition does not normally apply to payments made under certain kinds of non-traditional financial instruments where there is no underlying debt (for example, interest rate swaps). However, the definition will apply to the extent that a loan is considered to exist under a "substance over form" rule, an "abuse of rights" principle, or any other similar doctrine

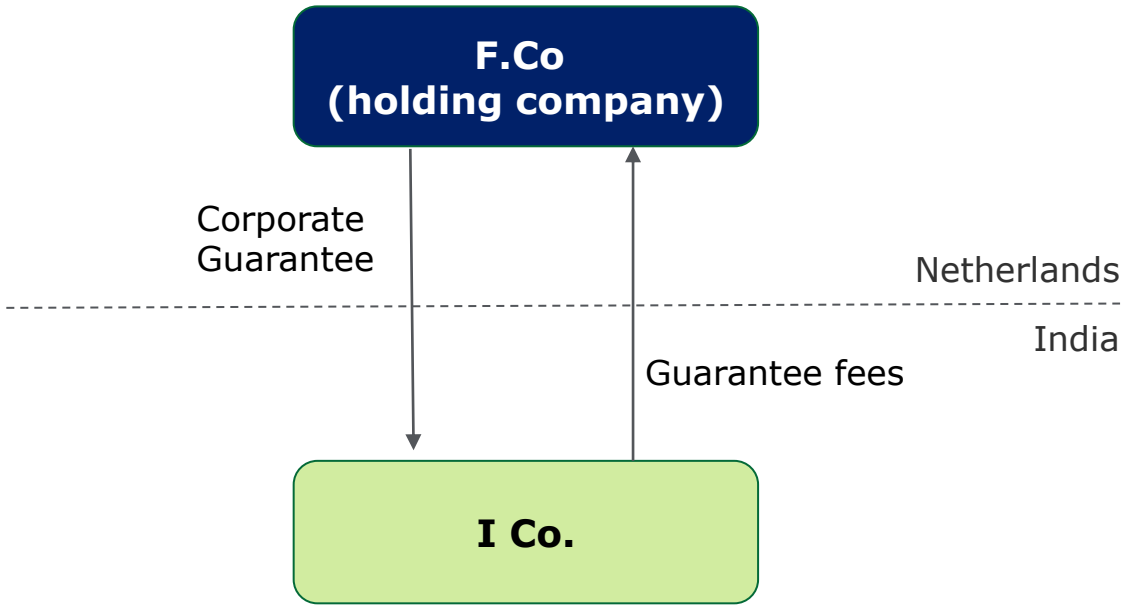
There is a wide definition in the OECD commentary which practically covers all the kinds of income which are regarded as interest in the various domestic laws

Other observations:

- The rate provided under the treaty is generally **10%/ 15%**
- In certain treaties such as Netherlands, Finland, Germany etc. exemption is provided w.r.t interest received by Government and certain institutions like RBI in the country of source
- Also, certain treaties such as Belgium, Denmark, Korea, Singapore etc. provide a lower rate of taxation only if loan is granted by banks

Interest

Case Study



Will payment of guarantee fee be considered as interest for withholding tax?

No, it was held in the case of Lease Plan India (P.) Ltd that where an Indian company pays corporate guarantee fee to its AE located in Netherlands, in absence of any provision of capital and debt claim between parties, amount so paid is not liable to tax as 'interest' in India under article 11 of India-Netherlands DTAA. **[Lease Plan India (P.) Ltd. ITA No. 6461 & 6462/Del/2015]**

Royalty

Royalty

Definition – Explanation 2 to Section 9(1)(vi)

Consideration (incl. lumpsum consideration) for:

Transfer of all or any rights (incl. granting of license) w.r.t	Imparting of any information concerning	Use of
• Patent, invention, model, design, secret formula or process or trademark, etc. (IP) • copyright, literary, artistic or scientific work including films or tapes used for television or radio broadcasting	• the working of or use of IP • technical, industrial, commercial or scientific knowledge, experience or skill	• any IP • or right to use any industrial, commercial or scientific equipment

Royalty also includes rendering any services in connection with the above

Consideration which would be income of the recipient chargeable under the head "Capital gains" is excluded

Royalty

Other explanations

Explanation 4	Explanation 5	Explanation 6
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	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	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 fiber or by any other similar technology, whether or not such process is secret

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

Royalty

Sale of product vs. underlying IPR

Underlying product	Embedded IPR content	What does Licensee of IPR expect?	What does Purchaser of product get?
Medicines	Patent	License to manufacture and sell	Ownership of drugs
Books	Copyright	Publishing house wants right of reproduction	Ownership of book
Packaged drinking water	Trademark	Franchisee wants right to manufacture and sell under trademark	Ownership of product
Washing machine	Know-how / experience	License to manufacture and sell.	Ownership of product

Royalty

Meaning of 'imparting of information concerning technical, industrial, commercial or scientific knowledge, experience or skill' ('know-how')

- Every information concerning the industries or commercial ventures does not qualify as royalty. Some sort of expertise or skill is required. Some sort of confidentiality/ secrecy & exclusivity is required. It should not be something readily available in the market.
  (CIT vs. HEG Ltd. (263 ITR 230) (MP)

- Allowing access and downloading business information reports, which is a compilation of publicly available commercial information is not royalty.
  (Dun & Bradstreet Espana SA (272 ITR 99) (AAR)

- Royalty signifies an extended or perpetual use for the payee, whereas FTS are relevant for one time job and useful for which they are rendered. For example, the copyrights, designs or plans confer a time-spread advantage to the payee. Similarly, information regarding an industrial 'experience', in the context, has to be interpreted as conferring similar perpetual or extended advantages, else there was no need to make a distinction between royalties and technical service fees .
  (Kirloskar Oil Ltd. (83 ITD 436) (Pune)

Royalty

Definition of use

- The application or employment of something; a long-continued possession and employment of a thing for the purpose for which it is adapted (Black Law Dictionary)

- Criteria for determination of right to use or use of equipment (OECD TAG Report)
  - Customer has physical control / possession over the equipment;
  - Customer has significant interest in the equipment;
  - Provider does not guarantee revenues;
  - Provider does not use the property concurrent to provide services to others.

- Use or right to use depends on the relation which exists as a matter of fact between the person and the property **(Tourapark Pty Ltd v FCT [12 ATR 842])**

- The expression 'use' (of copyright) is not used in a generic and general sense of having access to a copyrighted work. The emphasis is on the 'use of copyright or the right to use it'. In other words, if any of the exclusive rights, which the owner of copyright, is made over to the customer so that he could enjoy such rights either permanently or for a fixed duration of time and make a business out of it, then it would fall within the ambit of phrase 'use or right to use the copyright' (**Factset Research Systems Inc [182 Taxman 268]**)

Royalty

Exclusions to royalty - Capital gains

- The definition of royalty excludes any consideration which would be income of the recipient chargeable under the head 'Capital gains'

- Clause (i) and (iv) of the definition of royalty provides that transfer of all or any rights in respect of patent, invention, model, design, secret formula or process or trade mark, copyright, literary, artistic or scientific work, etc. would constitute royalty

- Definition of 'transfer' includes extinguishment of any rights in the asset as per section 2(47) of the Act

- Whether the transfer of all or any rights in patent, copyright, etc. can be treated as extinguishment of any right in the asset thereby chargeable under the head 'Capital gains'

