Royalties and FTS
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Interplay between Section 5, 9(1)(i) and 9(1)(vii) of Income-tax Act, 1961 (the Act)

Section 195 – Chargeable to tax

Section 115A – Rate of tax

Tax Treaty Network

Important Distinction – Resident vs Non-Resident
Domestic Company vs foreign company

Royalty / FTS interplay with Section 44DA
Royalty u/s 9(1)(vi) of the Act

Royalty deemed to accrue or arise in India when

• Payable by the Government

• Payable by resident to non-resident, except
  - where the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person (i.e., the payer) outside India
  - for the purpose of making or earning any income from any source outside India

• Payable by non-resident to resident, only if
  - the royalty is payable in respect of any right, property or information used or services utilized for the purposes of a business or profession carried on by such person in India
  - for the purpose of making or earning any income from any source in India
Royalty u/s 9(1)(vi) of the Act

Whether Royalty on exports covered under the clause?

- Branch office
- Dependent agent
- Case of Havells India / Aktiengesellschaft Kunhie Kopp & Kausch
**Royalty – Definition u/s 9(1)(vi) of the Act**

| Consideration, including lumpsum consideration (other than income chargeable as capital gains) for | Transfer of all or any rights (including the granting of a license) in respect of |
| Copyright, literary, artistic or scientific work (excluding sale, distribution or exhibition of cinematographic films) |
| Patent, invention, model, design, secret formula or process or trademark or similar property |
| Imparting of any information concerning the working of, or the use of |
| Use of |
| Technological, industrial, commercial or scientific knowledge, experience or skill |
| Imparting of any information concerning |
| Use or right to use |
| Any Industrial, commercial or scientific equipment (excluding section 44BB) |
| Transfer of all or any rights (including the granting of a license) in respect of |
| Copyright, literary, artistic or scientific work (excluding sale, distribution or exhibition of cinematographic films) |

**Royalty also includes income from rendering of services in connection with above**
Definition of Royalty u/s 9(1)(vi) of the Act

Retrospective amendments made by Finance Act, 2012 with effect from 1 June, 1976

• Explanation 3
  For the purposes of this clause, "computer software" means any computer programme recorded on any disc, tape, perforated media or other information storage device and includes any such programme or any customized electronic data.

• Explanation 4
  - Transfer of all or any rights in respect of any right, property or information includes transfer of all or right for use or right to use a computer software (including granting of a license) irrespective of the medium through which the right is transferred.
**Definition of Royalty u/s 9(1)(vi) of the Act**

Retrospective amendments made by Finance Act, 2012 with effect from 1 June, 1976

- **Explanation 5**
  - Royalty includes consideration in respect of any right, property or information, whether or not –
    - The possession or control is with the payer;
    - It is used directly by the payer;
    - Location is in India

- **Explanation 6**
  - “Process” includes transmission by satellite, cable, optic fibre or by any other similar technology, whether or not such process is secret

Judgements sought to be overruled by explanation 5 and 6: Asia Satellite Télécommunications Ltd. (2011) 332 ITR 340 (Delhi), ISRO Satellite Centre (2008) 307 ITR 59 (AAR)
Typical structure of Royalty article under Indian tax treaties

• Article 12(1) – State of residence to have right to tax royalty
• Article 12(2) – State of source also to have right to tax royalty, however ceiling of tax rate by the state of source subject to Beneficial Ownership
• Article 12(3) – Meaning of the term ‘Royalty’
• Article 12(4) – Taxation of Royalty if effectively connected with PE / Fixed Base of Non-Residents in the State of Source
• Article 12(5) – Arising of Royalty in the State of Source
  - Where payer is Resident; and / or
  - If the Payer has a PE / Fixed Base in the State of Source and the Royalty is connected and borne by such PE / Fixed Base
• Article 12(6) – Adjustments for related party transactions
  - Excess over Arm’s-length price to be taxable as per domestic provisions
Royalties – Key issues
Shrink wrapped Software – Arguments against Royalty

