SATURDAY INTERNATIONAL TAX GYAN !!!

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SITG No. 165

Vodafone Idea Ltd.
Vs
Deputy Director of Income Tax (IT)

The income received from transactions where the inter-connectivity services are being provided by a foreign company (NTO) to an Indian company for seamless communication cannot be taxed in India.

05.08.2023

Jain Shrimal & co

[2023] 152 taxmann.com 575 (Karnataka) [14-07-2023]

Facts of the Case

- **Vodafone Idea Ltd.** (the assessee, in the present case) holds an International Long-Distance License (ILD), responsible for **providing connectivity to the calls originating or terminating from any place outside India**. To ensure seamless connectivity to its customers, the assessee entered into an **agreement with Non-resident telecom operators (NTOs)** for such international connectivity services, against which the **assessee shall pay connectivity charges**.

- In pursuance of the agreement made by the assessee with the BICS S.A. and Omantel Telecom company, the **latter had transferred a portion of its capacity in the Europe-India Gateway (EIG) cable system to BICS against which BICS transferred a portion of its capacity to the assessee for consideration**.

- Drawing an inference from the above-discussed transactions, the **A.O. issued a notice** stating that the payments to NTOs and BICS S.A. between the A.Y. 2008-09 to 2015-16 were made **without deducting TDS u/s 195** of the Income Tax Act,1961 and hence the **assessee should be treated as 'Defaulter' u/s 201** of the act, against which assessee sent its reply pleading that NTOs are located outside India and provide their telecom service outside India, hence not liable to TDS.

- Resultantly, **A.O. passed an assessment order holding the assessee as a 'defaulter'** for not deducting TDS. Further, on the challenge, CIT(A) dismissed the appeal of the assessee.

Assessee's Contention

The Hon'ble Karnataka High Court admitted the appeal on the basis of question of law raised, against which the Ld. Counsel submitted as follows while pleading for the assessee:

- The **payment made** by the assessee **cannot be characterized as royalty or FTS, or business profits in India** since such **activities were not carried out in India** and the **payments to the NTOs are made in the nature of use of process or equipment**.

- The **NTOs have no presence in India** whatsoever, and the A.O. has not deviated from the stated view. Hence, without any PE of NTOs in the country, such **income is not taxable within the Indian territory**.

- The Ld. Counsel argues that the **revenue cannot invoke Explanation 6 to Section 9(1)(vi)** to the act while passing an order u/s 201, since the **burden to establish that such receipts fall within the taxing provisions always rests with the revenue**. Also, the **Ld. Counsel draws the attention of the Hon'ble High Court to the fact that there is a difference between 'grant of rights' and transfer of rights', and the assessee merely avails these services which come under the ambit of the term 'grant of rights' and not otherwise**.

Revenue’s Contention

Opposing the appeal and the arguments presented by the Ld. Counsel of the assessee, the counsel for the Revenue, submitted the following:

- **Section 195** of the act **mandates the assessee to deduct TDS** if the payment of the sum is chargeable to tax, and if in case the payer thinks otherwise, he has to **obtain certificates u/s 197 or 195(2)** or 195(3). The **agreements between the payee and the assessee do not disclose or establish that the income is not chargeable to tax**, and the **onus to establish such fact rests with the assessee** itself and not otherwise.

- The **characterization of receipt**, irrespective of whether it is a royalty or not, is a **mixed question of law and fact**, and hence the complete reliance cannot be placed on the authorities. Hence the **payment made to NTOs and BICS for connectivity and under-sea cable system** respectively **qualify as ‘Royalty’** and with or without, payment of such nature shall qualify as ‘Royalty’.

- The **assessee’s contention** that in Belgium DTAA, the **definition of ‘equipment royalty’ is missing, is untenable** since the issue involved here is related to **‘process royalty’ and not ‘equipment royalty’**, and the **definition of royalty under DTAA is in consonance with the act as well**.

Revenue's Contention

- Notwithstanding an amendment to Explanation 6, **whenever the right to use a process is given and consideration is paid against such service, such consideration would be tantamount to royalty**.

- Assessee's contention regarding the impossibility of deducting TDS is untenable because of the following reasons:
  i. Even without the **clarificatory amendment**, such a transaction was taxable.
  ii. The **Show Cause Notice (SCN) was issued** by the A.O. before the amendment.
  iii. There are **judicial precedents** before the amendment which suggested that such transactions shall be tantamount to Royalty and chargeable to tax in India both under the domestic law and DTAA.

