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Taxability of international private leased circuit charges, software maintenance and service fees

The Mumbai Bench of the Indian Income Tax Appellate Tribunal (ITAT) gave its decision that international private leased circuit charges were not taxable under Article 12 of the India-USA Tax Treaty as royalty or Fees for Included Services (FIS) or under the domestic income-tax law as fees for technical services. Further, software support / maintenance services in relation to software sold and other services rendered by the taxpayer were not taxable under Article 12 of the India-USA Tax Treaty as FIS.

Facts of the case:

- Netcracker Technology solutions LLC (the taxpayer)¹ is a tax resident of United States of America (USA) engaged in the business of managing, providing and developing billing information and software.

Issue 1 – Taxability of International private leased circuits (IPLC)

- During the Financial Year (FY) 2011-12 relating to the Assessment Year (AY) 2012-13, the taxpayer had received International Private Leased Circuit (IPLC)² charges of INR 14,277,485/-. The taxpayer had negotiated with third party telecom / internet service providers for such IPLC. The third party raised an invoice on the taxpayer and the taxpayer allocated a portion to group companies (including India group companies) based on circuits used.
- The taxpayer was of the view that IPLC charges are not taxable in India under Article 12 of the India-USA Tax Treaty (Tax Treaty) as royalty or Fees for Included Services (FIS) and thus, did not offer the same to tax.
- The Assessing officer (AO) as well the Dispute Resolution Panel (DRP), held that:
 - IPLC charges were for the 'right to use a process' and hence, taxable as royalty as per Article 12(3) of the Tax Treaty.
 - Services under IPLC were technical in nature and therefore, IPLC charges are taxable as Fees for Technical Services (FTS) as per Section 9(1)(vii) of the Income-tax Act, 1961 (ITA) as well as Article 12(4) of the Tax Treaty.

Issue 2 – Taxability of support and maintenance services.

- During the FY 2011-12 relating to AY 2012-13, the taxpayer provided support and maintenance services to certain parties in India amounting to INR 22,077,105/-. The services related to certain off the shelf / shrink-wrapped software sold by the taxpayer to the said parties during FY 2009-10 relating to AY 2010-11. The services provided included addressing standard software code product defect, bug, issue or technical query, etc.

¹ 116 taxamnn.com 243

² IPLC is a point-to-point private line used by an organisation to communicate between offices that are geographically disbursed throughout the world. IPLC is used for internet access, business exchange, videoconferencing and any other form of telecommunication. This service entitles the customer to high speed connectivity anywhere in the world via submarine cables.

- The support and maintenance services were ancillary and subsidiary as well as inextricably and essentially linked to the software supplied. They were rendered remotely from outside India.
- The taxpayer was of the view that receipts on rendition of support and maintenance services were not taxable in India as FIS under Article 12 of the Tax Treaty.
- The AO as well as the DRP held that such receipts were subsidiary and ancillary to the right to use of software. Considering that use of software qualified as royalty, support and maintenance services thereof were taxable as FIS under Article 12(4)(a) of the Tax Treaty.

Issue 3 – Taxability of Other Services

- During the FY 2011-12 relating to AY 2012-13, the taxpayer provided system performance tuning and other professional and consultancy services (Other Services) for a consideration amounting to INR 34,468,220/-. These services were sub-contracted to an Indian entity on a principal-to-principal basis.
- The taxpayer took the position that the said receipts were not taxable in India as FIS under Article 12 of the tax treaty.
- The AO in his draft order held that receipts on account of Other Services were subsidiary and ancillary to the right to use of software. Considering that use of software qualified as royalty, Other Services were taxable as FIS under Article 12(4)(a) of the Tax Treaty.
- On appeal before the DRP, the DRP held that rendition of Other Services required specialised technical input by the taxpayer and thus, were taxable as FTS / FIS.

Aggrieved by AO's final order passed, based on direction from the DRP, the taxpayer appealed before the Mumbai Bench of the Income Tax Appellate Tribunal (ITAT).

