International Tax

Consideration received for granting access to database is not taxable as Royalty under India – US tax Treaty

Dow Jones & Company Inc. [TS – 1114 – ITAT -2021 (Del)]
(in favor of assessee)

Facts/Background:

Assessee, a US based company was engaged in the business of providing information products and services containing global business and financial news to organizations worldwide. It offers information via newspapers, newswires, websites, applications, newsletters, magazines, proprietary databases, conferences and radio.

The assessee appointed its Indian associated enterprise for distributing its products in the Indian market on a principal-to-principal basis. The Indian associated enterprise had no authority to reproduce the data in any material form, to make any translation in the data or to make any adaptation in the data. Further, the end user did not acquire a copyright or right to use the copyright in the data.

During the assessment proceedings, the assessing officer was of the view that the consideration received by assessee from its Indian associated enterprise was taxable in India as Royalty under the Income-tax Act, 1961 (the Act) as well as India – US tax treaty. The assessee submitted that the consideration received was for providing use of database and not for use of any copyright and therefore, the receipts could not be taxed as 'Royalty'. However, the assessing officer did not accept the submission of the assessee.

Aggrieved by the order of the AO, the assessee filed objections with the Dispute Resolution Panel. However, the DRP confirmed the action of the AO.

The assessee therefore approached the Tribunal challenging the said order of the AO/DRP on the ground that the consideration received was not taxable in India.

Held:

Article 12 of the India - US tax treaty brings within the ambit of the definition of royalty, a payment made for the use of or the right to use a copyright of a literary,

artistic or scientific work. Thus, only those payments that allow a payer to use / acquire a right to use a copyright in a literary, artistic or scientific work are covered within the definition of royalty.

Payments made for acquiring the right to use the product it sells, without allowing any right to use the copyright in the product, are not covered within the scope of royalty which may get covered under the term 'Royalty' as per the Act.

The revenue derived by the assessee from granting limited access to its database was akin to sale of book, wherein purchaser does not acquire any right to exploit the underlying copyright. In the case of a book, the publisher of the book grants the purchaser certain rights to use the content of the book, which is copyrighted. The purchaser of the book does not acquire the right to exploit the underlying copyright. When the purchaser reads the book, he only enjoys the contents. Similarly, the user of the database does not receive the right to exploit the copyright in the database, he only enjoys the product in the normal course of his business. It is important to distinguish between a payment for the right to use the copyright in a programme and the right to use the programme itself.

The assessee had not transferred legal title in the copyrighted article and the same rested with the assessee. All rights, title and interest in the licensed software (claimed to be copyrighted article) were the exclusive property of the assessee. The payments made by Indian Counterpart for accessing the database would not qualify as payments for the use of copyright.

Thus, the payment received by the assessee could not be treated as a consideration for the transfer of any 'copyright'. The transaction under consideration was for the provision of access to the database which cannot be considered as 'royalty' under Article 12 of the India-US tax treaty.

CNK Comments:

The decision of the Tribunal makes the important distinction between payment for use of copyright and copyrighted article. The decision also touches upon the point that even if a payment is royalty under the Act, the definition of royalty under the tax treaty can be narrower and beneficial to the assessee. Hence, due care and consideration must be given before determining withholding tax on such payments.

Legal fees paid to a fiscally transparent partnership firm of Poland are not taxable in India under the India-Poland tax treaty

Infosys BPO Limited [TS – 983-ITAT-2021 (Bang)]
(in favor of assessee)

Facts/Background:

The assessee-company was engaged in the business of providing BPO services. It had made payments to a law firm in Poland, a limited partnership firm, towards legal service rendered to the assessee. The assessee deducted TDS on same under section 195 r.w.s 195A of the Act (i.e., after grossing up the tax). However, the assessee subsequently filed applications before the Commissioner (Appeals) under section 248 of the Act stating that no tax was deductible on the said payments. Hence, the assessee sought refund of the excess amount of TDS deposited under section 195 and 195A along with interest under section 244A.

During the course of the proceedings, it was submitted by the assessee that:

a. The Polish law firm was a limited partnership (LP) i.e., it was a 'fiscally transparent entity'.
b. All the partners of the LP were residents of Poland, and they did not have any Permanent Establishment (PE) or fixed base in India
c. The consideration paid to the LP was not taxable in India under Article 13 (fees for technical services) or Article 15 (independent personal services).

The Commissioner (Appeals) however, was of the view that TDS was to be deducted on such payment made by the assessee on ground that the payment was chargeable to tax in India as fees for technical services (FTS) under section 9(1)(vii) of the Act and also Article 13 of India – Poland tax treaty. The Commissioner (Appeals) also held that even if tax was to be refunded, it would not make the assessee eligible for interest under section 244A as there were no legal provisions to grant such interest.

Held:

The definition of 'Person' as per Article 3(1)(e) of India–Poland tax treaty specifies that it is applicable to 'persons' who are taxable under the domestic taxation laws of the contracting states. Further, as per Article 1(1) of the India - Poland tax treaty, the treaty can only apply to a 'person' who is resident of one or both the contracting states.

Therefore, in view of the provisions of Article 4(1) read with Article (1) and Article 3(1)(e), unless the payee is taxable under domestic laws of Poland, treaty benefits cannot be extended.

