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TAX FLASH NEWS

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Payments for availing bandwidth services are not taxable as royalty under the India-Singapore tax treaty

Recently, the Mumbai Bench of the Income-tax Appellate Tribunal (the Tribunal) in the case of Reliance Jio Infocomm Ltd.[1] (the taxpayer) dealt with the issue of taxability of bandwidth services. The Mumbai Tribunal held that an amount received by a Singapore entity for providing standard bandwidth services could not be characterised as 'royalty' under the India-Singapore tax treaty (tax treaty).

Facts of the case

The taxpayer is engaged in the business of providing telecom services in India. During the Assessment Year (AY) 2016-17, the taxpayer entered into a 'bandwidth service agreement' (agreement) with a Singapore based entity. The Singapore entity was holding a facility based operator licence in Singapore which enabled it to establish, install, maintain, operate and provide telecommunication services in Singapore and also provide bandwidth services to the service recipients across the globe. As per the terms of the agreement, the taxpayer remained under an obligation to withhold tax, if any, on the payments made to the Singapore entity for provision of bandwidth services. In pursuance of the aforesaid terms, the taxpayer remitted payment to the Singapore entity for provision of bandwidth services and deposited taxes at the rate of 11.11 per cent[2] in terms of Section 195 of the Act. However, the taxpayer thereafter took a stand that it was not obligated to deduct tax at source under Section 195 of the Act from the aforesaid payment made to Singapore entity. The taxpayer carried the matter to the Commissioner of Income-tax (Appeals) [CIT(A)] under Section 248 of the Act claiming that no tax was required to be deducted on the amount paid to the Singapore entity.

The taxpayer contended that the amount remitted for providing bandwidth services was the Singapore entity's business income. However, the Singapore entity did not have any business connection or Permanent Establishment (PE) in India and therefore, as per Article 7 of the tax treaty the amount remitted by the taxpayer to the Singapore entity could not be taxed in India. The Commissioner of Income-tax (Appeals) [CIT(A)] observed that the taxpayer had only received access to service and not to any equipment that was deployed by the Singapore entity for providing the bandwidth services. Therefore, CIT(A) concluded that the payments made for provision of bandwidth services were in the nature of business profits and could not be classified as royalty or fees for technical services.

Tribunal's decision

The taxpayer pursuant to the terms of the 'agreement' had only received standard facilities, i.e., bandwidth services from the Singapore entity. The Tribunal[3] observed that the taxpayer had access to services and did not have any access to any equipment deployed by the Singapore entity for providing the bandwidth services. Further the taxpayer did not have any access to any process which helped in providing of such bandwidth services by the Singapore entity. As a matter of fact, all infrastructure and process required for the provision of bandwidth services were always used and under the control of the Singapore entity, and the same was never given either to the taxpayer or to any other person availing the said services. The Tribunal agreed with CIT(A) that as the process involved to provide the bandwidth services was not a 'secret,' but was a standard commercial process that was followed by the industry. Therefore, the same could not be classified as a 'secret process' to treat the payment as 'royalty' under the tax treaty.

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[1] DCIT v. Reliance Jio Infocomm Ltd (ITA No.936/Mum/2017) – Taxsutra.com

[2] i.e. rate of 10 per cent under Article 12 of the tax treaty duly grossed upon in terms of Section 195A of the Act

[3] As observed by CIT(A)

The amount paid by the taxpayer to the Singapore entity was neither towards use of (or for obtaining right to use) industrial, commercial or scientific equipment, nor towards use of (or for obtaining right to use) any secret formula or process, therefore, the same could not be classified as payment of 'royalty' by the taxpayer. The amendment in Section 9(1)(vi) of the Act will not have any bearing on the definition of 'royalty' as contemplated in the tax treaty. The Tribunal relied on the decision of Bombay High Court in the case of Reliance Infocomm Ltd.[4] wherein it was observed that mere amendment in the Act would not override the provisions of tax treaties.

The Tribunal observed that though the term 'royalty' as used in Article 12 of India-Hungary tax treaty takes within its sweep transmission by satellite, cable, optic fibre or similar technology, the definition of 'royalty' in the India-Singapore tax treaty has a narrow meaning. It has been observed that despite the fact that the India-Singapore tax treaty was amended[5], however, the definition of 'royalty' therein has not been tinkered with and remained as such. Accordingly, the Tribunal held that the amount received by the Singapore entity from the taxpayer for providing standard bandwidth services could not be characterised as 'royalty' as per the tax treaty, and was taxable as 'business profits'. The Singapore entity did not have any business connection or a PE in India. Therefore, the business profits was not taxable in India.

Our comments

Taxability of bandwidth services has been a matter of debate before the courts. In some of the cases, the Courts[6] have held that consideration for such type of services does not amount to royalty under the Act as well as under the provisions of the tax treaty.

The Finance Act, 2012 has retrospectively inserted Explanations in Section 9(1)(vi) of the Act, inter alia, to include transmission by satellite, cable, optic-fiber or by any other similar technology within the scope of process and consequently within the definition of 'royalty'. Further, royalty includes payments relatable to the right, property or information irrespective of its control or possession, use or location.

