



Foreign company is having a service PE in India by virtue of employees of its sister concern being made available to the Indian subsidiary to carry out the project.

Further income from transfer of a copyrighted article (but not the copyright) is not taxable as royalty.

Background

The Delhi Bench of the Income Tax Appellate Tribunal (the Tribunal), in the case of Lucent Technologies International Inc.¹, USA (the taxpayer) held that the subsidiary of the taxpayer would be treated as a permanent establishment (PE) in India by virtue of employees of affiliates being made available to the Indian subsidiary to carry out the project.

Further, income from transfer of right to use of software loaded on the hardware is not royalty under the Income-tax Act, 1961 (the Act) or under the India-USA tax treaty (the tax treaty) as it was a mere transfer of a copyrighted article and not the copyright.

Facts of the case

- LTIL, a company incorporated in USA, entered into a contract with Escotel, an Indian customer, for supply of telecommunication equipment comprising of hardware and software.
- The Indian customer entered into a separate contract with Lucent technologies Indian Limited (LTIL), Indian subsidiary of the taxpayer company, for erection and installation of the equipment purchased from the taxpayer.

¹ Lucent Technologies International Inc. v. DCIT (2009-TIOL-161-ITAT-DEL)

- LTIL utilised the services of expatriate employees for short periods from other affiliated companies outside India.
- Escotel had made both, the taxpayer and LTIL responsible for the turnkey completion of the project, individually and severally.
- The Assessing Officer (AO) held that LTIL was a dependant agent of the taxpayer and consequently it formed a PE of the taxpayer in India. The taxpayer had provided training courses in India to its customers and the perusal of the contract clearly indicated that the hardware was supplied through PE in India.
- The taxpayer claimed that there was no transfer of copyright in the software to the Indian operator and what was transferred or sold was merely a copyrighted article. Further, Escotel had no right to sub-lease or sub-license the software and the copyright thus remained with the taxpayer.
- AO observed that the software constituted intellectual property right and not goods or equipment. Further observed that the license granted for use of software has to be analysed in the light of the relevant tax treaty as well as the Indian Copyright Act, 1957.
- Neither the Indian Copyright Act nor any circular issued by the Central Board of Direct Taxes (CBDT) makes any distinction between copyright right and copyrighted article. And such distinction made in US regulations cannot be extended to the Indian territory as within the territory of sovereign, the law promulgated by the Indian sovereign was applied. Further, the OECD Commentary making a distinction between a Copyright and copyrighted article cannot be used to interpret Indian Copyright Act in a different fashion than what the words used therein suggest.
- AO observed that the distinction between the copyright and copyrighted article created artificially, and not recognised by the Indian Copyright Act or by the Income-tax Act and should be ignored. Accordingly, AO held that the income from software supplied was fees for included services as prescribed under the tax treaty and brought the same to tax by estimating the profits therefrom at 40 percent

Issues raised before the Tribunal

- Whether the subsidiary of the taxpayer in India constituted its PE in India?
- Whether the receipts for allowing use of computer software under the licensing agreement is for a copyright or a copyrighted article and was taxable as royalty income or business income?

Tribunal Ruling

- Tribunal observed that the turnkey contracts were for two different purposes. Agreement between Escotel and the taxpayer was for

supply of the hardware and software and agreement between Escotel and LTIL was for commissioning, installation and operations.