Therefore, the law firm is a non-taxable entity as per the domestic laws of Poland, therefore, treaty benefit cannot be extended to the firm. However, the question needs to be addressed in whose hands the profit shares are to be taxed. In the instant facts of the case, the profit shares will be taxed in the hands of the partners of the firm who represent the partnership in Poland.

Based on the Tax Residency Certificate (TRC) issued by Polish Government to the partners of the firm, it was evident that the partners of the firm were liable to tax in Poland on their income from the partnership firm.

As the income was taxable in hands of the said partners, taxability in India will have to be governed by Article 15 of the India - Poland tax treaty (Independent Personal Services) and not Article 13 of India – Poland tax treaty dealing with FTS.

Since neither of the two conditions under Article 15 i.e., having a fixed base in India or having stay in India exceeding 183 aggregate days, was fulfilled by the partners of the firm, the payment to the firm was not taxable in India under Article 15.

Accordingly, the refund claimed by the assessee was to be allowed. Further, based on CBDT Circular No. 11/2016, interest was also to be granted to the assessee under section 244A on refund of excess TDS deposited under section 195.

CNK Comments:

Grant of tax treaty benefits to fiscally transparent entities i.e., pass-through entities has been a subject matter of debate in India. This decision provides valuable guidance in such cases. The decisions also upholds the view that payments for professional services are not to be automatically considered as payment of FTS and their taxability may be governed by the article on Independent Personal Services and not FTS.

NIL TDS certificate under section 197 of the Act cannot be denied to non-resident e-platform operator without considering provisions of section 10(50) of the Act pertaining to Equalisation Levy

Coursera Inc [[2021] 133 taxmann.com 326 (Delhi)]
(in favor of assessee)

Facts/Background:

Applicant / Assessee, a tax resident of USA, had no PE in India. It is engaged in the business of merely acting as an aggregator of educational institutions, making access to various courses easier. Also, upon successful completion of the course, a certificate to this effect which bears the seal of the institution concerned is awarded to the student.

During the year under consideration, it had applied for NIL withholding of tax under section 197 of the Act for financial year 2021-22 on the grounds that:

a. Being a non-resident entity not having any PE in India, business profits arising to the Applicant / Assessee in India were not liable to tax in India.
b. The gross receipts of the Applicant / Assessee could not be characterized as Royalty or Fees for included services ('FIS') in terms of Article 12 of India-USA tax treaty.
c. The Applicant / Assessee has not transferred any copyright to its customers as there is no right to commercially exploit the content hosted on the e-platform and/or the services rendered are technical or consultancy in nature.
d. Applicant / Assessee has already subjected itself to Indian taxation by paying Equalization levy @ 2% in terms of the Finance Act, 2020 and the entire receipts of the Applicant / Assessee relates only to such e-commerce activity covered under EL.
e. As per section 10(50) of the Act, income which is subjected to EL and not taxable as royalty or FTS/FIS under the Act or tax treaty, would be exempt from tax in India.

However, the tax authorities contended that, after amendment in Section 10(50) of the Act in 2021, the concept of apportionment of receipts has been introduced. Therefore, out of the total amount of receipts of the Applicant / Assessee, the amount characterized as royalty or fees for technical services will be chargeable to tax under the Act read with provisions of applicable tax treaty as royalty and / or fee for technical services for the purposes of withholding of tax under section 195 of the Act. Balance amount, if any, will be chargeable to Equalization Levy. Accordingly, to protect the interests of the revenue, the tax authorities rejected the Applicant's / Assessee's application for NIL withholding tax and directed the customers of the Applicant / Assessee to withhold tax @ 10% on payments made to the Applicant / Assessee.

Aggrieved by the same, the Applicant / Assessee filed writ petition before Delhi High Court.

Held:

There is no reasoning in tax authorities order rejecting the NIL TDS certificate as to how the rate of 10% TDS was arrived at. The said order did not taking into account the impact of section 10(50) which states that amounts not taxable as royalty/fees for technical services under the Act and tax treaty and subjected to EL will not be taxable in India.

The Applicant in its application for certificate under section 197 has described itself as a non-resident e-platform operator (including being a university for the purposes of article 12(5)(c) of the India-US tax treaty) and outside the purview of FIS or income-tax in India. However, the tax authorities have not given any reason for rejecting such contention of the Petitioner.

Accordingly, without expressing any opinion on the merits of the case, the order of the tax authorities rejecting the application for NIL TDS was to be set aside. A fresh and reasoned order would have to be issued by the tax authorities to the Applicant after taking into account section 10(50) of the Act. The Applicant would also need to expeditiously furnish requisite information to the tax authorities in this matter.

CNK Comments:

Levy of EL on the non-resident e-commerce operators is fairly recent and at a nascent stage in India. Hence, status of assessments of such e-commerce operators under EL provisions and the Act is not known.

Section 10(50) states that amounts not taxable as royalty/fees for technical services under the Act and tax treaty and subjected to EL will not be taxable in India. This judgment provides relief to non-resident e-commerce operators paying EL and seeking NIL TDS certificates from the tax authorities on the same amounts/income.

The income-tax department cannot routinely protect its interest by not only receiving EL from the e-commerce operators but also levying TDS on the same income from India. This judgment will enable e-commerce operators to expect a reasoned order from tax authorities if they seek to levy TDS on consideration received by such e-commerce operators.

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