- Tests to determine whether transfer of all or any rights in asset would constitute royalty
  - Ownership of the patent, copyright, etc. is not transferred [**HCL Limited (ITA nos. 93/2002 & 120/2008), Delhi Trib.]**
  - The asset is appearing in the books of transferor
  - The income received by the transferor is treated as revenue receipt **[Koyo Seiko Co. Ltd 233 ITR 421 (Andhra Pradesh HC)]**
  - The transferor does not forego his right to use the patent, copyright, etc. even after the rights are granted/ transferred to the transferee. **[Dr. K.P. Karanth 139 ITR 479 (AP High Court)]**
  - The transferee do not get enduring benefit out of the rights transferred
  - The transferee treats the payment made for rights as revenue expenditure

Royalty

Treaty

Section 90

Agreement with foreign countries or specified territories

Section 90A

Adoption by Central Government of agreement between specified associations for double taxation relief

Treaty

- Article 5 – Permanent establishment
- Article 7 – Business profits
- Article 12 - Royalties

Commentaries

- OECD model convention
- UN Model Double tax convention
- Commentaries on the article of the model tax convention

Royalty

Treaty

Royalty means 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, trade mark, design or model, plan, secret formula or process
- any industrial, commercial or scientific equipment, or for information concerning industrial, commercial or scientific experience

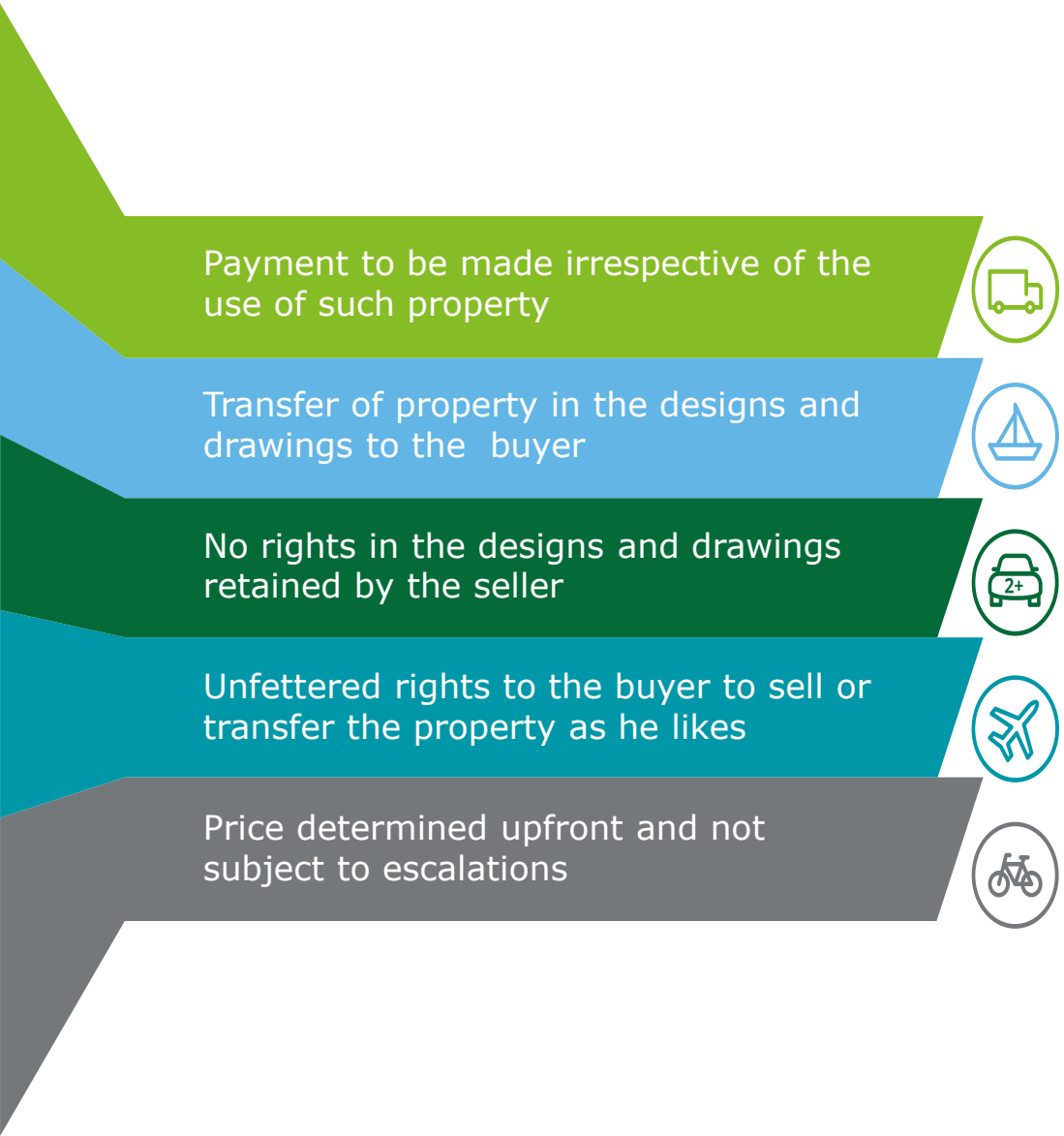
Royalty

Treaty

Country	Definition
Singapore	Includes gains from alienation of IPRs
US	Includes gains derived from the alienation of IPR which are contingent on the productivity, use, etc.
Morroco, Russia, Trinadad & Tobago, Turkministan, Kazakstan and Kyrgyz Republic	Specific inclusion of software
Libya	Rental and other income from cinematograph films considered as business profits and not Royalties
Greece, Israel, Sweden, Netherlands, Belgium	Does not include 'Equipment Royalty'
France, Netherlands and Spain	Does not include 'Equipment Royalty' – MFN clause
Australia	Includes FIS

Royalty

Engineering Drawings / designs / technical documentation - capital gains



- Supply of machine design to enable buyer to operate it without transfer of license of patent/copyright, thereby not allowing buyer to manufacture machine itself, cannot be regarded as Royalty. **[Neyveli Lignite Corporation Ltd. (243 ITR 459) (Mad) & Mitsui Engg. & ship Blg. Co. Ltd (259 ITR 248 (Del)]**

- Supply of technical documentations like designs, process, specification etc. before commencement of production is not royalty **[Nisshinbo Ind. Inc. vs. ACIT (83 ITD 748)(Chennai)]**

- Consideration for outright purchase of drawings and designs (i.e. transfer of ownership per se) is not royalty **[CIT v Davy Ashmore India Ltd. 190 ITR 626 (Cal), Leonhardt Andra Und Partner, Gmbh v. CIT (2001) 249 ITR 418 (Cal), Swadesh Polytex (38 ITD 326)]**

- Engineering drawings & designs supplied to an Indian Co. for lump sum consideration for setting up plant for its own client with the right to use, sell or transfer it is not alienation of right/property contingent upon productivity/use or disposition but an 'out and out' sale of property. **[Pro-quip Corporation (AAR) (255 ITR 354)]**

Royalty

Interpretation – Software

Meaning of 'copyright' – Section 14 of the Copyright Act, 1957

Exclusive right in respect of a work to reproduce, issue copies, perform in public, make translation, etc.

OECD Commentary

What constitutes Royalty?

- Payment for exploitation of rights that would otherwise be the sole prerogative of the copyright holder

What does not constitute Royalty?

- Payment for transfer of full ownership of the rights in the copyright
- Granting of rights for a limited period or for limited geographical area

Royalty

Interpretation – Software

Copyright

Right in which 'copyright' subsist, namely to reproduce, to issue copies, to sell or give on hire, etc.

Copyright

vs.