- Escotel had made both the taxpayer and LTIL responsible for the turnkey completion of the project, individually and severally. In case, if the taxpayer does not provide the requisite hardware and software, it would be the duty of LTIL to provide the same for completing the project. Further, the taxpayer would be responsible for commissioning, installation, testing etc. if LTIL does not comply with its duties.
- The Tribunal noticed that normally the warrantee for a particular product to be supplied by one person, is the responsibility of that person alone, but in the present case it was noticed that this burden was also shifted to the subsidiary being LTIL. Though, LTIL has certified that does not keep any spares on behalf of the taxpayer for the equipments supplied by the taxpayer under the contract with Escotel still the fact that LTIL has also assumed the responsibilities of the warrantee in regard to the hardware supplied by the taxpayer as also the responsibility to replace the same within the period specified in the support contract between Escotel and LTIL clearly shows that the subsidiary LTIL is also acting on behalf of the taxpayer.
- The Tribunal held that Article 5(2)(1) of the tax treaty clearly shows that it is not only the employees through whom if services are provided the PE is to set to come into existence. It also includes other personnel. The term other personnel has to be read with reference to the earlier words as provided in the said article 5(2)(1). The other personnel specified here would be persons over whom the enterprise would be having a control. In the present case, the employees of the affiliates over whom the taxpayer had a control would fall within the term “other personnel” and consequently, it would have to be held that a PE did exist as per the inclusive term as provided in article 5(2)(1) of the tax treaty. Further the expatriate personnel’s had been in India for more than 90 days within the twelve months period and hence it was held that LTIL in fact was a service PE of the taxpayer.
- Section 14 of the Copyright Act defines “copyright” as the exclusive right to do or authorise the doing of any of the prescribed acts in respect of a work or any substantial part thereof. The Tribunal observed that the right mentioned in sub-clause (2) of clause (b) of section 14 is available only to the owner of the computer programme. Accordingly, the tribunal held that if the licensees do not have any of such rights as mentioned in section 14, it would mean that they do not have any right in the copyright and in such a case, the payment made to them could not be characterised as royalty either under the Act or under the tax treaty.
- Tribunal observed that the software was not to be used exclusively by the operator. It could be used through the connectivity supplied to the customers without intervention of the taxpayer or its employees. From the agreement, tribunal noted that the licensee was

granted a non-exclusive restricted license to use the software only for its own operation and not otherwise. The grant of a non-exclusive restricted license to use the software again meant that the supplier of the software could supply similar software to any number of persons to which the licensee could have no objection.

- The licensee had been denied the right of making the copies of the software or parts thereof except for archival back-up purposes. The Tribunal held that merely because the licensee had been permitted to take copies just for back up purposes, it could not be said that he had acquired a copyright in the software.
- The Tribunal also observed that even though one cannot have the copyright right without a copyrighted article, it does not follow that one having the copyrighted article has also the copyright in it.
- The Tribunal also referred to the proposed amendments to the US International Regulation Service (IRS) and found that if the transferee acquires a copy of the computer programme but does not acquire any of the specified rights then the transaction shall be classified as the transfer of the copyrighted article and not the transfer of a copyright right.
- The Tribunal held that in the earlier judicial precedents², relied by the tax payer, it was held that there was merely a transfer of the copyrighted article and no transfer of copyright and the amount received for such transfer was not royalty either under the Act or under the relevant tax treaty.
- The Tribunal further observed that the decision of the Special Bench in the case of Motorola Inc. would squarely cover the facts of the taxpayer's case and just because Motorola had entered into a mutual agreement procedure it did not make the decision of the Special Bench of the Tribunal, otiose.
- Based on the above, the Tribunal held that the amount received by the taxpayer under the licence agreement for allowing the use of the software was not royalty either under the Act or under the tax treaty and the same constituted the business profit of the taxpayer.

Our Comments

It is pertinent to note that the Tribunal has distinguished the business of the foreign company with that of its Indian subsidiary in relation to support services which can be helpful in determining taxation aspects of such services.

Further, Tribunal has observed that the provisioning of services by the employees of the affiliates over whom the taxpayer had a control would fall within the term other personnel and consequently a PE exists as per the inclusive terms provided in article 5(2)(1) of the tax treaty.

² Motorola Inc v. DCIT [2005] 95 ITD 269 (SB) (Delhi)

The Tribunal has also held that the amount received for allowing the use of the software was not royalty either under the Act or under the tax treaty and the same constituted the business profit of the taxpayer. To uphold the same, the Tribunal followed the decision of the special bench in Motorola Inc. and held that just because Motorola has entered into a mutual agreement procedure it cannot be said that the decision of the special bench is of no use.

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