- For captive use
- No right to reproduce / distribute/ resell, etc.
- May be in the form of a network/site license
- For multiple users of the tax payer organisation
- No commercial exploitation of Intellectual Property by licensee
- Software supplied in CD is ‘goods’ TCS (271 ITR 401)(SC)
- Use of ‘copyrighted article’ (software) and not ‘copyright’ in software

Issue pending for adjudication before Supreme Court
Software with purchase of Hardware

Typical Facts

• Supply of integrated equipment comprising hardware and software
• Supply of Software is inextricably linked to supply of the hardware and,
• Both do not have independent existence / use
• Example – Telecom equipment’s in fixed and mobile networks

Key Aspects

• Payment made for supply of ‘goods’ and not for use of software
• Contract cannot be separated in two components i.e. Hardware and Software
• Amendment in domestic law not to impact tax treaty interpretation
  • Distinction between copyright and copyrighted article still relevant under tax treaties

Legal principles continue to be applicable post retro amendments
SUPREME COURT ON SOFTWARE AS ROYALTY

Purchase of computer software directly by a resident from a non-resident supplier or manufacturer;

Purchase of software by a resident Indian company acting as a distributor or reseller and reselling to Indian end-users;

Purchase of software by a non-resident distributor from a non-resident supplier and reselling to Indian distributors or end-users; and

Computer software bundled with hardware sold by non-resident suppliers to resident Indian distributors or end-users.
The distributor gets only a non-exclusive and non-transferable license to resell computer software;

No copyright in the computer program is transferred to either the distributor or to the ultimate end-user;

The end-user can use the computer program itself, but there is no further right to sub-license or transfer or reverse-engineer, modify, reproduce in any manner otherwise than permitted by the license to the end-user;

The distributor pays the computer program’s price as a good, in a medium that either stores the software or embeds it in the hardware;

The distributor does not get the right to use the product; and

The end-user can only use the computer program by installing it in the computer hardware owned by the end-user and cannot in any manner reproduce it for sale or transfer.
**Satellite / Transponder Payments**

**Mechanism**

- Process of transmission of TV programme starts with TV channels uplinking the signals containing TV programme
- Satellite receives signals; Post amplification and changing frequency, it relays down in India where cable operators catch them and distribute to public

**Position after Retro Amendment**

- Royalty under domestic law? [Refer Explanation 5 and 6]
- Under tax treaty scenario – Beneficial provisions would prevail - New Skies Satellite (382 ITR 114)
- (Delhi HC) Revenue’s appeal against above High Court Order admitted in Supreme Court (73 taxmann.com 38)

**Impact of amendment by Finance Act, 2017 in Section 90 – Explanation 4** which provides that any term not defined in the tax treaty but defined under the Act, will have the same meaning assigned under the Act and explanation, if any given by the government
Fees for Technical Services (FTS)
FTS under the Act

• FTS is deemed to accrue or arise in India when
  - Paid by government
  - Paid by resident except where
    ◦ Services are utilized in business or profession carried outside India;
    ◦ Services are rendered for earning income from any source outside India
  - Paid by non-resident where
    ◦ Services are utilized in business or profession carried in India;
    ◦ Services are rendered for earning income from any source in India
FTS under the Act

• FTS means
  - any consideration (including any lump sum consideration) for the rendering of any managerial, technical or consultancy services
  - including the provision of services of technical or other personnel
  - but does not include
    ◦ consideration for any construction, assembly, mining or like project undertaken by the recipient; or
    ◦ consideration which would be income of the recipient chargeable under the head Salaries
**FTS under Indian tax treaties**

- FTS generally defined to mean:
  - payments of any amount in consideration for the rendering of managerial, technical or consultancy services
  - including the **provision of services** of technical or other personnel
  - but does not include
    - payments for services mentioned in Independent / Dependent Personal Services
    - services that are ancillary and subsidiary to the rental of ships, aircraft, containers or other equipment
  - Few treaties have narrow scope in form of “make available” clauses to cover only those services
    - which **make available technical knowledge, experience, skill know-how or processes**; or
    - Consist of the **development** and **transfer** of a **technical plan** or **technical design**
FTS under the Indian tax treaties – Make available clauses