Copyrighted article

Copyrighted article

If the recipient acquires the article but does not acquire any of the rights over that article, namely to reproduce, to issue copies, to sell or give on hire, etc.

OECD recognises a distinction between the copyright in the program and software which incorporates a copy of the copyrighted program

Royalty

Supreme Court – Landmark Judgement – Engineering Analysis Center of Excellence Private Limited

The matter before the Supreme Court was – Whether payment made to Non-residents in the following 4 cases can be classified as 'Royalties'

- Resident Indian buyers/ end-users of computer software who purchase the same directly from foreign manufacturer/ supplier
- Resident Indian distributors/ traders/ resellers who purchase software from foreign manufacturers/ suppliers and resell in India to end-users
- Non-Resident vendors who purchase software from other foreign sellers and resell the same to resident India distributors/ end-users
- Computer software is affixed onto hardware and is sold as an integrated unit/ equipment by foreign non-resident suppliers to resident Indian distributors or end users

Royalty

Supreme Court – Landmark Judgement – Key observations

•EULA of the software do not transfer or assign the copyright over the software. No further right to sub-license, transfer or sale, nor any right to reverse-engineer, modify, reproduce in any manner otherwise than permitted by the licence to the end-user

•Distinction between copyrighted article and copyright has been upheld by following the Supreme Court Constitution bench judgment in the case of TCS, that classified shrink-wrap/packaged software as goods under the Constitution of India in the context of sales tax statute

Consideration for the computer software paid by resident Indian distributors/ end-users to non-resident computer software manufacturers/ suppliers, cannot be characterised as 'royalty' as per DTAA (i.e. the same does not amount to use of copyright in the computer software). Hence, no TDS

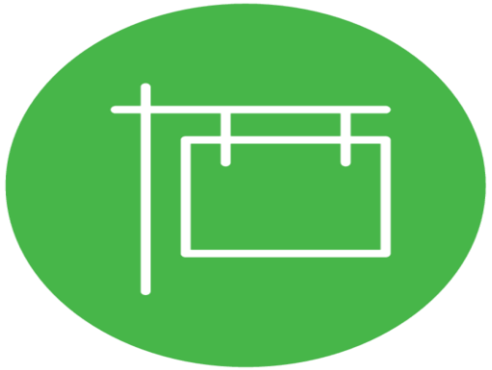
•If the provision as per DTAAs are beneficial to Non-resident assessees, the same shall be applicable to them. Also, the 2012 retrospective amendment to the definition of 'royalty' in the domestic law is to be read down as only a prospective amendment

Royalty

Interpretation – Advertisement

Does the following constitute Royalty?

Banner advertisement services?



Payment for website hosting?

Royalty

Interpretation – Advertisement

- Payment for advertising does not involve use or right to use by the client any industrial, commercial or scientific equipment; Uploading the advertisement was entirely the responsibility of the advertiser and client had no right to access the portal of the advertiser. Hence, not royalty **[Yahoo India (P.) Ltd. (2011) (140 TTJ 195) (Mum.)]**

- Payments for web-hosting services are in the nature of business income and not constitute royalties for "use of industrial, commercial or scientific equipment" **[EPRSS Prepaid Recharge Services India Private Limited ITA No. 828/Pun/2016 (Pune ITAT) dated 24 Oct 2018]**

- Income earned from rendering cloud hosting services to Indian customers, not royalty absent possession / physical control by customers over the servers / equipment. The term 'use' or 'right to use' for the purpose of DTAA entails that the payer has a possession/ control over the property and/or the said property is at its disposal **[Rackspace US Inc [TS-398-ITAT-2019(Mum)]**

- Web hosting charges via use of server – Not Royalty - **DDIT v. Savvis Communication Corporation [2016] 158 ITD 750 (Mumbai ITAT)**

Royalty

Interpretation – Advertisement

- Search engine advertisement payments to non-residents not in the nature of royalty – **[Pinstorm Technologies Pvt. Ltd. (45 SOT 278) (ITAT – Mumbai)]**

- The Google Adwords advertisement module is not merely an agreement to provide advertisement space but is an agreement for facilitating the display and publishing of an advertisement to the targeted customer using Google's patented algorithm, tools and software. Google Adwords uses data regarding the age, gender, region, language, taste habits, food habits, etc.. of the customer so as to maximize the impression and conversion to the ads of the advertisers. Consequently, the payments to Google Ireland are taxable as "royalty‟ **[Google India Private Ltd vs. ACIT (ITAT Bangalore)]**

- **Online advertisement -** Concept of Equalisation Levy introduced in Budget 2016 to tax such payments @6% for online advertisement and other specified services made to non-residents not having PE in India (this has to be evaluated on case to case basis)

Royalty

Interpretation – Advertisement

Does the following constitute use of equipment?

- A person is an owner of a web portal
- Customer approaches to the owner of web portal to advertise its products online on the web
- Web portal provides web search engine. A web search engine is basically a software code designed to search for information on the world wide web
- When an internet user visits web portal, it keys in the search words

- The results produced by search engine are sponsored search results which is de-facto advertisement

Royalty

Interpretation – Database

Does the following constitute Royalty?

- Payment to subscribe database maintained by a non-resident online
- The database pertains to Oil and natural gas and its exploration which is a field of specialized technical knowledge
- The database is not available for use of public at large

Royalty

Interpretation – Database

- Subscription fees for use of online database not taxable in India as royalty or fees for technical services [**Elsevier Information Systems GmbH Vs. DCIT [2019] 106 taxmann.com 401 (Mumbai ITAT)]**

- Information supplied in the nature of data. The data did not arise due to exploitation of the know-how generated by the skills or innovation. Hence, the payment for the same does not amount to royalty. **[P. T. McKinsey Indonesia (2013) (141 ITD 357) (Mum.)]**

- Payment for purchases of Business Information Reports which is a compilation of data in user friendly manner cannot be termed as 'royalties' under India-Spain Tax Treaty **[Dun & Bradstreet Information Services India (P.) Ltd. (2011) (338 ITR 95) (Bom.)]**

- Payments made for subscription fees for specialized database containing copyright material would not be regarded as royalty. The payment was for use of copyrighted material and not for use of copyright **[DCIT Vs. Welspun Corporation Ltd. (55 ITR(T) 405) (Ahmd.)]**

- The fees paid for procurement of information, which is in the nature of specialized technical knowledge about exploration of oil and gas and not general in nature would be covered under the definition of royalty **[ONGC Videsh Ltd. (2013) (155 TTJ 114) (Del.)]**

Royalty

Interpretation – Database

- Subscription charges through layers of multi system operators and cable operators, which would enable the customers to view channels operated by assessee not royalty as not parting with any of the copyrights **[MSM Satellite (Singapore) Pte. Ltd [TS-236-HC-2019(BOM)]**

- Mere access to that work or permission to use the work cannot imply that the payer is paying for use or right to use the copyright. **[American Chemical Society Vs. DCIT [2019] 106 taxmann.com 253 (Hyderabad ITAT)]**

- Subscription charges received from the customers in India is in the nature of royalty as it constitutes right to use of equipment and information. **Reuters Transaction Services Ltd. ITA Nos. 1393 & 2219/Mum/2016 dated 3 August 2018**

- Building platform comprising secure servers equipped with proprietary software which pulled content from customer's Web Server and replicated it for faster, more reliable delivery. End-users accessing customer's Website through platform— Not royalty [**Akamai Technologies Inc. (2018) 404 ITR 495]**