The Madras High Court in the case of Verizon Communications Singapore Pte Ltd[7], relying upon the above amendments, held that payment made by Indian customers to a Singapore company for providing end-to-end internet connectivity (bandwidth services) outside India was taxable as royalty under the Act. The High Court has distinguished some favourable rulings, including the Advance Rulings in case of Dell International Services India (P.) Ltd. and Cable & Wireless Networks India (P.) Ltd. on a similar issue under a common argument i.e. the amendments in Section 9(1)(vi) of the Act has expanded the scope of royalty to include such transactions within the purview of royalty. Further, the High Court had held that the definition of 'royalty' under the tax treaty is in 'pari materia' with the definition under the Act and therefore, the consideration was taxable as royalty under the tax treaty. The Chennai Tribunal[8] relying on the decision of the Madras High Court held on the similar lines.

However, the Mumbai Tribunal in the present case has held that amount received by the Singapore entity for providing standard bandwidth services could not be characterised as 'royalty' as per the tax treaty since it was neither towards use of (or for obtaining right to use) industrial, commercial or scientific equipment, nor towards use of (or for obtaining right to use) any secret formula or process. It was in nature of 'business profits' and in the absence of a PE, it was not taxable in India. The Tribunal observed that the amendment in Section 9(1)(vi) of the Act will not have any bearing on the definition of 'royalty' under the tax treaty.

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[4] CIT v. Reliance Infocomm Ltd. (ITA No. 1395 of 2016, dated 5 February 2019)
[5] Vide Notification No. SO 935(E), dated 23 March 2017
[6] Cable & Wireless Networks India Private Limited [2009] 315 ITR 72 (AAR), Dell International Services (India) Pvt. Ltd. [2009] 308 ITR 37 (AAR)
[7] Verizon Communications Singapore Pte Ltd. v. ITO [2014] 361 ITR 575 (Mad)
[8] DCIT v. Cognizant Technology Solutions India Private Limited (ITA. Nos. 1535, 1536/09, ITA 460 & CO.27/2010, ITA Nos. 751, 864 & 1922/Mds/2010)

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Ahmedabad
Commerce House V, 9th Floor,
902, Near Vodafone House,
Corporate Road,
Prahlad Nagar,
Ahmedabad – 380 051.
Tel: +91 79 4040 2200

Bengaluru
Maruthi Info-Tech Centre
11-12/1, Inner Ring Road
Koramangala,
Bengaluru – 560 071.
Tel: +91 80 3980 6000

Chandigarh
SCO 22-23 (1st Floor),
Sector 8C, Madhya Marg,
Chandigarh – 160 009.
Tel: +91 172 664 4000

Chennai
KRM Towers, Ground Floor,
1, 2 & 3 Floor, Harrington Road,
Chetpet, Chennai – 600 031.
Tel: +91 44 3914 5000

Gurugram
Building No.10, 8th Floor,
DLF Cyber City, Phase II,
Gurugram, Haryana – 122 002.
Tel: +91 124 307 4000

Hyderabad
Salarpuria Knowledge City,
6th Floor, Unit 3, Phase III,
Sy No. 83/1, Plot No 2,
Serilingampally Mandal,
Ranga Reddy District,
Hyderabad – 500 081.
Tel: +91 40 6111 6000

Jaipur
Regus Radiant Centre Pvt Ltd.,
Level 6, Jaipur Centre Mall,
B2 By pass Tonk Road,
Jaipur – 302 018.
Tel: +91 141 - 7103224

Kochi
Syama Business Centre,
3rd Floor, NH By Pass Road,
Vytilla, Kochi – 682 019.
Tel: +91 484 302 5600

Kolkata
Unit No. 604,
6th Floor, Tower – 1,
Godrej Waterside,
Sector – V, Salt Lake,
Kolkata – 700 091.
Tel: +91 33 4403 4000

Mumbai
1st Floor, Lodha Excelus,
Apollo Mills,
N. M. Joshi Marg,
Mahalaxmi,
Mumbai – 400 011.
Tel: +91 22 3989 6000

Noida
Unit No. 501, 5th Floor,
Advant Navis Business Park,
Tower-A, Plot# 7, Sector 142,
Expressway Noida,
Gautam Budh Nagar,
Noida – 201 305.
Tel: +91 0120 386 8000

Pune
9th floor, Business Plaza,
Westin Hotel Campus, 36/3-B,
Koregaon Park Annex,
Mundhwa Road, Ghorpadi,
Pune – 411 001.
Tel: +91 20 6747 7000

Vadodara
Ocean Building, 303, 3rd Floor,
Beside Center Square Mall,
Opp. Vadodara Central Mall,
Dr. Vikram Sarabhai Marg,
Vadodara – 390 023.
Tel: +91 265 619 4200

Vijayawada
Door No. 54-15-18E,
Sai Odyssey,
Gurunanak Nagar Road, NH 5,
Opp. Executive Club, Vijayawada,
Krishna District,
Andhra Pradesh – 520 008.
Tel: +91 0866 669 1000