Legal Provisions

According to **Section 9(1)(vi)** of Income Tax Act, 1961,

income by way of royalty payable by—

(a) the Government; or

(b) a person who is a 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 outside India or for the purposes of making or earning any income from any source outside India; or

(c) a person who is a non-resident, 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 in India or for the purposes of making or earning any income from any source in India :

***Provided** that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum consideration for the transfer outside India of, or the imparting of information outside India in respect of, any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process or trade mark or similar property, if such income is payable in pursuance of an agreement made before the 1st day of April 1976, and the agreement is approved by the Central Government :*

***Provided further** that nothing contained in this clause shall apply in relation to so much of the income by way of royalty as consists of lump sum payment made by a person, who is a resident, for the transfer of all or any rights (including the granting of a license) in respect of computer software supplied by a non-resident manufacturer along with a computer or computer-based equipment under any scheme approved under the Policy on Computer Software Export, Software Development, and Training, 1986 of the Government of India*

Legal Provisions

Explanation 6 to Section 9(1)(vi) of Income Tax Act, 1961 suggests that

Explanation 6.—For the removal of doubts, it is hereby clarified that the expression "process" includes and shall be deemed to have always included transmission by satellite (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fiber or by any other similar technology, whether or not such process is secret;

Ruling

- The Hon'ble High Court held that there is **no dispute that the facilities offered to the assessee were in relation to services situated outside India** and the process through which such service has been offered is publicly available and is a standard process hence same is not a secret process. Further, Revenue has in the **assessee's own case of subsequent years taken a view that such transaction cannot be considered as Royalty**.

- Since the service providers have **no presence in India** at all. Hence, the tax authorities in India shall have **no jurisdiction to bring to tax the income** arising from the extra-territorial source.

- With **regards to the liability for non-reduction of TDS for payment made** based on section 9(1)(vi), the Hon'ble HC for the **A.Y.s under consideration i.e., 2008-09 to 2012-13**, says that the Explanation relevant has been inserted by Finance Act, 2012, therefore, it was **not possible for the assessee to deduct the TDS** during that period. Hence, an **assessee is not obliged to do the impossible**, and in addition, the Hon'ble Court held that the **assessee is entitled to the benefits under DTAA.**

Our Comments

- Charges were paid for **inter-connectivity charges outside India** and the **agreement for payment** of such charges was **done with the foreign companies** who have **no PE in India** and all the **business is carried from a place outside India**, however, **revenue took the stance** that since the calls were either originating or terminating from any place in India, hence the **income arising from calls were accrued in India despite the foreign company providing such service is located outside India**.

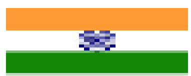
- However, considering the facts, that though the calls either originated or terminated in India, however, such **companies would offer their services only for the leg of call which is outside India**. Hence, such foreign **service providers would not provide any services for calls in India** and accordingly, their **services cannot be said to accrue in India.**

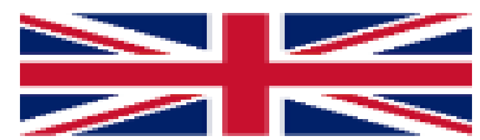
- In the present case, another important issue was regarding the jurisdiction i.e., the **assessee was claiming that the Ld. A.O. does not have any jurisdiction** in the present case whatsoever **to tax** the assessee outside India, whereas the **Ld. A.O. took the contrary view**. Therefore, there should be a **mechanism to first decide whether the Assessing officer has valid jurisdiction over the foreign entity or not**. Otherwise, it will lead to **unnecessary harassment of such foreign entities**, and this will consequently lead to a discouraging environment and unwillingness of such foreign entities to invest in India or to do business with India.

#taxinpic

India

UK





Aakash

Mr. Cook

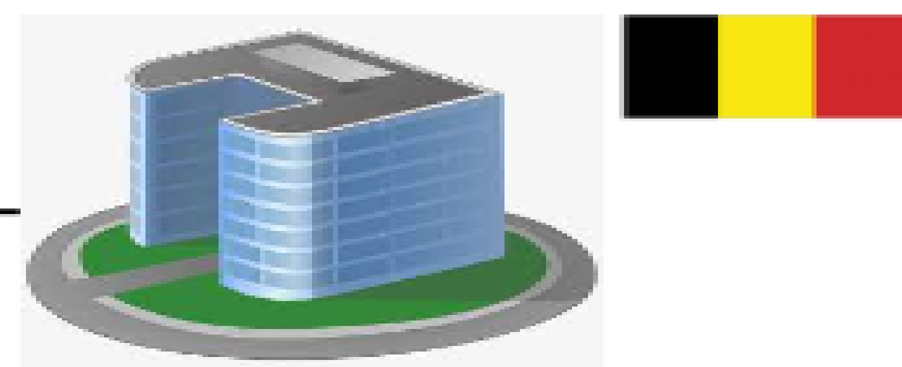
The Indian resident Aakash called his Mr. Cook, who is a resident of UK

LAG

The inter-connectivity services through which Aakash could able to call Mr. Cook is being provided by the company, in the present case, it is Vodafone Idea

Vodafone Idea Ltd.

The foreign company (BICS) has provided the services to Vodafone Idea (Indian Company) so that the Indian co. could able to provide Aakash and Mr. Cook a seamless communication



Belgacom (BICS)

The A.O. issued Show Cause Notice (SCN) to the company saying that such transaction is subject to tax since such income is accrued in India.

A.O.

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However, the Hon'ble Court took the contrary view to the A.O. and held that since such service provider is located outside India and the agreement made between the assessee and the service provider is done outside India, therefore the revenue cannot tax the assessee on such transaction.

Section/Article	Section 9(1)(vi)- Explanation 6 of Income Tax act.
DTAA/Country	-
Court	Karnataka High Court
Date of decision	14.07.2023

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