Royalty

Use of Transponder Capacity/ Broadcasting services

- Payment of monthly charges for use of transponder facilities through satellite – not royalty
  - **Independent News Service (P.) Ltd. (2018) 90 taxmann.com 163 (Delhi ITAT)**
  - **Taj TV (2016) 72 taxmann.com 143 (Mum ITAT)**
  - **New Skies Satellite BV (2016) 382 ITR 114 (Delhi HC)**
  - **Viacom Media (2015) 153 ITD 384 (Mum ITAT)**

- Payment to Overseas Broadcasters - not Royalty
  - **MSM Satellite Bombay High Court April 2019**

- Payment for international private leased circuit and connectivity charges for use of private bandwidth – not royalty or FTS
  - **Geoconnect Ltd. ITA No.1927/Del/2008, 127/Del/2011**
  - **Reliance Jio Infocomm Ltd. (ITA Nos. 6331 to 6334/Mum/2018) dated 15 Nov 2019** *Entire law on whether the retrospective amendments to the definition of "royalty" in s. 9(1)(vi) of the Act can have bearing on the interpretation of the same term in the DTAAs explained with reference to the doctrine of "treaty override" and the Vienna Convention*

Royalty

Interpretation – Use of Transponder Capacity/ Broadcasting services

Does the following constitute Royalty?

- Payment for use of facility provided by the non-resident without any control over equipment
- A process which is not a secret
- Equipment/ process used by the non-resident to provide a service and the payer does not use such equipment/ process directly

Royalty

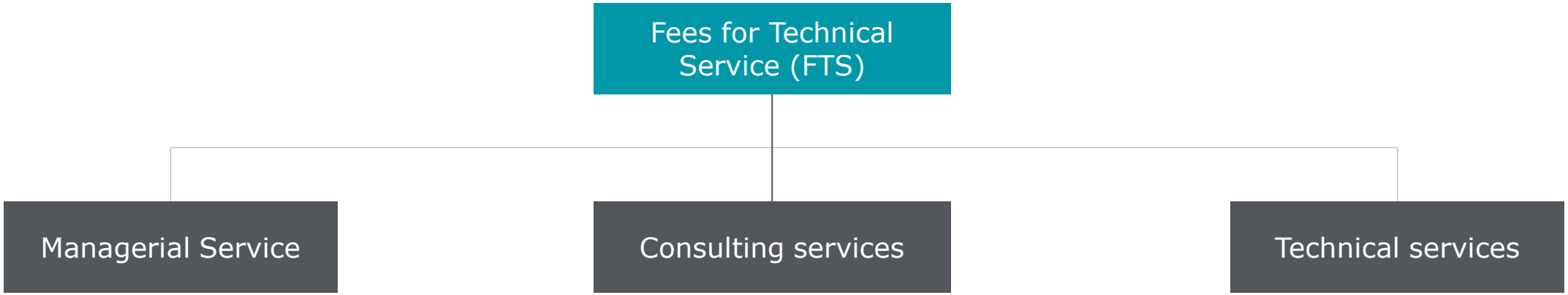
Use of Transponder Capacity/ Broadcasting services

- Payment of monthly charges for use of transponder facilities through satellite – not royalty
  - Access to transponder does not amount to use of equipment since assessee cannot operate the satellite by itself. Services are carried through transponders located in space wherein Indian company did not have any control over it. Hence, services were not carried out or performed in India. Not taxable as royalty. **[Independent News Service (P.) Ltd. (2018) 90 taxmann.com 163 (Delhi ITAT)]**
  - Transponder charges are only use of facility and not equipment. Not taxable as royalty. **[Taj TV (2016) 72 taxmann.com 143 (Mum ITAT)]**
  - Amendment of "royalty" meaning under the Act will not automatically affect treaty definition. Therefore following the decision of Asia Satellite Telecommunications it was held that transmission services do not provide control to customer over satellite or its process. Hence, not royalty. **[New Skies Satellite BV (2016) 382 ITR 114 (Delhi HC); Viacom Media (2015) 153 ITD 384 (Mum ITAT)]**
- Subscription charges to enable individual customers to view the channels and the programmes telecast on such channels are not in nature of royalty for use of copyright, since there is no transfer of copyright. [**MSM Satellite (Singapore) Pte Ltd [2019] 106 taxmann.com 353 (Bombay)]**
- Payment for international private leased circuit: Equipments were owned and used by non-residents only, hence cannot be said that payment by Indian company is for use of equipment [**Geoconnect Ltd. ITA No.1927/Del/2008, 127/Del/2011]**
- Connectivity charges for use of private bandwidth – not royalty under DTAA. *Entire law on whether the retrospective amendments to the definition of "royalty" in s. 9(1)(vi) of the Act can have bearing on the interpretation of the same term in the DTAAs explained with reference to the doctrine of "treaty override" and the Vienna Convention* **[Reliance Jio Infocomm Ltd. (ITA Nos. 6331 to 6334/Mum/2018) dated 15 Nov 2019]**

Fees for technical services

Fees for Technical Services

Definition



Includes:

Provision of services of technical or other personnel

Excludes:

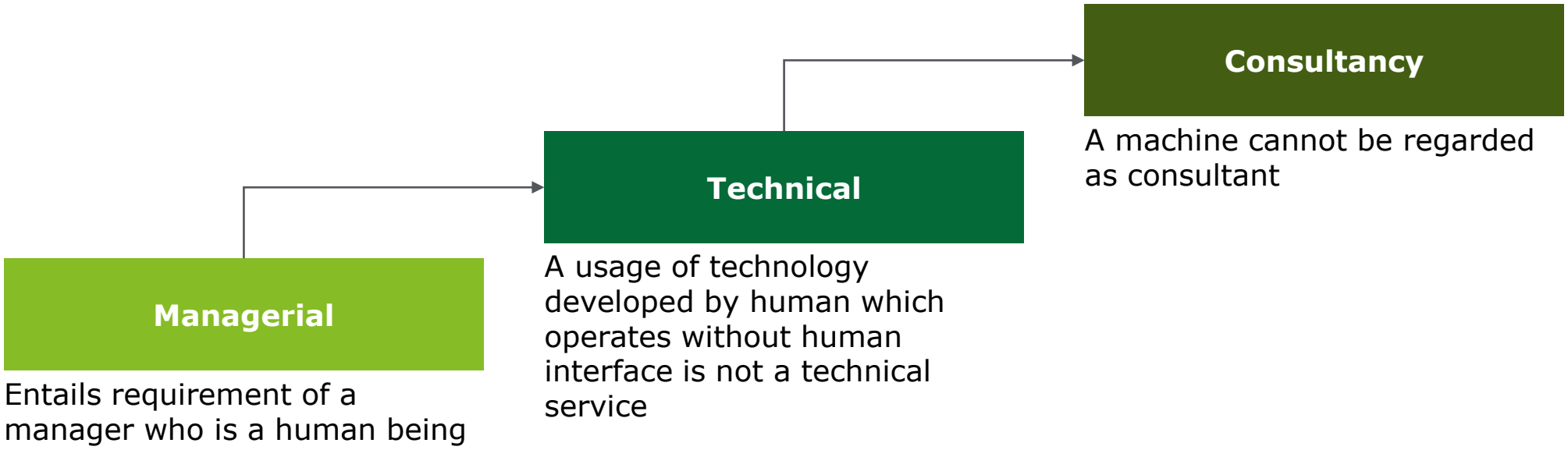
- consideration for any construction, assembly, mining or like project undertaken by the recipient
- consideration which would be income of the recipient chargeable under the head “Salaries”

