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Payment for toll-free telephone number qualifies as royalty

The Bangalore Bench of the Income-tax Appellate Tribunal held that the payment for toll-free telephone number charges qualified as royalty and subject to withholding tax.

Facts of the case:

- Vidal Health Insurance TPA Pvt. Ltd. (the taxpayer)¹ is a company engaged in the business of providing Third Party Administration services to insurance companies.
- During the Financial Years (FY) 2010-11 to 2013-14 corresponding to the Assessment Years (AY) 2011-12 to 2014-15, the taxpayer had claimed a deduction for charges paid in relation to a toll-free number provided by telecom operators. Under the arrangement with telecom operators, the taxpayer received dedicated private circuits / telephone lines and the charges for the calls made by consumers to the toll-free number, was borne by the taxpayer.
- The taxpayer had not withheld taxes from the payments made to the telecom operators in this regard, on the following basis:
 - The amendment introduced by the Finance Act 2012 (with retrospective effect from 1 June 1976) to define the term 'process' was not relevant for the purposes of withholding tax provisions; and
 - The charges in relation to toll-free telephone number did not qualify as royalty.
- The Assessing Officer (AO) did not accept the contentions of the taxpayer and held that the charges for toll-free telephone number qualified as royalty and thus, were subject to withholding tax under the Income-tax Act, 1961 (ITA). Considering that the taxpayer had not withheld tax from the payments to telecom operators, the AO did not allow deduction for such payments.
- On appeal, the Commissioner of Income-tax Appeals [CIT(A)] referred to the case of Verizon Communications² and upheld the order of the AO.
- The taxpayer appealed the CIT(A)'s order to the Bangalore Bench of the Income-tax Appellate Tribunal (ITAT).

Decision of the ITAT:

- The ITAT noted that:
 - Payment by the taxpayer was towards toll-free telephone number provided by telecom operators;
 - The charges for calls made by consumers to the toll-free number were borne by the taxpayer i.e. the taxpayer was charged for incoming calls;
 - Dedicated private circuit lines provided assured bandwidth to the taxpayer, through which the taxpayer was guaranteed transmission of data and voice of customers. The taxpayer had made payment for this exclusive telephone line;

¹ 116 taxmann.com 250

² Verizon Communications Singapore PTE Ltd. v. Income Tax Officer, International Taxation 361 ITR 575

- There was a 'process' involved for exclusive communication link of the customers with the taxpayer.
- The ITAT held that the consideration paid by the taxpayer was towards provision of bandwidth / telecommunications services for the 'use of' or 'right to use equipment' under the definition of royalty in the ITA.
- The ITAT held that the term 'process' always existed in the definition of royalty under the ITA. Hence, the retrospective amendment to define the term 'process' could be considered for interpreting the definition of royalty. The term 'process' under the ITA includes transmission by satellites (including up-linking, amplification, conversion for down-linking of any signal), cable, optic fibre or by any other similar technology, whether or not such process is secret.
- In view of the above, the ITAT held that the payments made by the taxpayer towards toll-free number charges were taxable as royalty under the ITA and subject to withholding tax. Considering that the taxpayer had not withheld taxes from such payments, the ITAT upheld the disallowance.
- The ITAT held that if the taxpayer is able to prove that due tax has been paid by the payee i.e. telecom operators on the payments, then the disallowance was to be deleted.

Comments:

This ruling has held that payment for toll-free number charges, qualifies as royalty under the ITA and subject to withholding tax. Taxpayers may want to evaluate impact of this ruling on their arrangements with telecom operators.



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