- India-USA tax treaty
  - "fees for included services" means payments of any kind to any person in consideration for the rendering of any technical or consultancy services (including through the provision of services of technical or other personnel) if such services:
    - (a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or
    - (b) make available technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or technical design."
FTS under the Indian tax treaties – Make available clauses

- India-Singapore tax treaty
  - The term "fees for technical services" as used in this Article means payments of any kind to any person in consideration for services of a managerial, technical or consultancy nature (including the provision of such services through technical or other personnel) if such services:
    (a) are ancillary and subsidiary to the application or enjoyment of the right, property or information for which a payment described in paragraph 3 is received; or
    (b) make available technical knowledge, experience, skill, know-how or processes, which enables the person acquiring the services to apply the technology contained therein; or
    (c) consist of the development and transfer of a technical plan or technical design, but excludes any service that does not enable the person acquiring the service to apply the technology contained therein.
FTS under Indian tax treaties – Make available meaning

- MoU to India-US tax treaty:
  - Person acquiring the service is enabled to apply the technology
  - Mere requirement of technical input by a person providing services does not necessarily mean that technical knowledge is “made available”
  - Use of a product which embodies technology cannot be considered to make technology available
- Factors held to be making available technical knowledge etc as per judicial precedents
  - Make use without recourse to the performer of the services in future
  - Should remain with the person even after the services comes to an end
(FTS) – Key Issues
No FTS Article – Key Aspects

• No Separate FTS Article in some Indian Treaties – Brazil, UAE, Greece, Mauritius, Saudi Arabia, Indonesia, etc.

• Characterization of FTS income

• View 1 – FTS income taxable in India only if non-resident payee has PE in India [View supported by various judicial decisions*]

• View 2 – Income covered under “Other Income” Article vis-à-vis Business Profits [Lanka Hydraulic Institute Limited (337 ITR 47)(AAR)]

• View 3 – Income to be taxed in accordance with domestic law [DCIT vs. TVS Electronics Ltd (TS-421-ITAT-2012-CHNY)]

• FTS income may also get covered under IPS Article (Article 15)
**Most Favoured Nation (MFN) clause under the Tax Treaties**

- More favorable tax treaty terms granted to other countries extended to existing treaty countries by source Country
  - Lower tax rate or narrowing the scope of income liable to tax
- Generally MFN status is contained in the protocol/exchange of notes – MFN Clause is generally only prospective
- Application is automatically or by negotiation and then notification

- Examples -
  - India - Netherlands tax treaty
  - India - Belgium tax treaty
  - India - France tax treaty
  - India - Sweden tax treaty
  - India - Switzerland tax treaty (to be negotiated)
  - India - Spain tax treaty
Global mobility arrangements – tax issues

Service PE

FTS/FIS

Withholding tax
Global mobility arrangements – tax issues

• Whether reimbursement of payroll costs constitutes FTS?
  - Delhi High Court in Centrica India Offshore Private Limited (364 ITR 336) held reimbursement of payroll costs of seconded employees to be FTS:
    ◦ Seconded employees made available their technical expertise and know-how to regular employees. Accordingly, reimbursement of salary cost to overseas entities under secondment agreement is FTS
    ◦ Supreme Court has dismissed the SLP simpliciter i.e. without giving any reason.
    ◦ Dismissal of SLP simpliciter is not law of the land under Article 141 of the Constitution of India – SC Employee Welfare Association v UOI & Anr (1990)
  - Supreme Court in A.P. Moller Maersk A S (392 ITR 186) held that reimbursements of costs cannot be regarded as FTS/cannot be brought to tax where there was no profit element involved

• Whether deputation of employees leads to service PE?
  - Conclusion based on facts of each case
  - Delhi High Court held in Centrica India Offshore Private Limited (364 ITR 336) that seconded employees constitute service PE under India-UK tax treaty
Thank You

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