Fees for Technical Services

Managerial, Technical and Consultancy services

Fees for Technical Services

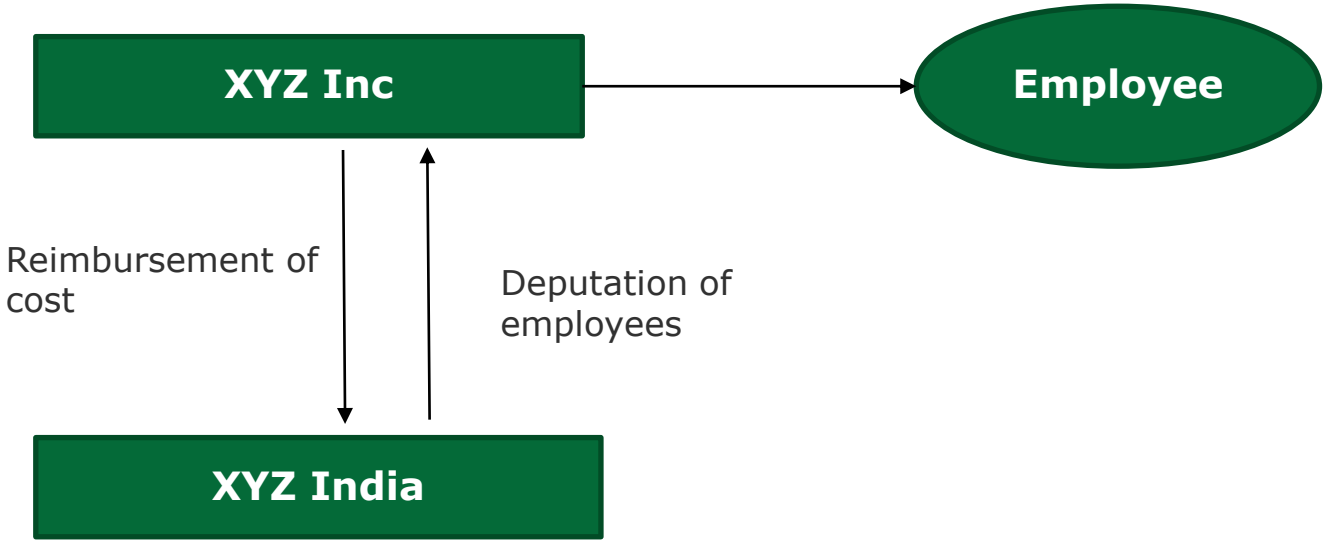
Whether human intervention required?



The essence of ‘managerial’, ‘technical’ and ‘consultancy’ services have an element of human intervention

Fees for Technical Services

Secondment of employees



- Tax implication dependent upon the terms of deputation agreement

	FTS
XYZ India to qualify as an economic employer of employee. Salary cost re-charged at actuals by XYZ Inc. to XYZ India	✗
XYZ India to qualify as an economic employer of employee. Salary cost re-charged at mark up by XYZ Inc. to XYZ India	✓
XYZ Inc. deputed employee for providing services to XYZ India. Cost at actuals re-charged by XYZ Inc.	✓

Fees for Technical Services

Secondment of employees

- Payments received by a foreign company from an Indian associated entity as a partial reimbursement of salary costs for a seconded employee were not FTS and, hence, were not taxable in India in the hands of the foreign company. **[M/s. Faurecia Automotive Holding ITA No.784/PUN/2015 (Pune ITAT) dated 8 July 2019]**
- The seconded employees retained their entitlement to participate in the overseas entity's retirement and social security plans and other benefits, and their salaries were payable by the overseas entity, which reclaimed the money from Indian entity;
- Whilst the agreement between the Indian company and the overseas entity granted the Indian company the right to terminate the secondment, the Indian company had no right to terminate the original underlying employment relationship between the secondee and the overseas entity;
- The payment was not in the nature of reimbursement, but rather, payment for services rendered. The employment relationship between the overseas entity and the Indian taxpayer from which the overseas entity's independent obligation to pay the secondees arose continued and the overseas entity was under no obligation to use the payments received from the Indian company to pay the secondees;
- The money paid by the Indian company accrued to the overseas entity, which may or may not have used the money to fund the payments to the secondees, based on the overseas entity's contractual relationship with the secondees

[Centrica India Offshore Pvt. Ltd. (2014) 44 taxmann.com 300 (Delhi), SLP rejected (2014) 51 taxmann.com 386 (SC)]

Fees for Technical Services

Secondment of employees

- The personnel seconded, have to work under the control, direction and supervision of the tax payer, as all are senior technical/managerial position employees, who report to the president and vice president and who in turn are expected to report to the tax payer. Since the employees are rendering highly technical services, they would fall under the ambit of FTS under the ITA. **[Panasonic Corporation I.T.A No.1483/Chny/2017 Chennai ITAT]**
- Merely supplying employees or assisting the Indian entity in the business did not constitute making available technical or consultancy services. Once the Indian entity has withheld tax on the salaries of seconded employees, that same salary income cannot be subject to withholding tax a second time when the income is remitted by the Indian entity to the foreign entity. **[Marks & Spencer Reliance India Pvt. Ltd. (ITA No. 893 of 2014) Bombay High Court]**
- Reimbursements of salaries of seconded employees were not FTS as they were working under the control and supervision of the Indian entity and were not furthering the business of the overseas entity. [**AT & T Communication Services (India) P. Ltd. [2019] 111 taxmann.com 201 (Delhi - Trib.)]**
- Reimbursements of salaries of seconded employees were taxable because the seconded employees temporarily exchange experience and skill, and do not lose the employer-employee relationship of the parent organization even after the secondment has ended. **[Nippon Paint (India) Pvt. Ltd. I.T.A. No. 2562/Chny/2018 dated 29 March 2019]**

Fees for Technical Services

Reimbursement of expenses

Whether reimbursement of expenses will be taxable in India?

- Cases in the **favour of taxpayer**, wherein it has been held that no withholding tax obligation arises in case of pure reimbursement to overseas entity by an Indian company are as under:

  ✓ *The Timken Company [TS-569-ITAT-2017(Kol.-Tribunal)];*

  ✓ *Global E-Business Operations Pvt. Ltd. [2013] 151 TTJ 19 (Bang -Tribunal);*

  ✓ *CIT v. Expeditors International (India) (P.) Ltd [2012] 24 taxmann.com 76 (Delhi HC)*

- In the following cases, the appellate authorities have held that payments towards reimbursements are **liable to withholding tax:**