Decision of the ITAT:

Considering that all the three issues were covered by the decision of the ITAT³ in taxpayer's own case for FY 2009-10 relating to AY 2010-11 and the facts remaining the same, the ITAT relied upon the said decision for its conclusion.

Issue 1 – Taxability of IPLC charges

- The Mumbai ITAT (earlier in taxpayer's own case) had relied on various decisions⁴ and held that ILPC charges were not taxable as royalty or FIS under the Tax Treaty or FTS under the domestic income-tax law on the following basis:
 - IPLC charges were for a service;
 - IPLC charges were not for scientific work or patent, trademark, design, plan or for secret formula or process or for information concerning industrial commercial or scientific experience;
 - IPLC services / facility were standard services / standard facility used by other telecom companies also;
 - IPLC services did not make available any technical knowledge, experience, skill, know-how, process. It did not involve development and transfer of any design or transfer of any technology.

³ Netcracker technology Solutions Inc vs ACIT 111 taxmann.com193

⁴ Geo Connect Ltd. vs Dy. CIT [2017] 88 taxmann.com 758 (Delhi ITAT); Converges Customers Management Group Inc. vs Asstt. CIT (IT) [2013] 34 taxmann.com 24/58 SOT 69 (URO) (Delhi ITAT); Interroute Communications Ltd. vs Dy. CIT (International Taxation) [2016] 68 taxmann.com 160 (Mum ITAT)

- In view of the above, the ITAT in the current case under consideration held that IPLC charges were not taxable in India as royalty or FIS under the Tax Treaty or as FTS under the domestic income-tax law.

Issue 2 – Taxability of support and maintenance charges.

- The Mumbai ITAT, earlier in taxpayer’s own case:
 - Had noted that support and maintenance services were ancillary and subsidiary to the shrink-wrapped software supplied by the taxpayer. Hence, the taxability of support and maintenance services would depend on the taxability of software.
 - Had placed reliance on various decisions⁵ and held that income from sale of shrink-wrapped software was for a ‘copyrighted article’ not for the ‘use’ of copyright. Hence, income from sale of shrink-wrapped software was not taxable in India as royalty as per Article 12 of the Tax Treaty. Considering that the sale of software was not taxable as royalty, the support and maintenance services (ancillary and subsidiary to sale of software) were not taxable in India as FTS under Article 12(4)(b) of the Tax Treaty.
- In view of the above, the ITAT in the current case under consideration held that support and maintenance services were not taxable in India as FIS under Article 12 of the Tax Treaty.

Issue 3 – Taxability of Other Services

- The Mumbai ITAT, earlier in taxpayer’s own case had held that services can be taxed as FIS only if they satisfied the “make available” test. The taxpayer had neither made available any technical knowledge, experience, skill, know-how or process nor developed and transferred any design. Thus, Other Services were not taxable in India as FIS under Article 12 of the Tax Treaty.
- In view of the above, the ITAT in the current case under consideration held that Other Services were not taxable in India as FIS under Article 12 of the Tax Treaty.

Comments:

- Taxability of IPLC charges has been a litigative issue. This ruling affirms the principle that provision of IPLC is a standard service / facility and thus, not taxable as royalty or FIS or FTS services. This ruling will give relief to taxpayers providing IPLC services.
- This ruling reaffirms the principle that services that do not make available technical knowledge to the recipient of services and do not involve development and transfer of technical plan or design are not taxable under the definition of FIS under Article 12 of the India-USA tax treaty.
- With the expansion of equalisation levy (EL) to e-commerce transactions from 1 April 2020, taxpayers will have to also analyse / evaluate applicability of EL on online transactions.

⁵ Converges Customers Management Group Inc. vs Asstt. CIT (IT) [2013] 34 taxmann.com 24/58 SOT 69 (URO) (Delhi ITAT); Addl. DIT (IT) vs Tata Communications Ltd. [2010] 3 taxmann.com 749 (Mum ITAT); DIT vs Infrasoftware Ltd. [2013] 39 taxmann.com 88/[2014] 220 Taxman 273 (Delhi HC);



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