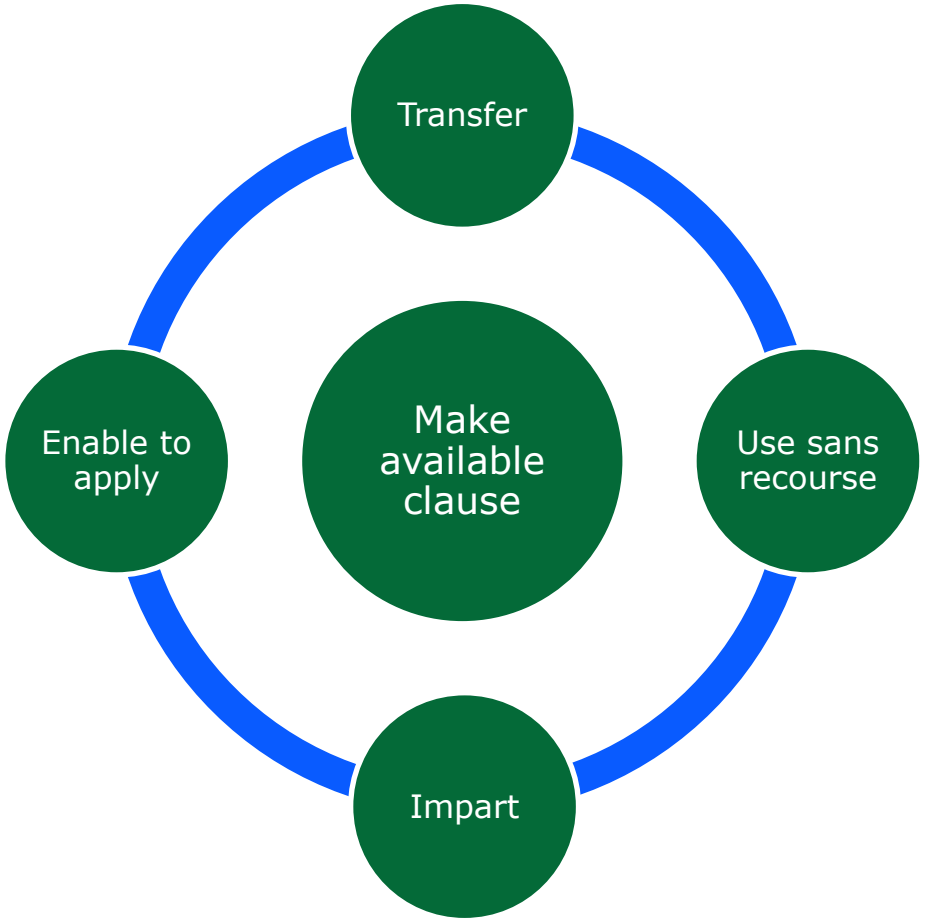
  ✓ *C. U. Inspections (I) Private Limited [ITA 577/ Mum/2011];*

  ✓ *Tungabhadra Steel Products [TS-485-ITAT-2017(Bang- Tribunal)];*

  ✓ *SMS Iron Technology Pvt Ltd [TS-555-ITAT-2017(Del- Tribunal)*

Fees for Technical Services

Make available – India US Treaty



"Included Services" defined narrowly to mean services which "make available" technical knowledge, experience, skill, know-how or processes or which consist of development and transfer of technical plan or technical design

MoU of the India USA Tax Treaty:

- Technology will be considered "made available" when the person acquiring the service is **enabled to apply** the technology
- Provision of requiring **technical input** by the person providing the service does not per se mean that technical knowledge, skills, etc., are made available
- Use of a product which embodies technology shall not per se be considered to make the technology available

If the services do not "make available" technical knowledge, etc., then, they are outside the ambit of FIS Article and not taxable

Fees for Technical Services

Make available – Judicial precedents

- To fit into the terminology "making available", the technical knowledge, skill, etc., **must remain with the person receiving the services even after the particular contract comes to an end**. It is not enough that the services offered are the product of intense technological effort and a lot of technical knowledge and experience of the service provider have gone into it. The technical knowledge or skills of the provider should be imparted to and absorbed by the receiver so that the receiver can deploy similar technology or techniques in the future without depending upon the provider [CIT v. De Beers India Minerals (P.) Ltd. **[2012] 21 taxmann.com 214 (Karnataka)**]

- Mere rendering of services is not roped in unless the **person utilizing the service is able to make use of the technical knowledge, etc., by himself in his business or for his own benefit and without recourse** to the performer of the services in future. Some sort of **durability or permanency** of the result of the 'rendering of services' is envisaged which will remain at the disposal of the person utilizing the services. The **fruits of the services should remain available to the person utilizing the services** in some concrete shape such as technical knowledge, experience, skills, etc. **[Raymond Limited v. DCIT [2003] 86 ITD 791 (Mumbai)]**

- Even if the services are technical services in nature but what is really the decisive factor for taxability is to see **whether the services results in transfer of technology**. The services do not enable the recipient of the services to utilise the knowledge or know-how on his own in future without the aid of the service provider. Therefore, make available condition is not satisfied **[ABB Inc. 59 taxmann.com 159 (Bang.)]**

Fees for Technical Services

Management charges – Judicial precedents

- The services rendered by the taxpayer under MSA were geared to ensure uniformity in processes / practices / systems followed by the taxpayer's group globally. These were only managerial in nature and not included in the definition of FTS under the India-UK tax treaty. Moreover, these services did not 'make available' any technical knowledge, experience or skill to Indian Co **[Aircom International Ltd. vs CIT AAR 1329/2012]**

- Services provided were simply management support of consultancy services which did not involve any transfer of technology. The mere fact that there were certain technical inputs or that the assessee immensely benefitted from these services, even resulting in value addition to the employees of the assessee is wholly irrelevant [**Bombardier Transportation India (P.) Ltd. 77 taxmann.com 166 (Ahm.)**]

- The services rendered were in the nature of business support, marketing information technology support services and strategy support etc. It will be too much to say that by providing such services, the applicant receiving the services is enabled to apply the technology contained therein i.e., the technology, knowledge, skills, etc., possessed by the service provider or technical plan developed by the service provider **[Bharati AXA General Insurance Co. Ltd. 194 Taxman 1 (AAR)]**

- Support services such as account receivable, human resources, and payroll management, tax support and administrative support, etc. The services rendered are administrative support services rendered from abroad and are in the nature of 'managerial services'. Such services do not make available any technical skill, information or knowledge to the employees of the applicant **[Foster Wheeler (G.B.) Ltd., In re 77 taxmann.com 205 (AAR)]**

Treaty considerations

Year of taxability

Accrual vs. Payment

Article of tax treaties: Interest/ Royalty/FTS arising in a Contracting State (CS) and 'paid' to a resident of the other CS may be taxed in the other CS:

- Credit entry in the books of accounts of the payer to the account of the payee amounts to its receipts by the payee. **[CIT v. Standard Triumph Motor Co. Ltd (201 ITR 391) (1993)(SC)]**.

- For taxability U/A 12 twin conditions of 'accrual' and 'payment' is required to be satisfied **[National Organic Chemicals Ltd. (96 TTJ 765) (2004)(Mum)]**

- **Flakt (India) Limited (AAR No.622 and 623 of 2003)**: For the purpose of taxing such royalties/fees in India, Para (1) is wholly irrelevant. It is also pointed out above that Para (2) thereof clearly lays down that the amount of such royalties/fees may also be taxed in India, in which they arise, and according to the laws of India. It is thus clear that the provisions of Article 12 of the treaty, discussed above, do not provide that taxability of such royalties/fees in India shall be on cash or receipt basis.

- It is only at point of time when payment takes place, that income embedded in payment becomes taxable under DTAA as also under domestic law **[Saira Asia Interiors (P.) Ltd. (2017) 164 ITD 687 (Ahd ITAT)]**

- In the following decisions, Royalties held to be taxable only when 'paid' to non-residents:
  - **Siemens Aktiengesellschaft [ITA no.124 of 2010]**
  - **Johnson & Johnson [60 SOT 109 (Mum)]**

- Treaty can only provide the characterization of income, scope and rate of tax and it is not within the scope of the treaty to provide when (i.e. year if accrual or receipt) the income is required to be taxed. Accordingly, it was held that income has to be taxed on accrual basis as per the Act **[Google India (P.) Ltd (86 taxmann.com 237)(Bangalore Tribunal)]**

Absence of Royalty/ FTS clause in tax treaty

Whether taxable as per domestic laws

- Illustrative list of treaty partners with whom there is a specific FTS clause agreed - Philippines, Thailand, UAE, Bangladesh, Greece

- Taxable in either of the following way:

  - **Taxable as per domestic law**
    - ✓ Circular No. 333, dated 02-04-1982;
    - ✓ CIT vs. Andaman Sea Food Pvt. Ltd (Cal HC)

  - **Taxable under "Other income" Article of the treaty**
    - ✓ Lanka Hydraulic Institute Ltd. (11 taxmann.com 97)(AAR)

  - **Not taxable in absence of PE**
    - ✓ DCIT v. IBM India (P.) Ltd. [2018] 100 taxmann.com 230 (Bangalore Tribunal)
    - ✓ McKinsey & Company vs. DDIT [TS-332-ITAT-2013-Mum](Mumbai Tribunal);
    - ✓ Paramina Earth Technologies Inc vs. DCIT [2020] 116 taxmann.com 347 (Vishakhapatnam ITAT)]

Beneficial Ownership

Who is a beneficial owner

- The concept of 'beneficial ownership' can be found in almost all tax treaties that India has signed with other countries mainly in the context of dividend, interest, royalty and fees for technical services Articles. However, the term 'beneficial owner' is not defined under any tax treaty signed by India

- **Circular no. 789 of 2000 -** Issued in the context of provisions of India-Mauritius DTAA, Circular 789 inter-alia provides that tax residency certificate issued by the Mauritian Tax Authorities, would constitute sufficient evidence for accepting the status of residence as well as beneficial ownership in context of income in the nature of dividend and capital gains

- **Whether benefit of Circular 789 can be taken with other treaty partners and stream of incomes other than dividend and capital gains:**
  - HSBC Bank (Mauritius) Ltd. v. DCIT [2018] 96 taxmann.com 544 (Mumbai - Trib.)
  - DIT v. Universal International Music B.V. [2013] 31 taxmann.com 223 (Bombay HC)

OECD Commentary

- The term 'beneficial owner' is not defined

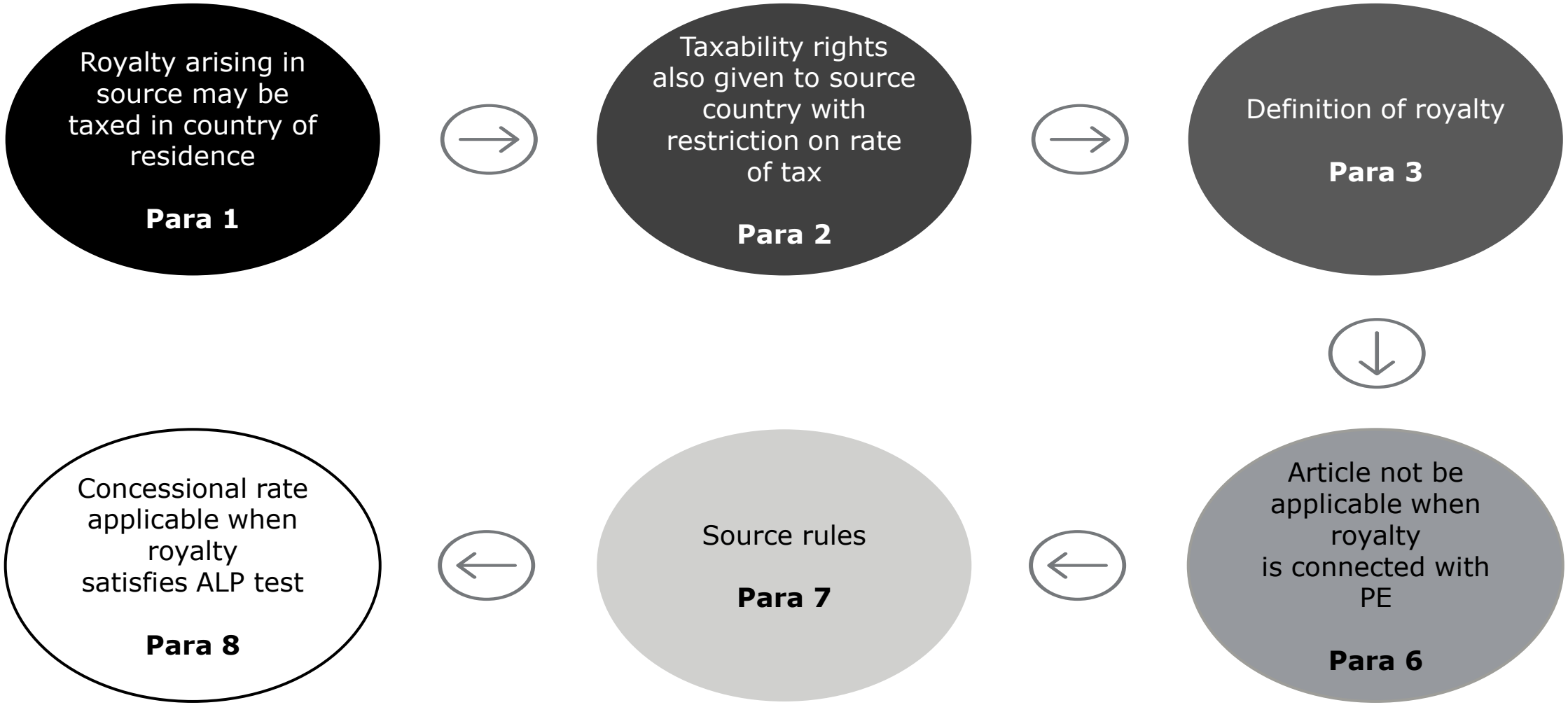
- Suggests that Instead agent, nominee, conduit company acting as a fiduciary or administrator, though being direct recipient, are not beneficial owners as their right to use and enjoy the income is constrained by a contractual or legal obligation to pass on such receipt to another person

- From an OECD perspective, a 'beneficial owner' is an individual / legal entity who has a right to use and enjoy the income unconstrained by a contractual, legal or factual obligation to pass on such income to another person. It is not necessary that such recipient also be the beneficial owner of the underlying asset yielding such income

Annexure

Royalty

Article 12 - Treaty



Royalty

OECD and UN Model convention

Royalty Definition

OECD Model	UN Model
Use of, or the right to use: • any copyright of literary, artistic or scientific work including cinematograph films	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
Use of, or the right to use: • any patent, trademark, design or model, plan, secret formula or process	Use of, or the right to use: • any patent, trademark, design or model, plan, secret formula or process • industrial, commercial or scientific equipment
for information concerning industrial, commercial or scientific experience	for information concerning industrial, commercial or scientific experience

Royalty under OECD model is narrower as compared to UN model

Royalty

OECD and UN Model convention

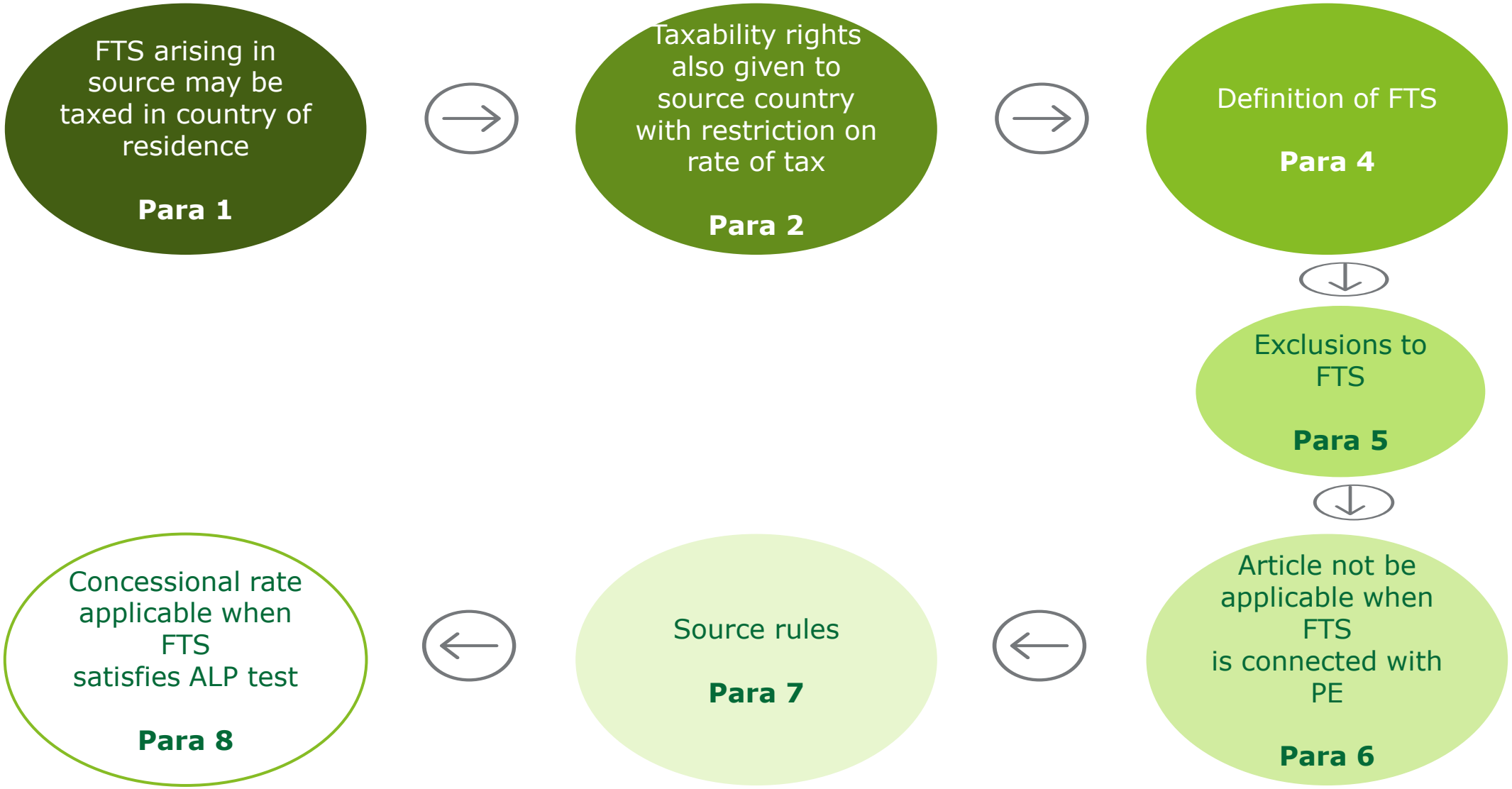
Accrual of income

OECD Model	UN Model
Royalties arising in a Contracting State and beneficially owned by a resident of the other Contracting State shall be taxable only in that other State (i.e. State of residence)	Royalties arising in a Contracting State paid to a resident of the other Contracting State may be taxed in that other State May also be taxed in the Contracting State in which they arise and according to the laws of that State
Article 7 shall apply -if the beneficial owner of the royalties, being a resident of a Contracting State • carries on business in the other Contracting State in which the royalties arise through a PE situated therein • right or property in respect of which the royalties are paid is effectively connected with such PE	Article 7 or Article 14, as the case may be, shall apply -if the beneficial owner of the royalties, being a resident of a Contracting State • carries on business in the other Contracting State in which the royalties arise through a PE situated therein • performs in that other State independent personal services from a fixed base situated therein • right or property in respect of which the royalties are paid is effectively connected with such PE or fixed base, or with business activities referred to in Article 7.1

Most of the treaties entered into by India follows UN model convention

Fees for Technical Services

Article 12 - Treaty



Fees for Technical Services

Article 12 - Treaty

FTS simpliciter : India Germany Treaty

"Fees for technical services" as used in this Article means payments of any amount in **consideration for the services of managerial, technical or consultancy nature, including the provision of services by technical or other personnel**, but does not include payments for services mentioned in Article 15 of this Agreement

FTS simpliciter with condition that service should be provided in the other state: India China Treaty

The term "fees for technical services" as used in this Article means any payment for the **provision of services** of managerial, technical or consultancy nature by a resident of a Contracting State **in the other Contracting State**, but does not include payment for activities mentioned in paragraph 2(k) of Article 5 and Article 15 of the Agreement.

FTS with restrictive scope: India US Treaty

Fees for included service ('FIS') means payments of any kind to any person in consideration for technical and consultancy services (including provision of services of technical or other personnel) if such services are:

- are ***ancillary and subsidiary*** to the application or enjoyment of the right, property or information or
- ***make available*** technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design

Fees for Technical Services

Article 12 - Treaty

Scenarios	Treaty Countries
FTS simpliciter	Germany, Japan, Denmark, Mauritius etc.
FTS simpliciter with a condition that the services should be provided in the other state	China
Covered only if ‘make available’ is satisfied	US, UK, Australia, Canada, Netherlands, Singapore
Includes MFN clauses in tax treaties	Netherlands, Belgium, France, Finland, Sweden, Switzerland, Spain and Hungary
No separate article for FTS and neither covered within royalty definition as well	Bangladesh, Brazil, Greece, Nepal, Philippines, Syria, UAE, UAR
FTS to include only technical and consultancy services	Canada, Netherlands, UK, US

Fees for Technical Services

Most Favored Nation ('MFN')

India Netherlands Treaty

"If after signature of this convention under any Convention or Agreement between India and a **third State which is a member of the OECD** India should **limit 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, then as from the date on which the relevant Indian Convention or Agreement enters into force the same rate or scope as provided for in that Convention or Agreement on the said items of income shall also apply under this Convention."

Highlights

- MFN triggered only if other OECD country favored
- Applied immediately
- MFN for scope as well as rate of taxation

Fees for Technical Services

Most Favored Nation ('MFN')

India Swiss-Confederation Treaty

If after the signature of the Protocol of 16th February, 2000 under any Convention, Agreement or Protocol between India and a third State which is a member of the OECD India should limit its taxation at source on dividends, interest, royalties or fees for technical services to a rate lower or a scope more restricted than the rate or scope provided for in this Agreement on the said items of income, then, Switzerland and India shall **enter into negotiations without undue delay** in order to provide the same treatment to Switzerland as that provided to the third State.

Highlights

- MFN triggered only for re-negotiation
- Cannot be applied without formal amendment to DTAA and notification thereof
- No notification yet
- Similar provision in case of India - Philippines DTAA as well

Fees for Technical Services

Most Favored Nation ('MFN')

India Norway Treaty

However, such royalties and fees for technical services may also be taxed in the Contracting State in which they arise and according to the laws of that State. But insofar as fees for technical services are considered, to the extent such fees are paid in respect of a contract which is signed after the date of entry into force of this Convention, the tax so charged shall not exceed 10 per cent of such fees. For the purposes of this paragraph, if a **lower rate** of Indian tax is agreed upon with any other State than Norway after the entry into force of this Convention, **such rate shall be applied**.

Highlights

- Clause in DTAA itself (not in protocol)
- Applicable only for lower rate (not for scope)
- Lower rate yet not agreed by India with any country
- Immediately applied

Thank You

Any Questions?